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Conference Proceedings

28th Conference on Gift Annuities

April 2-4, 2008 • Sheraton Chicago Hotel & Towers

Presented by the American Council on Gift Annuities

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Philanthropy: Going the Magnificent Mile

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American Council on Gift Annuities

thanks...

Principal Event Sponsor of the 28th 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.

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A Statement from the Chair...

Frank Minton, ACGA Board Chair

Welcome to Chicago and the 28th Conference on Gift Annuities! The American Council on Gift Annuities has been working side-by-side with the charitable community for over 80 years. Together, our efforts have steered the evolution of charitable gift planning and responsible philanthropy. We encourage and appreciate your participation in these efforts.

Organizing a conference is a considerable undertaking. It takes several teams of dedicated individuals: the team of volunteers who ponder the issues and design the program; the team of presenters who share their expertise; the hotel workers who serve each of our attendees; and the staff team who works with the program committee, the speakers and the hotel staff, perfecting countless details. But, the most important team at any successful conference is the team of individuals who have invested precious time and dollars to gather with their colleagues for a few days of learning, exchanging ideas and making contacts.

And so, I'd like to take this opportunity to thank each volunteer, each speaker, each hotel worker and each member of the ACGA conference staff for their total dedication to making this the best conference ever. And, I thank each of you for your confidence in all these teams, for your dedication to this profession, for Going the Magnificent Mile.

Frank Minton

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Education Agenda

Wednesday, April 2 • Schedule

8:00 am – 8:00 pm .... **Registration Open**
9:00 am – 3:00 pm .... **PG Fundamentals • Michigan**
1:30 – 3:00 pm .... **Symposium #1 • Sheraton Ballroom**
3:30 - 5:00 - pm .... **Symposium #2 • Sheraton Ballroom**
5:30 – 6:30 pm .... **Reception/Gathering • Exhibit Hall**
6:30 – 8:30 pm .... **Opening Dinner • Chicago Ballroom**

Keynote Address
Shawn Johnson, State Street Global Advisors

Planned Giving Fundamentals

Solid Footing for the Magnificent Mile: Planned Giving Fundamentals (Separate registration & fee required)

Shari M. Fox • University of Michigan, Ann Arbor, MI
Joseph Bull • The Nature Conservancy, Dublin, OH

Prepare yourself for that magnificent mile of philanthropy with this dynamic primer. We will discuss important building blocks of a solid planned giving program, including prospect identification, marketing, donor recognition, and those critical technical fundamentals. Join us to warm up and stretch in preparation for the rest of the conference.

Symposium #1

Assessing and Optimizing CGA Program Profitability

Bryan K. Clontz • Charitable Solutions, LLC, Jacksonville, FL
Mike Sutton • The Salvation Army, USA South Territory, Atlanta, GA

This session will demystify the key variables of a profitable gift annuity program such as; direct costs, indirect costs, opportunity costs, time value of money and longevity projections. The presentation will attempt to answer "Is our CGA program designed and managed to maximize the benefits to our charity?" This case study approach will provide attendees with specific tools they can use to perform a self-analysis. You will also learn the real application of sound financial practices and investment policy on a CGA reserve as well as the additional planned giving benefits of a well-managed CGA program. After this session, you will not look at a CGA program in the same way again.

Symposium #2

Ethical Issues in Gift Planning – Some Situations to Consider

Jonathan G. Tidd • West Simsbury, CT

A series of cases and problems that highlight ethical problems for gift planning officers. Some suggestions for avoiding ethical problems. Interactive. Bring your own issues or concerns, if you wish.

Thursday, April 3 • Schedule

7:30 am – 4:30 pm .... **Registration Open**
7:30 – 8:30 am .... **Continental Breakfast • Exhibit Hall**
8:30 – 9:45 am .... **Morning Breakouts**
9:45 – 10:15 am .... **Refreshment Break • Exhibit Hall**
10:15 – 11:30 am .... **Repeat Morning Breakouts**
11:45 – 1:15 pm .... **Chair's Luncheon • Sheraton Ballroom**

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 • Exhibit Hall**
3:15 – 4:30 pm .... **Repeat Afternoon Breakouts**
4:30 – 5:45 pm .... **Sweet Home Chicago Reception • Exhibit Hall**

Thursday Morning Breakouts

Track I
Starting a Gift Annuity Program

Cyndi Court • Boys & Girls Clubs of America, Atlanta, GA

What does your organization need to know to start a gift annuity program? What are the structural, legal, and political challenges? What policies and procedures need to be in place? Learn what steps one charity took to establish their program and what they are now doing to promote it.

Track I, II
Using Straw to Make Bricks Rather Than Break the Camel's Back

Ellen G. Estes • Estes Associates, Woodbridge, CT
Frank Estes • Estes Associates, Woodbridge, CT

You are a busy development officer trying to keep all of those balls in the air: annual appeals, major gifts, special events, that looming capital campaign. Who has time to focus on starting or enhancing a planned giving program? This session will explore some simple ways to integrate planned giving into your overall development program. We will discuss the basic gift options you can start promoting today, discuss who are your best planned giving prospects, provide tips on marketing, and outline how to incorporate planned giving into all that you do.

Education Agenda

Thursday Morning Breakouts, *continued*

Track I, II, III

The Best of Times, the Worst of Times: Recent Changes in the Legal and Legislative Landscape

Robert E. Harding • Gray, Plant, Mooty & Bennett, PA, Minneapolis, MN

Recent legal and legislative developments in the charitable giving arena have run the gamut from breakthrough legislation to congressional retrenchment. Perhaps the biggest news was the Pension Protection Act of 2006. Its permanent changes are mostly "reforms," i.e., new restrictions. If Congress extends or expands the PPA's IRA Rollover provision, we will celebrate by giving that legislation top billing. Also important is the legislative change to the UBTI rules for charitable remainder trusts, which cuts both ways. Like Congress, the IRS has not been idle. We will discuss "listed transactions" in the charitable area, new sample charitable lead trust agreements and recent rulings on the early termination of CRTs. Several state courts have addressed a trustee's duty to diversify assets of a charitable remainder trust – a topic of special interest to trustees. Finally, if hints of clarity emerge on estate tax reform, we will discuss that, too.

Track II

Case Studies in Creative Gift Planning

André R. Donikian • Pentera, Inc., Indianapolis, IN

This session will examine a series of actual case studies, some of which involve unusual twists and others with unintended consequences.

Track II, III

Keeping Your Charity Clean while Accepting Planned Gifts of Dirt

Reynolds T. Cafferata • Rodriguez, Horii & Choi, Los Angeles, CA

This presentation will cover special issues and considerations for accepting planned gifts of real property including environmental liability, encumbrances and real property taxes.

Track II, III

Planned Giving: The Secret to a Successful Campaign

Bruce Bigelow • Charitable Development Consulting, Frederick, MD
Carol Kolmerten • Charitable Development Consulting, Frederick, MD

Campaigns have changed dramatically since the days when they surfaced for a short time in the life of a charity to build a specific building and then disappeared until the next capital project. As campaigns became more comprehensive in nature, charitable organizations recognized that donors can and do make gift commitments through a variety of mechanisms, some of which defer the charitable benefit of a gift. Planned giving has come to play an increasingly important role in the success of today's campaigns. This presentation will examine the changed nature of campaigns, the role of planned gifts in campaigns, and some of the issues raised by including planned gifts in campaign strategies, campaign materials and marketing, and campaign counting. The presentation will also offer suggestions for the future, as we look at how campaigns will evolve and how planned gifts will influence that evolution.

Track II, III

Investing the Gift Annuity Pool

David G. Ely • State Street Global Advisors, Boston, MA

In this session, we will address the investment management of charitable gift annuity assets. We will examine various topics including: Setting a strategic asset allocation for the pool, addressing various regulatory implications to that strategic asset allocation, and understanding the structure of the liabilities and the implications to strategic asset allocation. We will also explore how best to involve the various constituencies which could and should have input into how gift annuity assets are invested.

Track III

Legal Fiduciary Investment Management Requirements Every Non-Profit Needs to Be Aware of, Including the New 2006 UPMIFA Act

Richard P. Triolo JD • Allianz Global Investors, San Rafael, CA

In addition to providing an in depth review of the Federal and State laws that apply to officers and directors of non-profit organizations when making investment decisions, Triolo will also provide a candid discussion of the new Uniform Prudent Management of Institutional Funds Act. This act was just approved and recommended for enactment in all states by the National Conference of Commissioners on Uniform State Laws in July 2006. The new act is intended to modernize prudence standards for the management and investment of charitable funds for endowment spending.

Thursday Afternoon Breakouts

Track I

Successful Solicitation: The Art of Negotiation

Dyan Sublett • YMCA of Metropolitan Los Angeles, Los Angeles, CA

Where does negotiation occur? How does it relate to our work in fundraising? What happens when you don't negotiate, or negotiate irrationally? How can we avoid common mistakes in negotiation? Learn strategies for success, techniques that can make us better listeners, and approaches that offer potential for deepening our major and planned gift work.

Track I, II

Bequests: A Fresh Take on an Old Staple

Grant H. Whitney • Harvard University, Cambridge, MA

Bequests are at the core of most planned giving programs. This presentation will highlight strategies and techniques that can help your organization identify, cultivate and steward future bequest donors regardless of size or mission. Two strategies that can breathe new life into the old staple: secured pledges binding on an estate and the "bequest-like" potential of donor advised funds will also be addressed.

Education Agenda

Thursday Afternoon Breakouts, continued

Track I, II
Best Practices in Charitable Gift Annuity Programs

Charles B. Gordy II • Harvard Law School, Cambridge, MA
Lindsay Lapole • The Salvation Army, Atlanta, Georgia

Many charities run successful charitable gift annuity programs that are invested appropriately, administered smoothly, and in compliance with Federal and State regulations. Others don't. In recent years, gift annuities have come under increased scrutiny from state regulatory agencies as abusive because of real or perceived illegalities engaged in by organizations offering gift annuities. Complying with gift annuity best practices should avoid this characterization and help ensure the continued success of gift annuities as a viable gift option for charitable organizations and their donors. This presentation covers what ACGA considers to be best practices for your CGA program.

Track II, III
Converting Deferred Gifts to Current Gifts

Frank Minton • Planned Giving Services, Seattle, WA
J. William Zook, Jr. • Planned Giving Services, Seattle, WA

Just because a donor has made a deferred gift doesn't mean the charity must continue to wait in order to receive its benefit. This session will explore the numerous options available to current beneficiaries of gift annuities, charitable remainder trusts, and pooled income fund contributions who might be interested in accelerating charitable use of some or all of the money involved. In addition, attention will be devoted to working with bequest donors, as well as with those who have made testamentary charitable beneficiary designations, to consider making lifetime gifts.

Track II, III
Is There "Security" in Planned Giving?

Robert F. Sharpe, Jr. • The Sharpe Group, Memphis, TN

There has been no shortage of information about how gift annuities and other gift plans work and the tax and other financial benefits donors can enjoy by making gifts in this way. It has become increasingly apparent, however, that lesser-known state and federal laws such as the Philanthropy Protection Act of 1995 that define gift annuities and certain other plans as securities can also have an important impact on the gift planning and marketing process. Learn what gift planners need to know to protect the interests of their organizations and their donors.

Track II, III
Planned Giving and Finance Offices: A Plan for a Productive Partnership

Cam Morin Kelly • Smith College, Northampton, MA

How would you describe the relationship between your planned giving office and your financial office? Friend or Foe? While many institutions enjoy a positive, professional relationship with a shared goal as their objective, others struggle to see eye-to-eye. This presentation will look at the priorities that are important to "both sides of the street," and share some practical ideas for working in a collaborative manner.

Track II, III
Top Ten Estate Settlement Problems & What to do About Them (a.k.a. Keeping Your Donors From Rolling Over in Their Graves)

Andrew M. Fussner • American Heart Association, St. Petersburg, FL

This is an intermediate level look at problems that arise during the estate settlement/bequest administration process. Ten fairly typical post-mortem "problems" will be explained and suggestions for dealing with them will be offered. Issues include: slow-moving administrations, excessive fees, will contests, determination of beneficiary issues and the "restricted" unrestricted gift.

Track III
Optimizing CRT, CGA and Endowment Investments

Donald F. Kent • Bernstein Global Wealth Management, New York, NY
Stephen M. Lippman • Bernstein's Wealth Management Group, New York, NY

Using probabilistic modeling tools and real life case studies, The presenters will share strategies used to help individuals and charities answer these and other complex questions. What is a reasonable expected return for stocks and bonds over the next few years? What is the best allocation for CRTs, CGAs and endowment assets? Is it ever advisable to invest a CRUT 100% in equities? Does it matter what the term or payout is? Is it ever better to use municipal bonds rather than taxable bonds? Should charities discourage donors from creating CRTs with high payouts? What is the optimal payout rate for donors who want to maximize their wealth? Is it better for a donor to use a CGA than a CRT, and under what circumstances?

Friday, April 4 • Schedule

7:30 am – 1:30 pm	**Registration Open**
7:30 – 8:30 am	**Continental Breakfast • Exhibit Hall**
8:30 – 9:45 am	**Morning Breakouts**
9:45 – 10:15 am	**Refreshment Break • Exhibit Hall**
10:15 – 11:30 am	**Repeat Morning Breakouts**
11:45 am	**Closing Luncheon • Sheraton Ballroom**

Conrad Teitell
Cummings & Lockwood, Old Greenwich, CT

Friday Morning Breakouts

Track I, II
Charitable Remainder Trusts — Better Living Through Charitable Giving!

Marc Carmichael • R & R Newkirk Company, Willow Springs, IL

How do charitable remainder trusts work? What are the tax advantages for donors? Who are the best prospects for a unitrust? An annuity trust? What assets are best for funding CRTs? Are there pitfalls to avoid? What personal and financial goals can CRTs accomplish for donors and their families? All these questions (and more) will be addressed in this basic session exploring "better living through charitable giving" — through CRTs.

Education Agenda

Friday Morning Breakouts, continued

__Track I, II__
Take the "Blues" Out of Your Planned Giving Marketing Program

Ellen O'Connor Shugart • American Heart Association, Wethersfield, CT
Kimberly Ann Soltis • American Heart Association, St. Petersburg, FL

Need new ideas to market bequests? Looking for a new way to market gift annuities to your constituents? Using the same ideas for stewardship year after year? This session is designed to explore marketing strategies with a special focus on gift annuities and emphasis on stewardship, all designed to increase planned gifts to your organization!

__Track I, II__
Working with *Elderly Donors*

Laura Hansen Dean • The University of Texas at Austin, Austin, TX

This session will review the joys and challenges of working with the truly elderly, those age 75 and older. Included are their emotional and financial concerns and the nature of the variety of relationships with gift planning professionals.

__Track II__
Charitable Gifts *of Retirement Plan Assets*

Jeremiah W. Doyle IV • BNY Mellon Wealth Management, Boston, MA

This session will discuss why, how and when to leave retirement plan assets to charity; how to structure the gift; how the minimum required distribution rules affect the gift; and how the Retirement Equity Act of 1984 affects the gift.

__Track II__
Gift Planning for Unmarried Couples and Other Unmarried Donors

Wendy Goffe • Graham & Dunn P.C., Seattle, WA

The bias in favor of married couples that is inherent in the transfer tax laws means that unmarried couples often bear a heavier estate and gift tax burden. Their advisors need to understand the disparities in the law relative to unmarried couples, and need to be able to recommend steps, if any, to mitigate the lack of parity with married couples. Because transfers between unmarried couples are not eligible for the marital deduction, unmarried couples often perceive that there is less available to give to charity. While this may not deter some couples from supporting charitable causes, for others the tax consequence may be an obstacle to charitable giving. Nevertheless, there are vehicles and options for charitable giving that unmarried couples ought to consider, some of which may actually allow one partner to transfer more wealth to a partner than he or she would be able to transfer otherwise.

__Track II, III__
Gift Acceptance *Policies and Procedures*

Philip M. Purcell • Ball State University Foundation, Muncie, IN

Creating and implementing gift acceptance policies and procedures is an important educational and effective governance opportunity. This session will explore how to create policies and procedures including ethics, all gift techniques, donor recognition, donated assets, campaign counting and much more. This interactive session will allow time for questions about current laws, limiting liability and current best practices.

__Track II, III__
State Regulations

Edie Matulka • Planned Giving Services, Seattle, WA
Kristen Kaye Schultz • Crescendo Interactive, Inc., Camarillo, CA
Zane A. Chrisman • Arkansas Insurance Department, Little Rock, AR
Kristofer Graap • Washington Office of the Insurance Commissioner, Olympia, WA

This year's state regulations session is aimed at educating charities on the ongoing compliance requirements relating to state gift annuity registrations. Individuals from state insurance departments will speak on a panel regarding regulatory issues relevant to their states. The goal is to educate charities on ways to comply with state law in issuing and administering gift annuities, with particular emphasis placed on meeting annual reporting requirements. The panel will be moderated and there will be time for Q&A from the audience.

__Track III__
UBTI *in Charitable Gift Planning: A Primer*

David Wheeler Newman •
Mitchell, Silberberg & Knupp LLP, Los Angeles, CA

Some gift assets, including real estate, interests in operating businesses and investment partnerships, create the possibility of unrelated business taxable income (UBTI), including UBTI resulting from debt financing. This session presents the basic UBTI rules and exceptions as they apply to charitable gift planning, reviews recent developments in this area and suggests strategies to avoid or minimize the negative impact of UBTI.

Specialized Learning Tracks

Choose sessions designed to meet your needs:

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Track II – Advanced Planned Giving
Track III – Financial, Investment & Administrative Issues

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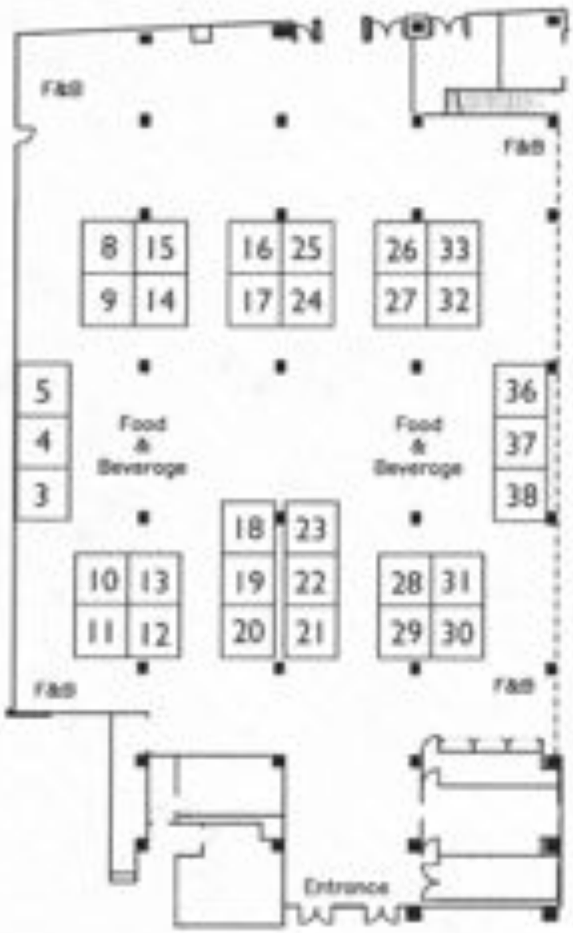
Exhibit Hall Diagram

River Exhibition Hall A • Level 1



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Conference Faculty

Conference Chair

J. Lance Jacobson is a regional gift planning manager in the Phoenix, Arizona, office of the Evangelical Lutheran Church in America, having recently retired as a development officer with the Mayo Foundation. Prior to Mayo, he was the director of planned giving at St. Olaf College in Northfield, Minnesota. Before his career in gift planning, Jacobson was in private law practice with the firm of Lampe, Fossum, Jacobson, Borene & Crow in Northfield. He is a member of the Minnesota Bar Association and serves on the board of directors of the American Council on Gift Annuities.

Keynote Address

Shawn C. D. Johnson is the chairman of the State Street Global Advisors (SSgA) Investment Committee, and director of institutional fiduciary services. He is a member of State Street Corporation's Major Risk Committee as well as SSgA's Independent Fiduciary Committee and the SSgA/Tuckerman Real Estate Investment Committee. In addition to managing SSgA's team of economists and strategists, Johnson oversees SSgA's Advanced Research Center Product Engineering as well as private equity investments, including CitiStreet, Wilson, ADCM and SSgI (Italy). He is also responsible for SSgA's merger and acquisition activities globally. Additionally, he is currently the vice chairman of the Financial Services Sector Coordinating Council (FSSCC), the private sector organization that coordinates homeland security issues with federal financial regulators. Prior to joining SSgA, Johnson was vice president of business development for MGA Software; a manager for Braxton Associates, Deloitte & Touche's Corporate Strategy Consulting Group; president of TMT Software Company; and a manager for General Electric's Aerospace Business Group. He also served as an Intelligence Officer with the United States Naval Reserve.

Plenary Sessions

Frank Minton is president of Planned Giving Services, Inc. of Seattle, a planned giving consulting firm serving clients in the U.S. and Canada. The firm specializes in starting and auditing planned giving and gift annuity programs, gift annuity state certifications, seminars, and assistance with various types of gifts. He earned a Ph.D. degree from the University of Chicago and was a college professor before entering the field of planned giving. He is co-author of Planned Giving for Canadians, principal author of Charitable Gift Annuities: The Complete Resource Manual and has published many articles. Minton is a past chair of the National Committee on Planned Giving and received its Distinguished Service Award. Currently, he is chair of the American Council on Gift Annuities.

Plenary Sessions

Cam Kelly currently serves as the director of campaign & 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 in 2005 and for campaign planning in 2007. 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. She 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.

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 professor at the University of Miami Law School and is also director of the Philanthropy Tax Institute, where he lectures on taxes, philanthropy, and estate planning. Teitell writes the monthly newsletter, Taxwise Giving, and is author of the five-volume treatise, Philanthropy and Taxation. He is listed in *The Best Lawyers in America* and is the recipient of NCPG's Distinguished Service Award and the recipient of the American Law Institute/American Bar Association's Harrison Tweed Award for Special Merit in Continuing Legal Education. He is counsel to the American Council on Gift Annuities and has spoken at every ACGA conference since 1968.

Symposia

Bryan K. Clontz is president and co-founder of Charitable Solutions, LLC, specializing in non-cash asset receipt and liquidation, gift annuity reinsurance brokerage, gift annuity risk management consulting, life insurance appraisals and CRT/CGA investment management. 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, the American Council on Gift Annuities' Rate Committee and the National Committee on Planned Giving Board for 2007-2010. He is a prolific author and frequent speaker on financial planning and planned giving topics. Clontz has also served as an expert witness on charitable gift annuity default and reinsurance and is a co-inventor of a patent-pending CGA risk management process (LIRMAS- Life Income Risk Management Analytic Suite).

Conference Faculty

Symposia

J. Michael Sutton has been with The Salvation Army in various capacities for over 16 years. Fourteen years of his career with the Army have been in positions in the areas of finance and planned giving. Sutton oversees the day to day operation of the Army's investment portfolio, communicating with managers, the custody bank and the consultant. Additionally, he is responsible for oversight of the planned giving accounting and administrative operations, including investments of trusts, gift annuities and pooled income funds. Sutton received has a BA in Business Administration from Asbury College in Wilmore, KY.

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. His clients include a wide range of educational, health care, arts, human rights and social service organizations. His articles on charitable gift planning have appeared in *The Journal of Taxation, Estate Planning, Taxes – The Tax Magazine, Trusts & Estates* and other professional journals. Formerly, he served as planned giving director for New York University.

Planned Giving Fundamentals

Joseph O. Bull joined The Nature Conservancy's Worldwide Office as Director of Philanthropy for Global Priorities–Central U.S. on August 1, 2007, following 16 years of service to his alma mater, The Ohio State University. For 13 of those years, he served as Ohio State's director of planned giving. He was the 2005 Chair of the Board of the National Committee on Planned Giving, and served a total of six years on the NCPG Board of Directors. Additionally, he serves as a member of the Editorial Advisory Board for the national newsletter *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. Bull is a former member of the board 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. He was co-chair of COPGC's *LEAVE A LEGACY* initiative, which became the model for NCPG's national initiative. He is admitted to the Ohio and North Carolina bars.

Planned Giving Fundamentals

Shari Fox is the assistant vice president and director of gift planning at the University of Michigan. Before joining the University in December 2006, she was director of gift planning with The University of Cincinnati Foundation. Prior to joining UC, Fox led all development and community relations efforts for Beech Acres, a 154-year old child-focused family service agency in Cincinnati. She is a past chair and current board member of the National Committee on Planned Giving and a past president of the Greater Cincinnati Planned Giving Council. She currently serves as a member of the Editorial Advisory Board for the monthly newsletter *Planned Giving Today*, and is an active member of the Planned Giving Roundtable of Southeast Michigan and the Washtenaw County Estate Planning Council.

Breakout Sessions

Bruce Bigelow is a founding partner of Charitable Development Consulting, a firm that offers targeted advice to non-profit organizations on a variety of fundraising issues. Until 2004 he served as the senior vice president for development and college relations at Hood College where he was responsible for all of the college's outreach efforts. He served for three years on the board of directors of the National Committee on Planned Giving. He has chaired the national task force on planned giving research for NCPG, and the Committee on International Outreach. In 1992 he chaired the national NCPG Annual Conference and currently chairs the NCPG Task Force on Reporting and Counting Gifts. Bruce is a founding member and past president of the Chesapeake Planned Giving Council in Baltimore and is a member of both the Planned Giving Council of Greater Washington and the CANARAS Group. He has written extensively in the field of planned giving and has presented a number of papers at a variety of development seminars and conferences.

Reynolds Cafferata is a partner in the Los Angeles law firm of Rodriguez, Horii & Choi LLP where he advises charitable organizations and individuals regarding complex charitable gifts, charitable trusts, donor advised funds, private foundations, support organizations, and other gift mechanisms. He also advises charitable organizations with respect to gift acceptance, risk management, unrelated business income, self-dealing and intermediate sanctions, endowment management, and state law compliance issues. Cafferata advises corporate fiduciaries regarding the management of charitable trusts. His representation of charities and fiduciaries includes contested probates and judicial reformation of trusts.

Conference Faculty

Breakout Session Speakers

Marc Carmichael is president of the R&R Newkirk Company, which provides planned gift training and marketing materials for hundreds of organizations. R&R Newkirk also publishes the Charitable Giving Tax Service, a four-volume reference library and CD on planned giving and charitable estate planning. Carmichael was the 1998 chair of the National Committee on Planned Giving and has served on the board of directors of the Chicago Planned Giving Council. He speaks regularly at the national conferences of AFP, ACGA, AHP, and local planned giving council meetings. He was chair of the 1996 National Conference on Planned Giving in Chicago and served for five years as chair of the NCPG Editorial Advisory Committee, which oversees publication of *The Journal of Gift Planning*. Carmichael is a graduate of the Indiana University School of Law and is a member of the Indiana State Bar Association. In 2005 he received the Russell V. Kohr Award for Excellence in Gift Planning from the Chicago Council on Planned Giving.

Zane A. Chrisman is an associate counsel in the legal division of the Arkansas Department of Insurance. Prior to coming to the Department, she was the Law Clerk to Judge Willard Proctor, Jr. in the Fifth Division Circuit Court. Chrisman has also practiced as a litigation attorney with The Law Offices of James F. Swindoll. In addition to her work as an attorney, Chrisman is an Associate Editor for the Arkansas Court Bulletin and has published summaries of opinions originating in the Eight Circuit Court of Appeals, the Arkansas Supreme Court, and the Arkansas Court of Appeals. She is licensed before the Arkansas Supreme Court, the Eastern and Western Districts of Arkansas, the United States Court of Appeals for the Eighth Circuit, and the Supreme Court of the United States of America.

Cyndi Court is senior vice president, resource development at Boys and Girls Clubs of America. In this role, she oversees all corporate, individual and foundation fundraising for the organization. In addition, Court leads a team responsible for providing resource development services to local Clubs, including the It Just Takes One campaign and planned giving support. With some 20 years of nonprofit experience, she is well suited to lead the organization and provide support to Clubs in the resource development arena. Prior to joining BGCA's senior management team, Court served as BGCA's vice president of planned and major gifts. Previously, she served as group vice president for the Arthritis Foundation's planned giving department in Atlanta and as director for The Salvation Army's Community Center in Tampa.

Laura Hansen Dean joined The University of Texas at Austin on April 1, 2007 where she serves as executive director of gift planning in the Office of the Vice President for Development. Prior to joining the University, she was President/CEO of the Community Foundation of Southern Indiana, a three-county community foundation. For over 20 years she has assisted individuals and families in estate planning, incorporating charitable giving in financial and estate planning, the creation of charitable organizations, and the selections of recipients of charitable grants. In addition, she has assisted charitable organizations in designing, implementing and evaluating major and planned giving programs, in charitable gift negotiations for the benefit of a wide variety of charitable organizations and in the management of charitable organizations. She is a frequent speaker to estate planning councils, professional advisor associations, and national conferences on resource development. Dean served on the board of directors of the National Committee on Planned Giving from 1991 through 1993, authored the 1992 Gift Planner Profile, the 1995 Gift Planner Profile and was the 1993 Chair of the Education Committee. She served as the 1995-97 President of The Planned Giving Group of Indiana. She has served on the editorial review committee for *The Journal of Gift Planning* since its inception and is a member of the board of directors of the Ball State University Foundation.

André R. Donikian is a noted planned and major gifts expert with 35 years of service in the field. As founder, president, and editor in chief of Pentera Inc., a full-service planned-giving firm based in Indianapolis, he has advised thousands of nonprofit organizations—including the nation's top nonprofits—on all aspects of connecting organizations and donors. Donikian has published and lectured extensively on philanthropic tax planning and has developed continuing education programs for state bar associations and accountancy boards. Donikian has served on the board of NCPG and the board of advisors of Union College and is a founder and former board member of the Planned Giving Group of Indiana. He is the recipient of numerous awards, including the David M. Donaldson Distinguished Service Award from the Planned Giving Group of New England in 1991, and The Spirit of Philanthropy Award from The Center on Philanthropy at Indiana University in 2006. Among his noted achievements: from 1989 to 1997 the organization now known as the Independent Colleges of Indiana Foundation retained Donikian under Lilly Endowment and Ball Brothers Foundation grants to act as gift-planning counsel to all of the independent colleges of Indiana, to train and educate their development staff, board members, and key volunteers and to conduct numerous seminars for prospects and donors.

Conference Faculty

Breakout Session Speakers

Jeremiah Doyle is an estate planning strategist for BNY Mellon's Private Wealth Management group and a senior vice president of Bank of New York Mellon. Doyle provides high-net-worth individuals and families throughout the country with integrated wealth management advice on how to hold, manage and transfer their wealth in a tax efficient manner. He is admitted to practice law in the Commonwealth of Massachusetts and before the United States District Court, United States Court of Appeals (First Circuit), United States Tax Court. He is the editor and co-author of *Preparing Fiduciary Income Tax Returns*, a co-author of *Preparing Estate Tax Returns*, a co-author of *Understanding and Using Trusts*, a co-author of *Drafting Irrevocable Trusts in Massachusetts*, all published by Massachusetts Continuing Legal Education, and a reviewing editor of the *1041 Deskbook* published by Practitioner's Publishing Company. Doyle served as president of the Boston Estate Planning Council and a member of its Executive Committee and was a 20-year member of the Executive Committee of the Essex County Bar Association. He has spoken at numerous professional education programs throughout the country on various topics, has been quoted in numerous business publications and has appeared on CNBC, MSNBC and CNN.

David Ely is a vice president of State Street Global Advisors and is a portfolio manager and investment team leader in the firm's Charitable Asset Management (CAM) Group. He is responsible for setting asset allocation strategy and managing charitable gift portfolios for all CAM customers. Ely serves on the CAM Investment and Annual Account Review Committees. Prior to joining State Street in 1999, David worked for Salomon Smith Barney's Private Client Group. David earned his BA in Economics from the University of North Carolina at Chapel Hill, and his MA in Finance at Northeastern University. He has earned the Chartered Financial Analyst designation and is a member of the Boston Security Analysts Society. He is also a member of CFA Institute. David represents CAM as advisor to the ACGA Rates Committee and serves on the CAM Investment and Annual Account Review Committees.

Ellen G. Estes, a graduate of the Yale Law School, started her career as an estate planning and tax attorney. She then became legal counsel to the Campaign for Yale, and later served as the first director of development of the acclaimed Long Wharf Theatre in Connecticut. Estes founded Estes Associates to provide consulting services on major and planned gift matters to nonprofit organizations nationwide. She is a regular speaker at professional conferences around the country. She serves on the national board of gift planning consultants of Planned Giving Mentor™. Estes is also widely recognized for her no-nonsense basic seminars, "Planned Giving – Plain and Simple™."

Frank Estes joined Ellen at Estes Associates after retiring from the American Red Cross, where he was a gift planning officer. His early career was spent practicing law in the areas of estate planning and banking law before becoming general counsel for two Connecticut regional banks. He then joined the planned giving field, doing major and planned giving at Trinity College before becoming director of planned giving and then director of development at Yale-New Haven Hospital. Estes currently serves on the board and as treasurer of the Planned Giving Group of Connecticut.

Andrew Fussner currently serves as the national vice president of estate settlement for the American Heart Association and oversees the administration of nearly $100 million in bequest assets annually for the organization. He is based in St. Petersburg, Florida. Before assuming his current position, he served as the vice president of planned giving for the AHA's Florida Affiliate and as the AHA's director of planned giving for the west coast of Florida. Prior to joining the AHA, Fussner was an attorney with the Tampa office of the national law firm of Foley & Lardner. He specialized in estate planning, probate/trust administration and tax law. He holds his law degree from the University of Florida where he was a member of the Florida Law Review and was inducted into the Order of the Coif. He also obtained a BS in Accounting and a BA in Political Science from the University of Florida and has been named to UF's Hall of Fame.

Wendy Goffe is a shareholder with the law firm of Graham & Dunn PC, Seattle, Washington. She is a Fellow of the American College of Trust and Estate Counsel. She has a comprehensive estate planning practice that involves all aspects of estate planning for high net worth individuals and families, advising both individuals and charitable organizations concerning planned giving, probate, and trust administration. Goffe is a member of the Estate Planning Council of Seattle Executive Committee, the YWCA Planned Giving Committee, The Nature Conservancy Planned Giving Committee, The Seattle Foundation Professional Advisors Council, and the Children's Legacy Council of the Children's Hospital Foundation. She is also an adjunct instructor at Seattle University Law School. She is a past member of the Acquisition Committee of the Tacoma Art Museum and the Executive Committee of the WSBA Real Property, Probate and Trust Section.

Conference Faculty

Breakout Session Speakers

Charles B. Gordy, III, is the director of planned giving at Harvard University Law School. Prior to that, he managed planned giving services for The Bank of New York and served as The Bank's senior planned giving officer. He has also been the director of planned giving at Yale University, and at Tufts University. He is on the board of ACGA, and the Planned Giving Group of Greater New York, and has served on the board of NCPG and the Planned Giving Group of New England. He received his B.A. from Colby College, Waterville, Maine, in 1981, and his J.D. from George Washington University, Washington, D.C. in 1986.

Kristopher Graap has been with the Washington Office of the Insurance Commissioner since 1995, and has spent the last seven years working with auxiliary line entities such as CGA-issuing charities. Prior to a brief stint at Safeco Insurance, he spent ten years teaching math to junior and senior high school students. Graap presently serves as corporate secretary for the Scottish Rite Foundation of Washington, which annually provides over a quarter-million dollars of graduate fellowships and undergraduate scholarships to Washington residents. Additionally, he was recently recognized as a 200-unit donor by the Puget Sound Blood Center. His formal education consists of a Master of Science degree in Mathematics from Central Washington University, as well as several undergraduate degrees in math and philosophy.

Robert E. Harding joined the Gray Plant Mooty law firm in Minneapolis, Minnesota, in 1983 and has been a principal since 1989. For most of his 24 years of practice he has focused exclusively on charitable gift matters and related tax-exempt organization issues. He represents colleges, universities, healthcare systems and other nonprofit organizations in the upper Midwest. He speaks regularly at regional and national conferences on charitable gift planning, and he publishes an e-newsletter on charitable giving called What Gives? Harding received undergraduate and graduate degrees in philosophy from Harvard University and his 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.

Don Kent brings twenty years of experience designing complex financial plans for high-net-worth families to his current role at Bernstein Global Wealth Management. For the past seven years, he and his team have worked closely with clients and other professional advisors to craft comprehensive strategies that address all aspects of their clients' wealth management needs. He also works closely with a select group of charitable institutions in building their endowment and planned gift programs and managing their assets. Prior to joining Bernstein, Kent was a Vice President at United Jewish Communities (formerly CJF) and devoted 13 years to building Federations' planned giving and endowment programs. During that period, he taught a planned giving course at NYU and served on the national board of the National Committee on Planned Giving. Kent lectures widely on charitable gift planning and financial planning topics.

Carol Kolmerten is a founding partner of Charitable Development Consulting and was, until recently, the director of major gifts and planned giving at Hood College. She is also a tenured full professor of English. After joining the development office in the late 1990s, Carol created a dynamic visitation system with over 600 active prospects. She designed the format and structure for all major and planned gifts activities, including creating a pyramid of top prospects and the strategies for each person. She has also managed the Hood College foundation effort for fifteen years. As a writer, Kolmerten brings in, on average for the past five years, over $1.5 million in funding per year from federal agencies and foundations. Her success rate hovers above 85% for the 35-40 proposals that she sends out each year. She has published several books on a variety of subjects and speaks frequently at conferences and workshops.

Lindsay Lapole is the territorial planned giving director for The Salvation Army, USA Southern Territory in Atlanta, Georgia, responsible for recruiting, training and managing the professional staff of 31 planned giving directors in the 15 southeastern states. He is also responsible for the administration, training, marketing and quality control for the program across the territory. Prior to joining The Salvation Army, Lapole served in fundraising and volunteer management with the Boy Scouts of America. He is a past director of the Georgia Chapter of the Association of Fund Raising 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 is the current secretary of the board of directors of the American Council on Gift Annuities, and he also chairs its State Regulations Committee. He was conference chair of the 26th Conference on Gift Annuities.

Conference Faculty

Breakout Session Speakers

Stephen M. Lippman is a specialist in Bernstein's Wealth Management Group. Based in New York, he works closely with the firm's clients and their professional advisors on a variety of complex investment planning issues, including pre-transaction planning, multi-generational wealth transfer, philanthropy, and diversification planning for holders of concentrated portfolios (both directly held shares and employee stock options). Prior to becoming a wealth management specialist in the fall of 2006, Mr. Lippman served as a quantitative analyst in Bernstein's Wealth Management Group, assisting high-net-worth clients with decisions about asset allocations by the development of customized analytics. Prior to joining the firm in 2001, he was a consulting actuary at William M. Mercer, Inc., a global benefits consulting firm, for six years.

Edie Matulka has been with Planned Giving Services, a division of PG Calc Incorporated, since 1997. In addition to the practice of law, her background includes work in government, public, and nonprofit settings. A member of the Washington and Oregon State Bar Associations, she graduated from Northwestern School of Law at Lewis and Clark College in Portland, Oregon, and earned a B.A. in Political Science from the University of Washington. Among her duties at Planned Giving Services, Matulka has primary responsibility for assisting charities in complying with state regulations for issuance of gift annuities. She is the primary author of certain chapters of *Charitable Gift Annuities: The Complete Resource Manual* and also worked on the development of the gift annuity agreement forms integrated in PG Calc's software. Matulka has spoken on gift annuities and state regulation at the Washington Planned Giving Council and American Council on Gift Annuities conferences. She currently serves on the State Regulations Committee of ACGA.

David 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.

Phil Purcell is vice-president for planned giving and endowment stewardship at the Ball State University Foundation. Formerly, he served as director of gift planning for the Central Indiana Community Foundation (Indianapolis, IN). Purcell is an attorney and member of the American and Indiana State Bar Associations. He currently serves as a volunteer on the Tax Exempt Organization Advisory Council for the Internal Revenue Service (Great Lakes States region). He teaches courses on Law and Philanthropy, Nonprofit Organization Law and Planned Giving as adjunct faculty for the Indiana University School of Law (Bloomington) and Indiana University Center on Philanthropy and Fundraising School (Indianapolis). Purcell serves as a member of the board of directors for the National Committee on Planned Giving, Association of Fundraising Professionals Indiana Chapter, and the Central Indiana Land Trust Advisory Board. He is past president of the Planned Giving Group of Indiana.

Kristen Schultz is senior vice president of Crescendo Interactive, Inc. She is responsible for tax planning advisement, client education and consultation for Crescendo's software and Internet products. She is a frequent speaker and writer in the area of gift planning and conducts seminars nationwide on strategies to identify and close major gifts. Prior to joining Crescendo, Kristen served as counsel to the Assistant Secretary of Education in Washington, D.C. Schultz received her J.D. from the University of California Los Angeles School of Law where she served as Editor of the UCLA Law Review. Kristen is a member of the State Bar of California, the District of Columbia Bar and the Maryland State Bar. She serves on the American Council on Gift Annuities (ACGA) State Regulations Committee, is a member of the Planned Giving Roundtable of Ventura County, California, and a Certified Master Trainer (ePMT) with the international ePhilanthropy Foundation.

Robert F. Sharpe, Jr. is president of The Sharpe Group. He has over 25 years of gift planning experience. 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. Sharpe has authored many articles and other publications covering numerous gift planning topics. His remarks on this subject have been featured in the *Wall Street Journal, The New York Times, Newsweek, Forbes, Smart Money* and other national publications. He is a frequent speaker for gatherings including planned giving groups in New York, Los Angeles, and other cities, the National Conference on Planned Giving, the American Bankers Association Trust Asset Management Conference, the Association of Fundraising Professionals, and AHP and CASE conferences, among others.

Conference Faculty

Breakout Session Speakers

Ellen O'Connor Shugart has served as a vice president for planned giving for the American Heart Association since 2002. In her role as vice president and team leader for the Eastern United States, she supervises a staff of nine planned giving professionals. Prior to joining the American Heart Association, Shugart worked for the Arthritis Foundation for 13 years, the last four serving as the associate vice president of planned giving in the Northeast. She has served as the president of the Planned Giving Group of Connecticut, and has been a presenter for AFP, Connecticut and Upstate New York Chapters, and the Planned Giving Group of Connecticut. Shugart is a regular guest presenter for the planned giving workshop, "Planned Giving – Plain & Simple."

Kimberly Ann Soltis is director of planned giving for the American Heart Association Greater Southeast Affiliate. She has served the American Heart Association for nine years, being very active in their marketing program. Soltis currently serves as co-chair for the National Marketing Group at the American Heart Association.

Dyan Sublett currently serves as executive vice president, financial development, for the YMCA of Metropolitan Los Angeles. Previous to her work at the YMCA, she served as senior vice president for advancement at the Natural History Museum of Los Angeles County. Prior to that, she was senior vice president for institutional advancement at Art Center College of Design. Along with Karen Stone, Sublett founded the innovative Women and Philanthropy Program at the University of California, Los Angeles. The program has served as a model for nonprofits nationwide, and raised an unprecedented $50 million from UCLA women in its first ten years. Sublett is a contributing writer to the book *Women as Donors, Women as Philanthropists*, is a frequent public speaker, and is a consultant with educational, environmental and social change organizations.

Philanthropy: Going the Magnificent Mile

28th Conference on Gift Annuities

Richard Triolo is a senior vice president and divisional sales manager for Allianz Global Investors with over 25 years of experience in the investment industry. He has extensive experience working with foundations, endowments and nonprofits, ERISA plans and private family offices. Triolo received his BA in Political Science from Iona College in New Rochelle, New York, in 1971 and his Doctor of Jurisprudence from the University of Tennessee, College of Law in 1978. He is a nationally recognized speaker and author on advanced fiduciary and investment management topics. Triolo has served on the Faculty at IMCA where he taught the Legal Fiduciary Responsibilities section of the CIMA class in the executive education programs at both the Wharton School of Business and at the University of California, Haas School of Business. He is also on the IMCA Committee for the development of the Foundations and Endowments Certificate Program which is now offered at the Wharton School of Business.

Grant Whitney is the senior associate director of gift planning for the Faculty of Arts and Sciences at Harvard University with over ten years of planned giving experience. In addition to day-to-day gift planning fundraising, he manages the John Harvard Society, the FAS stewardship and recognition society for donors who make life income gifts and/or notify the institution of a bequest intention. Before coming to Harvard, Whitney started the planned giving program at Lesley University. He has been an active volunteer at his alma mater and is currently president of the Planned Giving Group of New England (PGGNE). He has served as PGGNE's Government Relations Chair, Vice President for Programming and PGGNE All-Day Conference Chair. Whitney earned an undergraduate degree from Cornell University, and a JD from Albany Law School of Union University. He is a member of the Massachusetts and New York Bars.

Bill Zook is executive vice president of Planned Giving Services, a division of PG Calc Incorporated. He consults with many different charitable organizations, donors, advisors, and financial services professionals on a wide variety of matters related to planned giving. In particular, he assists with the establishment and operation of planned giving programs, as well as the design and completion of numerous types of planned giving arrangements, including gifts, conversions, and sales of income and annuity interests. He also serves as an appraiser of income and annuity interests.

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. Revised April 1999.

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.


Make it Last.

Assessing and Optimizing CGA Program Profitability

Presented by:

Bryan K Clontz, CFP, CLU, ChFC, AEP
President
Charitable Solutions, LLC
Jacksonville, FL

Mike Sutton
Director of Investment Operations
The Salvation Army, USA Southern Territory
Atlanta, GA

28th Conference on Gift Annuities
Thursday, April 3, 2008

Assessing and Optimizing CGA Program Profitability

Bryan Clontz, CFP®
President, Charitable Solutions, LLC

Mike Sutton
Director of Investment Operations, The Salvation Army Southern Territory

Agenda

- CGAs within the Fundraising Pyramid
- Strategic CGA Questions
- Activity Based Costing: A Summary
- CGA Activity Based Costing Process
- Present Values of CGA Residuums
- Small Pool Case Study
- Large Pool Case Study
- Large Pool Overview
- Optimizing Investment Approach
- Optimizing Expense Reduction
- Additional Profitability Recommendations
- Risk Minimization and Concerns
- Review of Sample Reporting

CGAs within the Fundraising Pyramid

1. What is the purpose of fundraising?
   To maximize financial resources necessary to execute the charity's mission – or to raise the most money possible to do the most good stuff possible.
2. Beyond charitable gift annuities, what other vehicles and programs do charities employ to maximize donations?
   Annual membership, major gifts, bequests, direct mail, special events, cause-related marketing, charitable trusts, pooled income funds, etc.
3. What is the primary strategic decision that a VP of Development must make?
   What efforts will produce the most money with the least resources – or where is the maximum bang for the buck?
4. How would a financial services company evaluate a gift annuity program?
   A cost accounting approach called activities based costing (ABC) within a benefit-cost analysis to determine the maximum internal rate of return (IRR).

3

Strategic CGA Questions

1. Do we know if CGAs are profitable for our charity, and if so, at what level?
2. If they are not profitable, are we positioning them as "loss leaders" with the intention of generating additional "gateway gifts"?
3. Do we have a handle on the component benefits and costs to our CGA program?
4. Do we really understand the opportunity costs and benefits of a CGA program?

4

Activities Based Costing: A Summary

A process generally used to determine profitability and then to make strategic decisions regarding pricing, outsourcing and measuring process/product improvement.

5-Step ABC Process

1. **Identify Activities**
2. **Determine Cost of each Activity**
3. **Determine Cost Drivers**
4. **Collect Activity Data**
5. **Calculate Product Cost**

This analysis shows:

1. **Profitable products**
2. **Unprofitable products**
3. **Break-even point**
4. **Specific components of cost drivers**

ABC: Special Event Example

Event Gross Revenue (117 Checks)	**$38,500**
Direct Expenses: Mailing, Caterer, MC, A/V, Decorating, Invitations, Auctioneer	**$18,500**
	$20,000
Indirect Expenses: Check Processing ($12 x 117)	**$1,404**
.25 FTE @ $40,000 = $10,000 x 1.33 Benefits	**$13,333**
.10 FTE @ $25,000 = $2,500 x 1.33 Benefits	**$3,325**
Overhead at 10% of Salary (Lease, Utilities, Phone/Computer, Supplies)	**$1,250**
	$688
Opportunity Cost: 250 hours of Volunteer Time ($20/hr.)	**$5,000**
Opportunity Cost: 800 hours of Staff Time ($25/hr.)	**$20,000**
	$25,000
Possible Future Outright or Deferred Gifts from Event	**$25,000 PV.**

CGA Activities Based Costing Process

1. Direct CGA Pool Expenses Embedded in ACGA Rate Assumptions @ 1%

   Fees: Investment management, transactions, custody, administration, tax preparation, state reserve compliance

2. Indirect CGA Pool Expenses

   Staff time to: manage vendors, CGA processing, financial reporting, existing annuitant service, registration issues, etc.

3. Direct CGA Program Expenses

   Outside consulting, marketing collateral, website services, training, software, etc.

4. Indirect CGA Program Expenses

   Staff time to: plan/build/implement program, report to management/Board, develop marketing materials, training, etc.

Opportunity costs and benefits ignored at this point.

Present Value of Residuums

Average Residuums from ACGA Surveys

76% (1994) 96% (1999) 65% (2004)

PV of $10K CGA Average 50% Residuum @ 5.25% Discount Rate

70 $1,870.12 or $92.12/yr.

75 $2,285.43 or $139.69/yr

80 $2,736.36 or $213.11/yr.

85 $3,191.35 or $323.33/yr.

See ACGA Rate Committee Memo.

Small Pool Case Study: $800K/20 CGAs

Assumptions: All annuities occur in 2007, split evenly between 80 year old men and women with no new additions

		Expense
Direct Pool Expense is $8,000/1% Matches Assumption		$0
Indirect Pool and Program Expenses (On-going):		
.05 FTE @ $75,000 = $3,750 x 1.45 Benefits/OH		$5,437
.05 FTE @ $40,000 = $2,000 x 1.45 Benefits/OH		$2,900
.10 FTE @ $25,000 = $2,500 x 1.45 Benefits/OH		$3,626
Direct Program Expenses (On-going)		$3,000
		$15,000
PV of All On-going Expenses $15,000 @ 5.25%		$137,598
Direct/Indirect One-Time Start-Up Expenses		$12,402
	Total	$150,000
PV of All Assumed Benefits		$219,880
Net "Profit" and Return-on-Investment		$69,000 or 46% ROI/ 10% Margin
Break-even Pool Level		$550,000/$27K average CGA

Large Pool Case Study: $89.7M/1,768 CGAs

Assumptions: Average annuitant is 80.

		Expense
Direct Pool Expense is $163,000/.82% Under Assumption		$738,000
Indirect Pool and Program Expenses (On-going):		
Field Support Staff		$86,275
Field Planned Giving Staff		$293,234
HQ Planned Giving Staff		$77,391
HQ Administration Staff		$139,041
Direct Program Expenses (On-going)		$242,875
PV of All On-going Past Expenses $100,000 @ 5.25%		$1,272,863
PV of All On-going Future Expenses $100,000 @ 5.25%		$862,339
	Total	$2,134,902
Direct/Indirect One-Time Start-Up Expenses		None
PV of All Assumed Benefits		$31,500,000
Net "Profit" and Return-on-Investment		$29,300,000 or 1500+%
Margin or Profit Per CGA		20-30% or $12K/CGA

Large Pool Overview

- Salvation Army Southern Territory CGA's brief history
  - Roots of program – date of inception
  - Gifts to date
    - 3,427 gifts written
    - 1,768 active gifts
    - 1,044 active annuitants
    - $90 million reserve pool
    - Calculated liability $48 million (Annuity 2000 table and 5% discount rate assumption)
  - Structure of operation
    - Finance (business office)/Planned Giving Dept. (development)
  - Workflow of program
    - Planned Giving or Development maintains all relations with the donor and/or beneficiary.
    - Finance or Business Office maintains all relations with financial institutions payment providers.
    - Good communication between Planned Giving and Finance, not only the key, but absolutely essential and critical.

Optimizing Investment Approach

- Conservative nature of Salvation Army
- Historical asset allocation – 60% to 70% equities
  40% to 30% fixed
- More recent allocation

Asset Class	Existing Allocation	Proposed Allocation
Large Cap Core	60%	35%
Small Cap Core	0%	10%
International Equities	0%	15%
Fixed Income	40%	40%
Total	100%	100%

- Invest in the most diversified manner possible within the law
- Use appropriate assumptions for reserve & termination calculations

Optimizing Expense Reduction

- Invest in "in-house" administration
  - Software
  - Staffing
  - Unnecessary expense to outsource
- Place all gifts in the reserve
- Use appropriate assumptions for reserve & termination calculations
- Use real expense costs
- Leverage other assets and relationships for investment of CGA assets to maximize economies of scale reducing management fees

Additional Profitability Recommendations

- Other gifts that CGA's assist in generating
  - Easy
  - Entrée gift
  - Repeat CGA's
- Customer service business
  - Christmas Card mailing
  - Birthday Card mailing
  - ACH advantages to reduce fraud
- Incent Planned Giving reps. and local units – a Salvation Army model

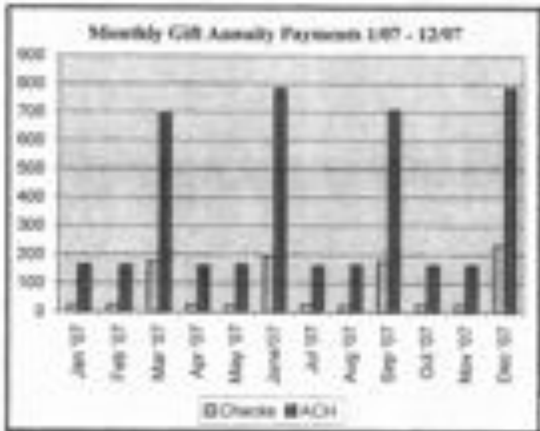
Risk Minimization and Concerns

- Don't raid the reserves
  - Excess reserves can be a temptation for perceived "legitimate" removal of assets from the pool
- Don't "prepay" residuum of annuities
- Use ACGA approved rates
- If appropriate, have the CGA program audited
- Track and adhere to state regulation guidelines

Review of sample reporting

- One page snapshot of program

Sample Quarterly Gift Annuity Report
December 31, 2007



Information	
Total Gift Annuities (written between 1960 and December 2007)	1,469
Active Gift Annuities (includes deferred)	1,768
Active Gift Annuitants	1,044
Historical Average Gift Annuity Value	$ 13,599

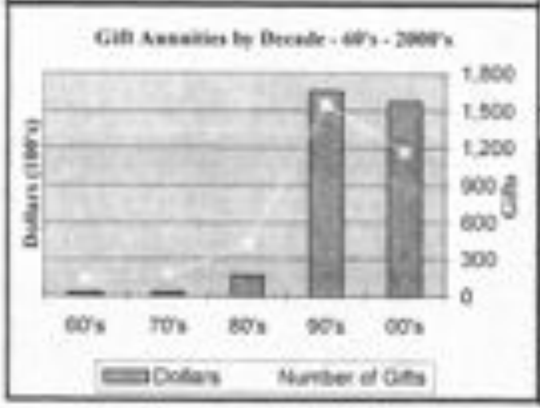
Gift Annuity Rates	
Highest Gift Annuity Rate	12.00%
Lowest Gift Annuity Rate	2.80%
Average Gift Annuity Rate	8.07%

Actual Effective Payout Rate

$x,xxx,xxx (12 months G/A payments) ÷ $xx,xxx,xxx (GA Portfolio) =

6.6%

Liability	
FASB Calculation (Annuity 2000 Table)	$xx,xxx,xxx

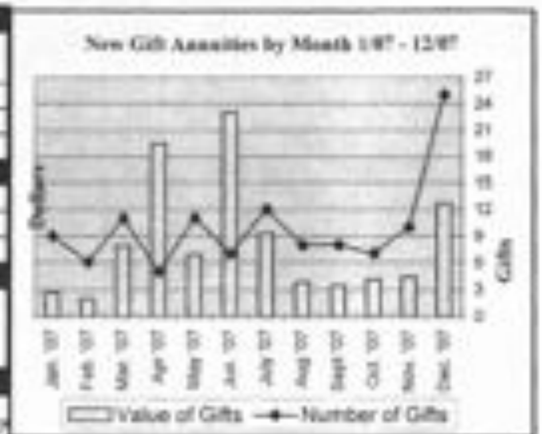


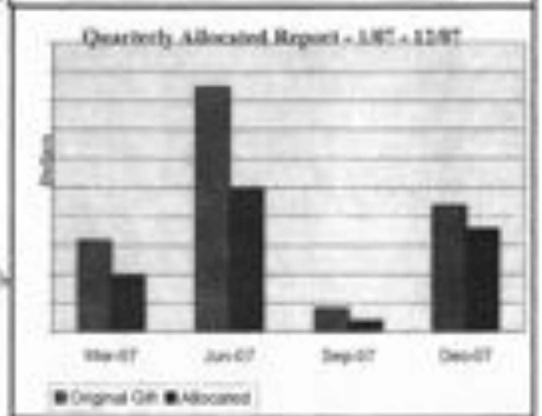
Top 3 (5) Active Gift Annuities

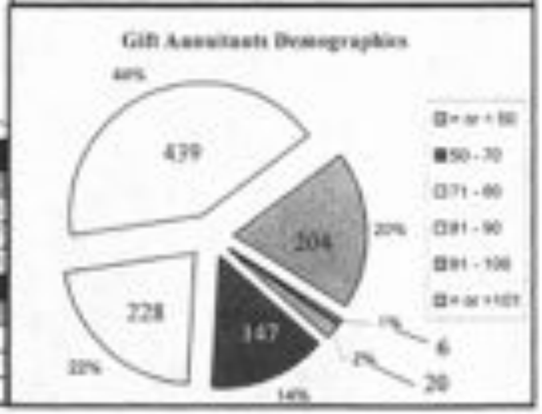
[illegible]	[illegible]	[illegible]	[illegible]
1	Donor A	XX43	$1,404,071
2	Donor B	XX31	$1,328,477
3	Donor C	XX56	$1,023,913

3 Oldest Active Annuitants

[illegible]	[illegible]	[illegible]	[illegible]
1	Donor X	Multiple	103
2	Donor Y	Multiple	103
3	Donor Z	Multiple	103







Ethical Issues in Gift Planning – Some Situations to Consider

Presented by:

Jonathan G. Tidd
West Simsbury, CT

28th Conference on Gift Annuities
Wednesday, April 2, 2008

I. THREE GENERAL AREAS OF ETHICAL CONCERN

1. Advice given by attorneys to donor-clients.

2. Advice given by attorneys to charity-clients.

3. Advice given by charities to donors.

4. <u>Note</u>: "Advice" here includes lack thereof.

II. SITUATIONS FOR DISCUSSION

<u>CASE #1</u>

In the last half of 2008, Dan calls XYZ and gets XYZ's planned giving director, Phil, on the line. Dan says he and his wife want to establish a 5-percent charitable remainder unitrust for the eventual benefit of XYZ; that he's quite familiar with unitrusts, having set them up before; that he's calling to get a trust instrument (doesn't want to pay an unnecessary legal fee); and that his accountant will be trustee of the trust. Oh, and also that the trust will be funded with $500,000 worth of jointly owned securities.

Phil takes all this down and then gets to work obtaining the requested document from XYZ's legal counsel.

One thing Dan didn't tell Phil, by the way, was that Dan and his wife were 3 days away from finishing up a very friendly divorce.

Any problem(s) here?

CASE #2

In 2003, attorney D.N. helped his client A.B. set up a charitable remainder unitrust funded with real estate. The game plan was for A.B. to serve as the initial trustee of the trust until the real estate was sold and then for Charity X (the remainder beneficiary of the trust) to step in as successor trustee.

Things went according to plan, except that A.B. did not find a buyer for the property. A.B., on his own, went to Charity X and asked charity X to step in as trustee, which Charity X did.

Charity X also had trouble finding a buyer, even at a reduced price.

Meantime, trust expenses (real property taxes, insurance, etc.) began to mount. So Charity X began paying the expenses out of its own pocket.

A.B. began complaining that he never received any payments from the trust (set up as a flip unitrust). Charity X in response began making the required payments out of its own pocket, treating the payments as loans to the trust. To-date, the property still has not sold.

Yesterday, A.B. met with attorney D.N., laid out all the facts and admitted that he had not reported any of the payments he received as income. A.B. asked what the chances were "IRS will find out about all this."

1. What are attorney D.N.'s ethical obligations here?

2. How stands A.B.'s claim of a 1998 federal income tax charitable deduction?

3. What might be the best way for A.B. and Charity X to deal with this situation? (Note that the number of possible ways depends on whether the trust is in fact still a qualified unitrust.)

CASE #3

Attorney G.M. is experienced in estate, trust and tax matters. She also sits on the Planned Gift Advisory Council of ABC University.

D.V., aged 78, approaches for assistance in setting up a "life income" plan to benefit the university.

How do we size up this situation in terms of attorney G.M.'s ethical obligations?

CASE #4

Attorney S.R. is a member of XYZ Church and longtime financial supporter of the church.

Now XYZ has launched a capital fund drive, seeking to build its endowment. Church leaders expect that 25 to 50 percent of the funds the church receives over the next 5 to 10 years will be in the form of bequests.

At a board meeting, attorney S.R. announces that he will, without any charge, draft the will of any individual wishing to leave a bequest to the church.

Are there any ethical concerns about attorney S.R.'s offer of service?

CASE #5

H.R., aged 81, wants to establish a charitable remainder unitrust and fund the trust with a very valuable tract of real estate. Although H.R. is "property rich," he is "cash poor" and therefore does not want to pay the legal costs of setting up the trust.

The prospective remainder beneficiary of the trust is LM College. The college is willing to pay the fee of attorney E.D. to prepare the trust instrument and otherwise advise H.R. in the matter at hand. H.R. has talked with attorney E.D. and is agreeable to attorney E.D.'s helping him.

What are attorney E.D.'s ethical obligations here?

CASE #6

Attorney S.M. is a partner is a firm on retainer to advise XMZ University as to charitable giving program and various other matters.

XMZ's planned giving director, D.V., has asked attorney S.M. to review the revocable trust agreement of C.Y., a potential donor to the university. The reason for the request is that C.Y. wants to set up a gift annuity using trust assets and wants to have the annuity payments made to the trust. The assets in question include some publicly traded but S.E.C.-restricted stock.

Are there ethical concerns here for attorney S.M.?

C.Y., by the way, is a resident of California.

CASE #8

Attorney S.M. is asked to review XMZ's gift annuity program, including its policies and procedures. As part of this review, it comes to the attention of attorney S.M. that XMZ's planned giving department provides to all gift annuity donors a detailed computer printout, created by a widely used software program, of the tax consequences of the annuity transaction, including the donor's "charitable deduction" (in these words).

In each instance, the software program makes use of the highest IRS discount rate for the three months consisting of the month of the gift and the two preceding months. Section 7520(a) of the Internal Revenue Code provides that an individual may elect to use the discount rate for either of the two months immediately preceding the month of gift.

What are the ethical/legal issues here as to which attorney S.M. should advise XYZ University.

CASE #8

Attorney S.M. is also asked to review XMZ's policies and practices for issuing gift receipts. Attorney S.M. learns that for stock gifts, the practice for many years has been to list on the gift receipt

-- the date the stock was received by XMZ, and

-- the amount which XMZ netted from selling the stock, which the receipt states is the amount for which the donor is being "credited" by XMZ.

Attorney S.M. has certain concerns with this practice, which she shares in a conference call with certain representatives of XMZ, including XMZ's longtime employee, D.Y.

D.V. insists that (a) this practice has always been used, (b) this practice has never been challenged by the IRS or anyone else, and (c) to change the practice will greatly upset some of XMZ's longtime repeat donors.

What are the ethical concerns here for attorney S.M.? What, perhaps, is some good advice attorney S.M. could give here regarding the issuance of gift receipts?

CASE #9

In reviewing XMZ's planned giving policies and procedures, attorney S.M. learns these additional facts:

1. Planned giving officer D.V.'s business card contains the designation "Esq." -- because D.V. is a licensed attorney.

2. On several occasions, D.V. has agreed in his individual capacity to serve as the executor for donors to XMZ.

3. D.V. as well as other XMZ gift officers occasionally have received gifts from donors with whom they have been working.

4. D.V. on several occasions has recommended that donors in need of legal counsel engage the services of specific lawyers D.V. knows to be competent to provide the needed work.

5. D.V. has kept pretty good written notes of his dealings with donors to XMZ, even though his job description and university rules do not require him to do so.

6. On several occasions, D.V. has escorted elderly donors to attorneys' offices.

7. Also on several occasions, D.V. has attended dinners and social occasions (the symphony, etc.) as the guest of donors who have come to view D.V. as a friend and who value greatly his companionship.

What are the ethical or legal issues posed by these facts?

Starting a Gift Annuity Program

Presented by:

Cyndi Court
Senior Vice President, Resource Development
Boys & Girls Clubs of America
Atlanta, GA

28th Conference on Gift Annuities
Thursday, April 3, 2008

Starting A Gift Annuity Program

In the current economic climate and with the high demand on development staff to raise increased amounts of revenue in support of on-going operating costs, many organizations which do not currently have a gift annuity fund are examining this type of gift vehicle more closely before establishing one and launching the program. In addition, boards more closely scrutinize all financial matters especially when there is potential risk. This leaves small non-profits and some large national non-profits the very difficult task of persuading their board and senior leadership to establish a gift annuity fund. There are many tools that exist and best practices available to make the job of establishing a gift annuity fund easier and make you and your organization more successful.

In addition, many organizations which find themselves in this situation lack programs such as direct mail, which make the marketing of gift annuities and planned giving more difficult. We will take some time during this workshop to explore a unique opportunity for non-profits to run a planned giving program with little or no mass marketing.

Getting Started

For many of us that have been part of large, successful planned giving programs and now find ourselves with organizations that do not have a gift annuity fund, we do not spend the time needed to know the facts and meet the organization where it currently is. This leads to frustration, wasted time and wasted energy.

Before your first meeting with senior leadership, you should consider the following:

> Assess your organization:
- financially
- structurally
- politically

> Research and know what external resources exist

> Benchmark other similar organizations

> Prepare a business plan

> Conduct separate meetings with specific staff

> Revise your business plan to ensure that potential objections are addressed

Volunteer Leadership

Once you have senior leadership on board, your next challenge is the finance and investment committee. Depending on your volunteers, this could be your greatest challenge. In some cases, these are incredible business leaders who understand finance and insurance but have little or no knowledge of and/or experience with charitable estate planning. The best step to take is to work with your CEO to identify or recruit a board member with expertise in this area.

Whether you have a volunteer expert or not, it is critical that you do the following to prepare for this challenge:

> Educate them about gift annuities. This should include a comparison of gift annuities against other financial vehicles that they understand.

> Draft policies and procedures that address their concerns and minimize risk.

> Understand and educate them about state(s) regulations.

> Research organizations that can provide administration to assist with policies regarding investment and expenditures.

> Benchmark other organizations and educate your volunteers about the fundraising continuum.

> Manage expectations.

Launching the Program

For some planned giving programs we should dig back into our knowledge of basic development principals and consider a campaign approach to either jump-start a new planned giving program or establish a new gift annuity fund. For some planned giving professionals who do not have a broad development background, this concept may be new. For other mature programs that have saturated their marketing outlets, this may be a new strategy to reinvigorate your older, more established program.

A campaign concept can be used as part of a larger endowment campaign, planned giving campaign or just to launch a new gift annuity fund. The following principles provide the underlying strategy for the campaign plan.

1. Personal face-to-face solicitation is the most efficient and effective form of fundraising.

2. 100 percent board participation is essential.

3. Each prospect should be asked to <u>consider</u> giving a specific amount.

4. Volunteers are effective if properly trained, supported and thanked.

5. Challenge gifts are effective in both raising donor sights and empowering volunteer solicitors.

6. The "case for support" must be presented clearly and concisely.

7. Donor recognition and stewardship are important parts of the fundraising process.

8. Individual donors are the greatest source of funds.

The following basic campaign steps should be followed:

1. Develop a case for support.

2. Conduct prospect research.

3. Set a goal.

4. Conduct a feasibility study.

5. Create a deferred giving society.

   To develop a basic campaign plan for your organization's planned giving program, ask your board for a resolution to form this club/society. This society will be an association of supporters who have assured that the future needs of your organization are met by making some kind of planned gift. This club/society should be an important part of your stewardship plans. Ask the board to establish a recruitment period (12 - 18 months for example) to identify *"founding members."*

6. Conduct a "Founding Members" campaign.

   If your organization is starting a planned giving program or launching a gift annuity fund for the first time, add a "founding members" campaign to your deferred giving society. This approach builds a planned giving program from within, starting with your most loyal prospects. It uses membership as a motivating factor. Once your organization has experienced success, marketing to other segments is the next logical step.

7. Start with your leaders.

   Leadership by example is critical to the success of any campaign. To launch your deferred giving society, you should first seek to secure a planned gift commitment/gift annuity from the planned giving chief volunteer, the board chairman and the chief professional officer. This step, while it may appear symbolic, is critical to the success of the plan. Participation by your leadership is vital to your program success, and you should strive for 100% participation results.

8. Recruit the board.

   One of the leaders mentioned earlier – preferably the board chair – should make a presentation to the entire board soliciting their participation. Board packets should be given to each member immediately following the presentation

   During the meeting, board members can be asked to indicate whether or not they have included your organization in their will or estate plan. Completed letters of commitment may be retrieved at the end of the meeting or during the follow-up process. This process should be repeated at each board meeting.

9. Follow-up.

   Following each board meeting, the planned giving chair, the board chair, or the chief professional officer should contact each board member who has not joined to discuss their participation. Your director of planned giving can offer confidential assistance during this step.

10. Provide recognition.

    At each board meeting or other appropriate venue, such as an annual dinner or community event, society plaques or other recognition materials should be presented to board members who have included a planned gift to your organization, and have self-identified by submitting a letter of commitment.

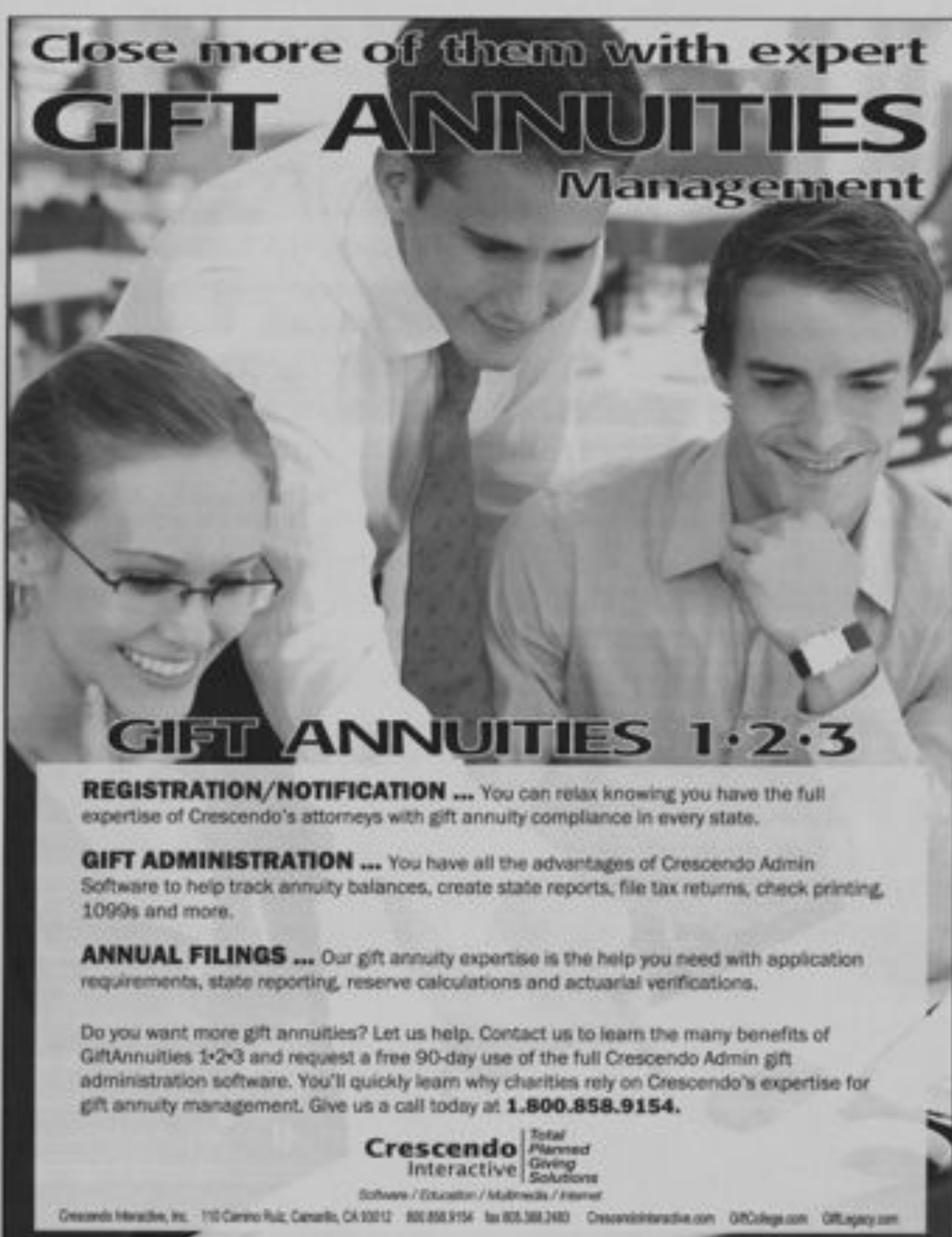
11. Systematically promote.

    Look for opportunities to present information about planned giving/gift annuities at every board meeting. In some cases, it may be a brief report on the status of the program by the planned giving committee chair. In other instances, you may want to have a planned giving donor speak briefly as to why they have arranged this type of gift. Board members should be reminded of the importance of participation by *all* board members. At least once a year, the planned giving director should be offered an opportunity make a presentation to the full board.

12. Going Public.

    Once you have commitments from most or all of your board members, it is time to recruit other "family" members. This might include volunteers, other committee members, individuals who have previously self-identified as planned giving donors and your top prospects. (This is part of the "founding members" campaign discussed earlier.) This strategy creates a sense of urgency and a desire to belong. It also helps focus the activities of the staff and volunteers. Just as with recruitment of the board, this step is accomplished through personal solicitation of each prospect. A follow-up strategy should also be utilized; good recordkeeping is critical to success. Board packet materials may be utilized during this step.

Once this face-to-face campaign has been completed and your best prospects have committed, you can continue your efforts with mass or gorilla marketing to ensure that the repeated message stays in front of potential donors.


Close more of them with expert
GIFT ANNUITIES
Management
GIFT ANNUITIES 1·2·3
REGISTRATION/NOTIFICATION ... You can relax knowing you have the full expertise of Crescendo's attorneys with gift annuity compliance in every state.
GIFT ADMINISTRATION ... You have all the advantages of Crescendo Admin Software to help track annuity balances, create state reports, file tax returns, check printing, 1099s and more.
ANNUAL FILINGS ... Our gift annuity expertise is the help you need with application requirements, state reporting, reserve calculations and actuarial verifications.
Do you want more gift annuities? Let us help. Contact us to learn the many benefits of GiftAnnuities 1·2·3 and request a free 90-day use of the full Crescendo Admin gift administration software. You'll quickly learn why charities rely on Crescendo's expertise for gift annuity management. Give us a call today at 1.800.858.9154.
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Using Straw to Make Bricks Rather Than Break the Camel's Back

Presented by:

Ellen G. Estes LLB
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Frank Estes
Planned Giving Consultant
Estes Associates
Woodbridge, CT

28th Conference on Gift Annuities
Thursday, April 3, 2008

What are we going to cover?

- What is Planned Giving and how does it relate to your development program.
- What are some of the common gift vehicles that are available.
- Who are your best planned giving prospects.
- What can any organization do to get started in planned giving.

Planned Giving

What is it?

Basically, "planned giving" provides a way to help a donor – **who wants to make a gift** – do so - most effectively. The planned giving process strives to achieve:

•Lowest net cost of the gift, thereby allowing …

•The maximum size of gift that is consistent with the donor's circumstances and desires.

Is Planned Giving "right " for your Organization?

Yes – if you have at least 3 of the following –

- Clearly articulated, compelling Case
- A core of loyal, long-term donors (5+ years)
- Good direct mail program
- Good donor records
- Aging donor base
- Your organization is 20+ years old

Why Start a Planned Giving Program?

- Help donors make gifts that can *provide for their own security* and allow them to *make a difference* at the same time

- Ultimately, raise more gifts for your organization

What's Out There?

- Gifts of Appreciated Securities
  - Better than cash (sort of):
    - You get full value of the security
    - Donor gets income tax charitable deduction for the full market value
    - Nobody has to pay the capital gains tax on the appreciation

What's Out There?

- Bequests
  - Most important single form of planned gift - 2/3 of all planned gifts (# & $)
  - Inevitable for everyone
  - If you involve them, they will come
  - Surprises are nice, but knowledge is better -
    - Assures the correct language
    - Assures an appropriate purpose
    - Permits you to honor them while they are still living

Every charity can and should have a strong Bequest Program

- Requires a minimal amount of staff time and money – a very cost-effective way of raising funds for your organization
- Does not require a lot of technical expertise
- Can provide significant financial rewards for your organization
- Can enhance your organization's relationships with your existing donors
- Can assure the future viability and stability of your programs
- Can be successfully promoted by ANY charity

What's Out There?

- Beneficiary Designations – at death:
  - IRAs and Retirement Plans
    - Uncle Sam loves you to have them - hates you to leave them to heirs
    - Estate tax of up to 45%
    - Income tax of up to 35%
    - Great asset for charitable giving at death
    - Done by contract not through will

What's Out There?

- Beneficiary Designations
  - Insurance Policies
    - Receipt of proceeds as beneficiary
    - Gift of policy with cash surrender value
    - Excellent source of gifts, but avoid convoluted arrangements

Keep in mind -

Studies have shown that the 2 most important concerns for older individuals are –

- Maintaining control (over health, assets, life)
- Leaving a Legacy – desire to make a lasting difference

Bequests and Beneficiary Designations allow donors to do both

What's Out There?

- Charitable Gift Annuities
  - Contract (not a trust) between Donor & Charity
  - Donor irrevocably transfers assets to Charity
  - Payment by Charity of fixed dollar amount yearly for life
  - Rate based on age of recipient
  - Backed by general assets of Charity
  - Usually has minimum size (5K) and age (55)

Charitable Gift Annuities

Some Benefits:

- Fixed income at attractive rate
- Possibly increase income
- Income tax charitable deduction
- Portion of payments are tax-free
- Avoid and defer capital gains
- Retirement planning with Deferred CGA
- Simple to do – Donors love them!

Charitable Remainder Trust

- Most flexible life income arrangement
- Donor irrevocably transfers assets to trustee
- An "income" is paid to people named by donor for life or for a term of years
- Trust then terminates and pays to charity
- Rate of income payout is set by donor, but must be at least 5%

Charitable Remainder Trust

- Two major types:
  - Charitable Remainder Annuity Trust
    - Income is a fixed dollar amount for the life of trust
    - Think fixed income
  - Charitable Remainder Unitrust
    - Income is a fixed percentage of the value of the trust, revalued on an annual basis
    - Think variable income
- Size of trusts is usually large ($100K+)
- Trust can benefit more than one charity

Charitable Remainder Trust

- Benefits
  - Income tax deduction for present value of remainder interest
  - Avoidance of capital gains taxes
  - Flexibility as to income recipients
  - Flexibility as to level and type of income
  - Can *increase* beneficiary's income
  - Helpful in retirement planning
  - A way to make a really big difference to one or more Charities

What's Out There? – Recap -

- Gifts of Appreciated Securities
- Bequests
- Beneficiary Designations
  - IRAs and Retirement Plans
  - Insurance Policies
- Charitable Gift Annuities
- Charitable Remainder Trusts

Who Are Good PG Prospects?

- Long term consistent donors (even of small amounts)
- Donors age 55 and older
- Unmarried, or married without children
- Long-term relationship with your Charity
- Board and former board members
- Received services from your Charity
- Volunteers
- **WOMEN** in all of the foregoing categories

Who Are Good PG Prospects?

"I love your Charity, and I wish that I could do more to support it, but .....

- I'm worried about retirement.
- I have children (parents) to support.
- My income now is barely enough.
- I have a lot of other charitable interests.
- My assets are all tied up in ....
- It's mine, and I am going to enjoy it 'till I die!

Getting Started

Get Your House in Order

Is your Board on board?

- Does it accept the value of a future payoff?
- Is there a Champion?

Are human and $ resources allocated?

- Maybe not a lot, but firmly committed

Is the program's priority established?

- Able to withstand other pressures

Getting Started

Get Your House in Order

Policies and Procedures

- Gift Acceptance Policy
  - What kind of assets
  - What kind of gifts
  - Where does it go - endowment, designated funds, operations
- Requirements for named funds
- Securities acceptance procedure
  - Prepare a one page instruction sheet for staff and donors
  - Give it to all paid and volunteer staff - particularly telephone answerers

Planned Giving Program Basics

"Never Sleep" Marketing

Letterhead & envelope tag lines

Direct Mail Check-off Boxes

- "I have included you in my will or estate plan"
- "I am interested in learning more about how to include you in my estate plans"
- "How can I make my gift using appreciated securities?"

When someone responds, follow up - letter, telephone, personal visit

Planned Giving Program Basics

- Put a simple planned giving message in ALL of your outreach materials and on your web site -
  - "Remember us in your will and estate plans"
  - Testimonial or profile of a planned giving donor (use personal stories and lots of pictures)
  - "Make your gift using appreciated securities"
  - Planned Giving Tip of the Month
  - Provide correct language for including Charity in will
  - Tell people about your Legacy Society

Planned Giving Program Basics

- Start a Legacy Society
  - Anyone who makes a planned gift or tells you they have
  - Ask each Board Member to join
  - List names in your Annual Report
  - Put profiles in your newsletter
  - Give them a pin and a certificate
  - Include in stewardship functions

Getting More Focused

Create some stand-alone PG messages
- Information about one topic – for example, bequests – discussing the benefits in simple language.
- Include in both general and targeted mailings

Present some seminars – works best if mission related, with a PG "commercial".

Recruit some expertise to help you answer technical questions.

Planned Giving Program Basics

Get Personal!
- Development work is all about **building relationships**.
- The strongest relationships tend to be created through inter-personal contact – not by mail.
- Planned giving is a face to face, individual contact business.
- Success lies in visiting your prospects and continuing to visit your donors.
- Be aware of PG opportunities in each of your visits.

Next Steps - Train Yourself

- Attend a basic Planned Giving course that focuses more on identification and cultivation & less on technical aspects
- Join your local Planned Giving Council
- Join Leave A Legacy - which says:
  - Everybody Ought to Have a Will & Estate Plan
  - Charitable Interests Should Be Included

Recapitulation - Activities

Get organized
- Determine realistic scope of program
- Get Board and Administration buy-in
- Find a Planned Giving Champion

Include planned giving information in all outreach material and on your web site.

Develop a list of planned giving prospects from your donor and volunteer database.

Create planned giving information material for identified prospects.

Visit your prospects!

Whatever You Do..

Keep doing it - consistency is the key

Evaluate the program on a non-cash basis

- Monitor the activities
- Purpose is to assure the future

Remember:

Patience is still a virtue

The best childhood training for PG Officers ...

"My parents are trying to wean me off instant gratification."

Whatever You Do..

Don't do

NOTHING

A bequest is a gift that keeps on giving.
Contact your chapter today!

American Red Cross
Mid-Fairfield County Chapter
36 Church Lane
Westport, CT 06880

STAMFORD CT 069
PM

Frank Estes
41 Spoke Drive
Woodbridge Ct 06525

06525+1140

United Way

Connecticut Food Bank
P.O. Box 8686
New Haven, CT 06531-0686

CFB welcomes questions, comments and ideas. All correspondence should be addressed to the development department.

If your name is incorrect or you are receiving duplicate mailings, please call (203) 469-5000.

Correction – We incorrectly identified the site featured in last year's Holiday of Hope cover story photo. The holiday distribution took place at St. Matthew's UFW Church in New Haven.

Taste of the Nation
x 2

doubles the pleasure for area residents and doubles the benefits for Connecticut Food Bank. CFB is the fortunate beneficiary of a Taste of the Nation event in New Haven, which benefits the main warehouse and a Stamford event, benefiting our Fairfield branch. Organized nationally by Share Our Strength and locally by dedicated volunteer committees, Taste of the Nation raises money and awareness for anti-hunger efforts. The popular, gourmet food-tasting events take place in cities across the United States. National sponsors include Williams-Sonoma and American Express. CFB uses the funds to support our programs of transporting, warehousing and distributing donated food.

Top right: *The Stamford Taste of the Nation offered attendees a sampling of Fairfield County's finest foods and beverages in an elegant setting at the Westin Hotel.*
Bottom right: *New Haven's Taste of the Nation event, held at the Omni Hotel, featured more than 50 area restaurants and specialty food and beverage vendors. Highlights included a lively chef auction and a spirited swing dance demonstration.*

LEAVE A LEGACY™ CONNECTICUT

is a statewide program to encourage people to make gifts from their estates to support causes they care about. The campaign has a simple message: "Leave something in your will for a cause that is important to you." Part of the Connecticut Council for Philanthropy's broader initiative to stimulate and diversify philanthropy in Connecticut, the goal of Leave a Legacy is to increase statewide philanthropic capital to support programs that benefit state residents.

CFB is supporting the Leave A Legacy campaign by spreading the word to our supporters. We want you to know how important your bequest or other planned gift is to us. If you have any questions or would just like to begin talking to us about how a planned gift could be made to CFB and how it would continue to benefit poor and hungry people in the state for years to come, please call the development director, Mary Johnson, at 203 469-5000.

When you include charities in your estate planning, you can make a difference in the lives that follow.

Tell you what you Did Not what you Have

In 1998, Connecticut Food Bank distributed 6.5 million pounds of food to more than 500 feeding programs in Fairfield, Litchfield, Middlesex, New Haven, New London and Windham counties.

THIRTEEN Reasons To Have A Will

1. Disperse your assets to whom you choose
2. Name a personal representative for handling your estate
3. Name a guardian for your minor children (and special-needs adults)
4. Make use of tax-saving techniques
5. Detail how your assets should pass to heirs
6. Provide funeral instructions
7. Protect heirs from outside influences
8. Avoid unnecessary legal proceedings and financial costs
9. Prevent excessive family tensions
10. Provide for special needs of your dependents
11. Provide for common disasters/presumption of death clauses
12. Give yourself peace of mind
13. Make provisions for your favorite charities

Though it never seems like the right time to be thinking about your will, the truth is that the best time is right now! Life is too unpredictable to leave your affairs to chance. You should exercise as much control over your estate as you can. The best way to start is with a carefully planned will.

The Office of Planned Giving is available to assist you with the plans to best integrate your charitable intentions with your overall financial objectives. Please do not hesitate to call for a confidential conversation (212) 560-4989, or write to Davida Isaacson at Thirteen/WNET, 450 West 33rd Street, New York, New York 10001.

A Proud Tradition of Service

For more than 100 years, the American Red Cross has been giving people who can help others a means to reach those in need — relieving human suffering and saving lives. Founded in 1881 by Clara Barton, the Red Cross is a humanitarian organization led by volunteers and guided by its Congressional Charter and the Fundamental Principles of the International Red Cross Movement. We provide relief to disaster victims and help people prevent, prepare for and respond to emergencies. The American Red Cross is supported by the generous contributions of the American public, and not by the federal government.

Our national network of more than 1,000 chapters, 36 Blood Services regions and 109 military installations stands ready to provide hope and help through the following five lines of service:

Disaster Services responds to more than 67,000 disasters a year whether an entire region is devastated by a hurricane or flood or one family is displaced by fire. We meet victims' immediate needs by providing food, clothing, shelter and emotional support. All Red Cross disaster assistance is free.

Biomedical Services is the steward of approximately half the nation's blood supply, collects more than six million blood units yearly from volunteer donors and serves 3,000 hospitals nationwide. The Red Cross national research program also makes significant contributions to biomedical science, blood safety, plasma-derived therapeutics and transfusion medicine.

Health, Safety and Community Services provides the lifesaving skills and information Americans need to be safe at home, in school and in the workplace. Last year, 12 million people enrolled in courses ranging from first aid and cardiopulmonary resuscitation (CPR) to Automated External Defibrillator (AED) training and HIV/AIDS prevention education. Red Cross chapters also offer specialized services based on local community needs.

"June 1944. England. Among the first women setting out for the beachhead, American Red Cross hospital workers, [illegible] of [illegible], Miss. and [illegible] of [illegible], Ohio, make the last stop on the [illegible] route to the embarkation point, bringing up the rear of a field unit of the Army Hospital to which they are assigned."

"June 11-15, 2001. Houston, TX. Tropical Storm Allison. Children playing in a shelter."

For more information on the benefits of charitable giving, please call your local Red Cross chapter. Or contact:

American Red Cross Planned Giving Office
430 17th Street, NW
Washington, DC 20006
Tel: (202) 434-4059

International Services works around the world to provide food, water and health services to reduce the suffering during war and disasters. In more than 40 countries, Red Cross workers are helping prevent deaths from measles, diarrhea and malnutrition.

Armed Forces Emergency Services (AFES) assists hundreds of U.S. service men and women every day with emergency communication between families, confidential counseling and other social services. Each year, the Red Cross transmits up to 4,000 emergency messages, helping military families connect with each other.

Your gifts provide meaningful support to the Red Cross' vital work, and may also assist you in meeting your personal financial goals. The following are a few of the many gift opportunities available to you:

- Cash, securities, real estate
- Planned gifts (bequests, memorial gifts)
- Charitable remainder trusts
- Charitable gift annuities
- Pooled income fund
- Charitable lead trust

The Red Cross depends on generous, compassionate individuals like you to support our lifesaving work at home and around the world every day.

American Red Cross

Together, we can save a life

HOW TO GIVE SECURITIES TO THE CHARTER OAK CHAPTER OF THE AMERICAN RED CROSS

1. SECURITIES HELD BY YOU:

Please send or deliver unendorsed certificates by regular First Class Mail along with a letter of transmittal giving your name, address, and purpose of the gift to:

American Red Cross
Greater Hartford Chapter
209 Farmington Avenue
Farmington, CT 06032

Attention: Development Office

Under separate cover please mail to the same address a stock power executed in blank for each security along with a copy of your letter of transmittal. Please DO NOT send signed stock certificates and stock powers together in the same envelope.

CAUTION: For most expedient handling, do not fill in any name as transferee on either the stock certificate or the stock power, and please do not send stock certificates to a transfer agent for transfer into the Red Cross's name.

2. SECURITIES HELD BY YOUR BANK OR BROKER:

Tell your bank or broker the number of shares of each security you wish to give and give him or her the following information needed to transfer the shares to the Greater Hartford Chapter:

Agent: David Ellovich
Solomon Smith Barney
185 Asylum Street
21st Floor
Hartford, CT 06103
Telephone: (860) 275-0700

Account Name: Greater Hartford Chapter American Red Cross
Account Number: 619-06880
DTC Number: 418
Tax ID Number: 06-0646527

Please DO NOT tell your bank or broker to sell for the Red Cross's account.

VALUATION: Your gift is considered made on the date the securities pass unconditionally from your control. In the case of securities mailed by you, this date is the date of mailing of the securities and the stock power(s). In the case of securities transferred by your broker, this will be the date the stock is transferred on the books of the corporation or the date your broker acts to transfer the stock to the Red Cross. For listed securities, the value of the gift is the mean between the high and low quotations on the date the gift is made.

Your bank or broker can supply you with blank stock powers, or the Development Office will be happy to send them to you.

Donors should consult their own attorneys for tax advice about specific gifts

The Best of Times, the Worst of Times: Recent Changes in the Legal and Legislative Landscape

Presented by:

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Principal
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28th Conference on Gift Annuities
Thursday, April 3, 2008

THE BEST OF TIMES, THE WORST OF TIMES:

Recent Changes in the Legal and Legislative Landscape[1]

I. Pension Protection Act of 2006 – Greatest Hits

In the world of charitable giving the PPA is most famous for its IRA Rollover section, which afforded lifetime charitable gifts of IRA assets more favorable tax treatment than they had received under prior law. By its terms the IRA Rollover expired at the end of 2007. Congress has not seen fit to extend it, expand it or enact a substitute. As of this writing, however, several bills have been introduced in Congress that would extend the IRA Rollover for one or two years or make it permanent. We can always hope for good news by April.

The PPA divides its other philanthropy-related provisions, all of which remain in force,[2] into "incentives" and "reforms." These are Congressional code words, so it is probably more helpful to break the charitable giving component of the PPA into four topics: specific types of gifts, donor advised funds, supporting organizations, and penalties/compliance.

A. Related Use Tangible Personal Property

Under prior law, if a donor gave appreciated tangible personal property to a charity, the amount of the donor's deductible charitable gift depended on the donee's use of the gift property. If that use was related to the basis for the donee's exemption under Section 501(c)(3), the deductible gift equaled the fair market value of the donated property.[3] If, on the other hand, the donee's use of the property was unrelated to the donee's exempt purposes, the deductible gift was limited to the donor's basis in the property. Under the PPA a deduction in excess of the donor's basis will generally be disallowed or recaptured if the donee disposes of the property within three years of the gift. There are exceptions where the charity certifies that it has put the gift to a related use in the interim or that the intended related use became impossible or unfeasible.

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[1] I would like to thank my colleagues Sarah Duniway and Sheryl Morrison, both of whom made essential contributions to these materials.

[2] The Technical Corrections Act of 2007 made several changes to the charitable sections of the PPA. This outline identifies those changes as they relate to the topics covered here.

[3] This discussion assumes that all of the gain on a sale of the gift property by the donor would have been long-term capital gain.

1. Scope

The new recapture rule applies to charitable gifts of appreciated tangible personal property in the following circumstances:

a. The donor claims a deduction in excess of $5,000 for the gift; **and**

b. The donee institution identifies its use of the gift property as related to its exempt purpose.

2. Disallowance

If the donee institution disposes of the gift during the taxable year in which it is made, a deduction in excess of the donor's basis will be disallowed unless the donee makes a related-use certification.

3. Recapture

If the donee disposes of the gift property after the taxable year of the gift but within three years after the gift was made, the donor will take into income ("recapture") an amount equal to the excess of the claimed deduction over the donor's basis in the property. Here again, the rule applies in the absence of a certification.

4. Certification

For the donor to avoid disallowance or recapture, the donee organization must make a certification, signed by one of its officers under penalty of perjury, which takes one of two forms:

a. Version 1 – the certification:

i. States that the donee used the property for a related purpose;

ii. Describes how the property was used and how that use furthered the donee's exempt purposes; **and**

iii. Certifies that the donee's use of the donated property was "substantial."[4]

b. Version 2 – the certification

i. States the intended use of the property by the donee; **and**

[4] This requirement was added by the Technical Corrections Act of 2007.

ii. Certifies that the intended use has become "impossible or infeasible to implement."

5. Reporting

The period during which the donee must file IRS Form 8282 to report a disposition of the gift property has been extended from two years after the gift to three. This change affects all gifts with respect to which the donor must obtain a "qualified appraisal," not just contributions of related use tangible personal property. The Form 8282 must now include a description of the donee's use of the property and state whether that use was related or unrelated. If the donee made the certification described above in connection with the disposition of the gift property, the donee must include a copy with the Form 8282.

6. Fraudulent Identification of Related Use Property

Any person who identifies donated tangible personal property as related use property, knowing that the property is not intended for such a use, is subject to a penalty of $10,000.

B. Fractional Interests in Tangible Personal Property

The PPA tightened the rules on charitable deductions for gifts of fractional interests in tangible personal property. The new law has three components: situations in which a deduction will be disallowed, rules for valuing such gifts when they are deductible, and conditions under which the deduction will be recaptured.

1. Disallowance

a. In general, no income tax deduction will be allowed unless all interests in the property are held, immediately before the charitable gift, by the donor or by the donor and the donee.

b. The PPA authorizes the IRS to promulgate regulatory exceptions to this general disallowance rule where all persons who hold interests immediately before the charitable gift make proportional charitable contributions of undivided interests in the interests they hold.

c. The same disallowance rule and authorization for regulatory exceptions apply with respect to a gift tax charitable deduction.

2. Valuation

Assume that a donor makes more than one charitable gift of an undivided fractional interest in the same tangible personal property.

a. For income tax charitable deduction purposes, the value of each additional contribution made after the initial one[5] will be determined by reference to the lesser of the fair market value of the property at the time of the initial contribution and its value at the time of the later contribution in question.

b. The PPA established the same rule with respect to gift and estate tax charitable contribution deductions. The Technical Corrections Act of 2007 retroactively repealed those gift and estate tax rules, however. The correction eliminated an unintended "valuation whipsaw" which would result if the property appreciated in value between the initial gift and the later one. In such a case, the gift would be included in full for gift or estate tax purposes but would not be fully offset by a gift or estate tax charitable deduction.

3. Recapture

a. **Any one** of the following circumstances will trigger recapture of income and gift tax deductions:

i. The donor does not contribute all remaining interests in the property to the **same** donee before the earlier of ten years from the date of the initial contribution and the death of the donor (hereinafter "the drop-dead date").

ii. The donee has not, between the time of the initial contribution and the drop-dead date, had "substantial physical possession" of the property.

iii. During the pre-drop-dead period, the donee has not used the property for a related use.

b. If the deductions are recaptured, additional income and gift taxes of 10 percent of the recaptured amount are also imposed.

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[5] A fractional interest gift made before August 17, 2006 does not constitute an "initial contribution."

C. Donor Advised Funds

A donor establishes a donor advised fund by making a gift to a public charity with the understanding that the donor and other designated individuals can give the donee institution non-binding advice about how to invest and use the fund. Typically, the donee makes grants from the fund to other charities. Community foundations have accepted and administered donor advised funds for decades. Because of the popularity of this concept, other charitable organizations (*e.g.*, colleges, healthcare organizations, and churches) have begun offering donor advised funds to prospective donors.[6] In addition, financial services companies have established separate charitable organizations whose sole activity is to solicit gifts to and maintain donor advised funds established by the company's customers.

Oddly enough, there was no legal definition or formal regulation of donor advised funds until the enactment of the PPA. It gives a precise legal definition and imposes three categories of detailed operating rules: prohibitions against and taxes on certain transactions with donors and other disqualified persons, a prohibition against "excess business holdings" modeled on the one for private foundations, and a change to the substantiation requirements for contributions to donor advised funds.

1. Definitions

    a. Donor advised fund – the PPA's definition

        i. A donor advised fund is a fund or account:

            - Separately identified by reference to contributions of one or more donors,

            - Owned and controlled by a "sponsoring organization," **and**

            - With respect to which a donor or someone appointed by the donor has or reasonably expects to have advisory privileges with respect

[6] Can an organization whose purposes do not include making grants to unrelated charities make grants from a donor advised fund to public charities whose activities and purposes do not further its own? This writer is not aware that the IRS has ever addressed that question. Argument in favor: the IRS and Congress should not care because all grants will go to Section 501(c)(3) public charities so all assets contributed to, held in and distributed from the donor advised fund are used for deductible, tax-exempt purposes throughout the process. Argument against: if the sponsoring organization's purposes do not include those of the grantee organization and the sponsoring organization's Section 501(c)(3) exemption was not based in part on grantmaking as an activity, it is arguable that the sponsoring organization holds the assets not as a genuine sponsoring organization of a donor advised fund but as trustee of a freestanding charitable trust. In that case, a variety of unpleasant reporting requirements and/or penalties may apply.

to distributions from or investment of fund assets *by reason of the donor's status as a donor*.

ii. Exceptions

Donor advised funds do not include funds:

- Which make distributions only to a single identified organization or government entity.
- With respect to which donors or their designees advise as to which individuals receive grants for travel, study or other similar purposes, but only if the following three conditions are satisfied:
  - These persons act as members of a committee appointed by the sponsoring organization.
  - Donors and their designees do not control the committee.
  - All grants are awarded on an objective and nondiscriminatory basis according to a procedure approved by the governing board of the sponsoring organization, and the procedure meets the requirements for similar grant programs administered by private foundations.

b. Sponsoring organization

A sponsoring organization is any organization which meets the following criteria:

i. It is an organization (other than a government unit) described in Code Section 170(c).

ii. It is not a private foundation.

iii. It maintains one or more donor advised funds.

c. Fund manager

Fund managers are:

i. officers, directors and trustees of the sponsoring organization, and

ii. other employees of the organization who have relevant responsibilities with respect to donor advised funds.

d. Disqualified supporting organizations

The definition is complicated, but in essence it includes Type III supporting organizations other than "functionally integrated" Type IIIs and Type I and Type II supporting organizations controlled by donors and their designated advisors.[7] For fun, try to explain to a friend what a "functionally integrated Type III supporting organization" is.

2. Taxable Distributions

a. The PPA imposes penalty taxes on the sponsoring organization and fund managers with respect to "taxable distributions" from a donor advised fund. The tax on the sponsoring organization is 20 percent of the taxable distribution, and the tax on each involved fund manager is 5 percent, with an aggregate limit on the fund manager tax of $10,000 with respect to any one taxable distribution.

b. Taxable distributions from a donor advised fund include the following:

i. A distribution to a natural person.

ii. A distribution for a purpose other than one of the standard charitable ones, unless the sponsoring organization exercises "expenditure responsibility."

c. Exceptions from the definition of a taxable distribution are distributions:

i. To a public charity other than a disqualified supporting organization.

[7] For more on the mysteries of supporting organizations, refer to I.D below.

ii. To the sponsoring organization itself.

iii. To another donor advised fund.

3. Tax on prohibited benefits.

a. This tax applies to any distribution from a donor advised fund which provides a "more than incidental benefit" to the donor or certain related persons. The tax on the recipient of the benefit or the person who advises as to the distribution is 125 percent of the amount of the benefit, and the tax on relevant fund managers is 10 percent of the benefit, with an aggregate limit per distribution of $10,000.

b. The persons who may not receive these more than incidental benefits are:

i. Donors and advisors they designate.

ii. Members of the families of such individuals.

iii. Thirty-five percent controlled entities.

4. Tax on Excess Benefit Transactions

Prior law already imposed taxes on excess benefit transactions between certain disqualified persons and Section 501(c)(3) organizations. The PPA expands that tax to apply to sponsoring organizations with respect to certain activities of donor advised funds.

a. Excess benefit transactions now include **any** grant, loan compensation or other "similar payment" from a donor advised fund to a donor or donor-advisor. In such cases the "excess benefit" to which the tax applies is the **full amount** of that grant, loan, etc. In other words, grants, loans, compensation and other "similar payments" from a donor advised fund to a donor or donor-advisor are effectively prohibited.

Note that this rule is in some ways more restrictive than the self-dealing prohibition applicable to private foundations. For example, a private foundation may pay reasonable compensation to a disqualified person for personal services necessary in accomplishing the foundation's charitable purposes.

b. The PPA also expanded to investment advisors of donor advised funds the prior law that prohibited all Section 501(c)(3) organizations from paying more than reasonable compensation to disqualified persons. The term "investment advisor" refers to compensated outside investment managers retained by the sponsoring organization, members of their families and 35 percent controlled entities. As a result, sponsoring organizations must now ensure that they pay no more than reasonable compensation to their investment advisors. They may, however, follow the rebuttable presumption process in the existing excess benefit transaction rules, which permits them to create a presumption that such compensation is reasonable by following certain procedures.

5. Excess Business Holdings

The PPA extends to donor advised funds the prohibition against excess business holdings that has applied to private foundations for almost four decades. The definition of "disqualified person," however, is the one used in the prohibitions against excess benefit transactions. In essence, the excess business holdings prohibition prevents a private foundation (and now a donor advised fund) and its disqualified persons from holding, in the aggregate, more than a fairly limited percentage of the interests in a business entity. A private foundation or donor advised fund which has excess business holdings must normally divest itself of them within five years after their acquisition.

6. Charitable Contribution Deduction

The PPA disallows income, gift and estate tax charitable deductions for contributions to create donor advised funds unless the organization is of a permitted type and provides appropriate substantiation.

a. Charitable organizations are permissible sponsoring organizations unless they are veterans' organizations, fraternal societies, cemetery companies or Type III supporting organizations which are not "functionally integrated."

b. The taxpayer (or presumably the personal representative in the case of an estate tax deduction) must obtain a "contemporaneous written acknowledgement" from the sponsoring organization which states that it has "exclusive legal control over the assets contributed."

D. Supporting Organizations

Supporting organizations ("SOs"), which have been described in the Code since 1969, are public charities that provide support to or carry out functions of the two other types of public charities: institutions that qualify as public charities because of what they do (e.g., churches, schools and hospitals) and those which qualify because they receive broad support from the general public in the form of contributions and/or fees for services. (The PPA now refers to these beneficiary organizations as "supported organizations.") To qualify as an SO under prior law, an institution had to: (i) be organized and operated exclusively for the benefit of one or more supported organizations, (ii) have a sufficiently close relationship with one or more of those supported organizations,[8] and (iii) not be controlled by disqualified persons (as defined in the private foundation provisions of the Code).

Because prior law allowed some flexibility with respect to identity of and distributions to supported organizations, SOs have become attractive alternatives to private foundations. They afforded more favorable rules regarding deductibility of contributions and less strict operating regulations. The problem was that the donor could not control an SO. For roughly a dozen years before the enactment of the PPA, the name of the game was to structure a Section 501(c)(3) organization to come as close as possible to giving the donor control, yet still qualify as an SO. In addition, SOs sometimes became holding tanks for investments without providing substantial benefits to their supported organizations. Finally, some SOs were misused to provide private benefit to donors and related parties.

To correct these abuses, the PPA enacted four changes: new requirements for qualification as an SO, taxes on excess benefit transactions with disqualified persons, prohibition against excess business holdings, and new annual payout requirements for Type III SOs. These rules are labyrinthine, mind-numbing and of limited interest to other types of public charities and their development efforts. It is true, however, that a public charity may be approached by a major donor with a proposal that the charity will become a supported organization of an SO created by the donor. The discussion which follows is limited to those parts of the PPA's SO provisions which may be of interest to developmental officers who encounter such donors.

The SO section of the PPA has four components: stricter rules for qualification as an SO, imposition of penalty taxes on excess benefit transactions between an SO and its disqualified persons, extension of the private foundation excess business holdings prohibition to SOs, and annual payout requirements for Type III SOs. If a donor wishes to create

[8] The type of qualified relationship determines whether the SO is a Type I, a Type II or a Type III.

an SO, the donor's tax and legal advisors will be primarily responsible for navigating the intricacies of the SO rules in general and the new rules established by the PPA. Even so, development officers and others involved in the administration of gifts to public charities should be conversant with the basics of the PPA in order to discuss the basics of SOs knowledgably with prospective donors.

1. Qualification as an SO

   a. An organization which would otherwise qualify as a Type I or Type III SO will fail to qualify if that organization receives gifts from certain persons who control the organization's supported organizations. In effect, this rule prevents a donor from laundering contributions to an organization he or she controls in an effort to prevent the entity from being categorized as a private foundation.

   b. In a change from prior law, charitable trusts that have certain characteristics under state law will not automatically meet the "relationship test" for a Type III supporting organization. The rule under prior law was a favorite aid in walking the razor's edge between a donor-controlled private foundation and a Type III SO.

   c. The PPA authorizes the IRS to promulgate regulations which require Type III SOs, other than functionally integrated Type IIIs, to make distributions of a specified percentage of their income or assets to their supported organizations each year. This requirement is modeled on the rule that private foundations must distribute roughly five percent of their assets to other Section 501(c)(3)s (typically, public charities) each year.

2. Excess Benefit Transactions

   a. Prior law imposed a penalty tax on a transaction between a Section 501(a) public charity and a disqualified person if the transaction conferred an "excess benefit" on the disqualified person. Disqualified persons were individuals in a position to exercise substantial authority over the organization's affairs. The PPA expands the definition of "disqualified person" so that it includes not only individuals with substantial influence over the organization itself, but also individuals with substantial influence over an SO with respect to which the organization in question is a supported organization. For this purpose, disqualified persons also include certain family members and 35 percent controlled entities. This rule means that an excess benefit transaction can occur even if the person receiving the benefit has no control over the organization providing the benefit, provided that the individual has substantial influence over an SO which supports the entity.

b. The PPA also expands the definition of "excess benefit transaction." Under prior law, an excess benefit transaction was just that: it conferred a benefit on an individual which was excessive in relation to the benefit's fair market value and the consideration the individual provided to the organization in return. The term "excess benefit transaction," as the PPA applies it to SOs, is arguably a misnomer. It includes **any** grant, loan, compensation or other similar payment provided to roughly the same group of individuals and entities who are disqualified persons for purposes of the donor advised fund excess benefit rules. In addition, **any** loan from an SO to a disqualified person as defined in the excess benefit provisions themselves is an excess benefit transaction. Thus, these rules are more like the absolute prohibitions of the private foundation self-dealing rules because they do not make reference to the fair market value of the benefit or the adequacy of the consideration.

3. Excess Business Holdings

With several modifications, the PPA extends to SOs the excess business holding prohibitions which apply to private foundations. Not all SOs are affected, and as you might expect, the definition of "disqualified person" for determining whether the SO has excess business holdings are baroque.

a. The excess business holdings rules apply to two types of SOs:

i. Type III SOs which are not functionally integrated.

ii. Type II SOs which accept gifts from certain persons with a close relationship to any of their supported organizations. Unfortunately, the definition of this group overlaps only partly with the definition for purposes of qualification of an SO described at Section D.1 above.

4. Payout Requirement for Type III SOs

The PPA directs the IRS to promulgate regulations on payout requirements for Type III SOs. The regulations must require Type IIIs to make distributions of a percentage of their income or assets to their supported organizations "in order to insure that a significant amount is paid to such organizations." Functionally integrated Type IIIs are exempted.

E. Compliance and Penalties

1. Reporting with Respect to Acquisition of Interests in Insurance Contracts

One of the newer ways in which investors have tried to use charitable organizations for private gain involves insurance contracts in which both investors and a charity hold interests. The insured is typically a donor to the charity, so the charity has an insurable interest under state law. The investors provide the funds to purchase the contract. Congress has concluded that these schemes, at least in some forms, are abusive, and has attempted to regulate them by imposing reporting requirements on charities with respect to "reportable acquisitions" of "applicable insurance contracts."

a. In general, an applicable insurance contract is one in which both a charitable organization and a private entity hold interests. There are, of course, intricate exceptions.

b. The PPA also imposes substantial penalties on a charity which acquires an applicable contract but fails to file the required report with the IRS in a timely fashion.

2. Overvaluation Penalties and Qualified Appraisals

The PPA lowers the threshold for substantial and gross valuation misstatements that lead to an underpayment of income tax. It also imposes penalties on qualified appraisers on whose appraisals such understatements are based. Finally, it imposes stricter standards for determining who can serve as a "qualified appraiser."

a. Under prior law, a substantial valuation misstatement occurred (and was penalized) when the value of a charitable gift claimed for federal income tax deduction purposes was 200 percent or more of the amount determined to be the correct value. The PPA lowers that threshold to 150 percent. The threshold for a gross valuation misstatement and the higher penalty that goes with it has been lowered from 400 percent of the actual value to 200 percent.

b. The PPA imposes a penalty on an appraiser who prepares a qualified appraisal if:

   i. The appraiser knows or reasonably should have known that the appraisal would be used in connection with a federal income tax return or claim for refund, **and**

   ii. The claimed value based on the appraisal results in a substantial or gross valuation misstatement.

   iii. The penalty will not be imposed if the appraiser establishes to the IRS "that the value established in the appraisal was more likely than not the proper value."

c. The definition of a "qualified appraisal" has changed slightly. In addition to complying with existing requirements, the appraisal must now be conducted "in accordance with generally accepted appraisal standards" and any regulations promulgated by the IRS.

d. The standards for a qualified appraiser have been raised substantially:

   i. In general, a qualified appraiser is someone who:

      - Has received an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements established by the IRS;

      - Regularly performs appraisals for a fee; and

      - Meets any other requirements established by IRS regulations

   ii. Even if an individual meets the above requirements, he or she will not be a qualified appraiser with respect to any specific appraisal unless:

      - The appraiser demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

      - The individual has not been prohibited from practicing before the IRS during the three-year period that ends on the date of the appraisal.

II. The New UBTI Rule for CRTs

Before 2007, receipt of UBTI by a CRT could be a disaster. If the trust received **any** UBTI for a given year, it lost its tax exemption entirely for that year. Thus, if it had UBTI for the year in which it sold an appreciated asset with which the trust was funded, all of the gain on the sale was taxed at corporate rates (higher than capital gains rates for individuals). This is exactly the result that the use of the CRT was designed to avoid. Under a new rule hidden in the Tax Relief and Healthcare Act of 2006, a CRT that has UBTI retains its income tax exemption, but the UBTI is subject to a confiscatory 100 percent excise tax. I.R.C. § 664(c)(2)(A).

A. The Good News

Donors and charities need not worry that receipt of a small amount of UBTI will result in tax on the gain the trust realizes on a later sale of an appreciated asset with which the donor funded the trust. Of course, any such UBTI will be confiscated via the 100 percent excise tax and will therefore not pass through to the donor/income beneficiary in the case of a net income CRUT. Two common examples of income which used to cause this type of concern:

1. Income from some kind of services provided by the landlord of a rental building which may not fall within the UBTI rent exception, e.g., income from coin-operated laundry machines, game machines or similar income. In general, rents do not constitute UBTI, but there has been a lingering question as to whether some of these other types of income fall outside the rent exception.

2. Income from an entity such as a motel or hotel. Such income is not rent under the IRS definition and therefore constitutes UBTI. In the past, funding a flip CRUT with a motel was risky at best. Now it may be an attractive option if the CRUT can sell the motel expeditiously without running into prearranged sale problems.

B. The Bad News

A loan from the charity to the trust to allow it to make the annual payments could result in a disaster.

1. A loan to the trust can convert an appreciated funding asset into debt-financed property if the loan is related to the property and was reasonably foreseeable when the trust was funded. I.R.C. § 514(c)(1)(C). That would arguably be the case if the trust has to borrow to cover carrying costs associated with unproductive property. Depending on the circumstances when the trust later sells the property, a substantial portion of the gain on the sale can

constitute UBTI under the debt-financed income rules. I.R.C. § 514(a)(1). All such gain will disappear in the form of tax.

2. Fortunately, that may not be the outcome. There is an obscure rule designed to combat some variants of the "accelerated CRT" scam which arguably treats these loans as if they were sales. *See* Treas. Reg. § 1.643(a)-8. If that exception applies to this type of case, it may avoid UBTI. Unfortunately, that result is not certain. This regulation was designed to deal with another type of situation, and the IRS has not ruled that it would apply to this type of loan.

III. Early Termination of a CRUT

In the wake of the market crash between 9/11 and the start of the Iraq war, many donors became disillusioned with their CRUTs. Standard CRUTs in particular are vulnerable to a downturn in the market. The payment, completely dependent on the annual value of the trust corpus, decreases. In addition, the trust has trouble recovering even when the market later turns around because the trust must pay the full specified percentage even in down years. Donors began requesting, and the IRS began granting, private letter rulings that donors/income beneficiaries and charitable remainder beneficiaries could terminate a CRUT early. The income and remainder beneficiaries would divvy up the trust's assets according to the respective actuarial values of their interests.

A. Basic Early Termination

The somewhat surprising downside of the early termination for the donor/income beneficiary is the resulting taxable income.

1. In its PLRs, the IRS has consistently taken the position that the donor/income beneficiary is treated as selling his income interest to the remainder beneficiary. *E.g.*, Priv. Ltr. Rul. 89-48-023.

2. Under a special rule tucked away in Section 1001(e) of the Code, the donor has a zero basis in his income interest, so the entire amount he receives as a result of the early termination is gross income.

3. The only good news is that the gain is long-term capital gain, provided that the donor set up the trust more than 12 months before the termination occurs. Rev. Rul. 72-243, 1972-1 C.B. 233.

4. The basic early termination (and the exchange of the donor's CRUT interest for a CGA, discussed below) is permitted only if the donor has a normal life expectancy. If the donor had a terminal condition but computed the value of his CRUT interest based on normal life expectancy tables, he would receive far too much under either of these plans, thereby engaging in a prohibited act of self-

dealing. In its private letter rulings on early terminations, the IRS has consistently recited the fact that the donor and the donor's physician have made sworn statements that the donor has no condition which would result in his having a shorter than normal life expectancy. *E.g.*, Priv. Ltr. Rul. 2007-25-044. Donors should always provide such statements to the trustee before the early termination occurs.

B. Deferring the Gain on an Exchange of a CRUT Interest for a CGA

The IRS has ruled on a number of occasions that a donor can exchange his income interest in a CRUT for a CGA issued by the charitable remainder beneficiary. *E.g.*, Priv. Ltr. Rul. 2001-52-018. Although this transaction avoids only a small portion of the gain, it has the virtue of deferring the rest by spreading it over the donor's life expectancy.

1. The charity must write the CGA based on the value of the donor's income interest in the CRUT, not based on the value of the trust corpus as a whole.

2. The actuarial value of the CGA must be less than 90 percent of the value of the donor's income interest. I.R.C. § 514(c)(5)(A). As a result, the donor is making a deductible charitable gift of at least 10 percent of the value of his CRUT interest.

3. The donor is funding the CGA with an asset (his CRUT interest) in which he has a zero basis under Code Section 1001(e). As a result, he reports the bargain sale gain ratably over his life expectancy as a portion of each annual CGA payment. Treas. Reg. § 1.1011-2(b)(4)(ii).

C. New Development

If the trust is a NIMCRUT, the donor must compute the value of his CRUT interest using the lesser of the unitrust percentage stated in the trust agreement or the applicable federal interest rate for the month in which the termination occurs. Priv. Ltr. Rul. 2007-25-044. This rule can have a substantial negative effect on the value of the donor's income interest. The relative values of a CRUT's income and remainder interests, in contrast to those of a CRAT, are not particularly sensitive to changes in the AFR. But under this rule, the AFR will be used not only as the discount rate but as the deemed unitrust payout percentage if lower that the actual one. As anyone who has worked with charitable deductions for CRUTs well knows, a small change in the payout rate can make a substantial difference in the proportionate values of the income and remainder interests.

IV. Trustee's Duty to Diversify

A. Uniform Prudent Investor Act ("UPIA")

The Minnesota Prudent Investor Act ("MPIA"), Minn. Stat. Section 501B.151 is a version of the UPIA.[9] Minnesota adopted the MPIA effective as of January 1, 1997.

1. Default Rule

The Prudent Investor Rule of the MPIA is a default rule. In other words it "may be expanded, restricted, eliminated or otherwise altered by the provisions of a trust." Minn. Stat. Section 501B.151, subd. 1(b).

2. Trustee's Reliance on Trust Agreement

The MPIA provides that a trustee is not liable to a beneficiary "to the extent that the trustee acted in reasonable reliance on the provisions of the trust." *Id.*

3. Diversification Requirement

Subdivision 3 of the MPIA requires that the trustee diversify trust investments unless the trustee reasonably determines that because of special circumstances the trust's purposes are better served without diversifying.

4. Overriding the Diversification Requirement

Given that a trust agreement can override the diversification requirement of the MPIA, and given that a trustee can reasonably rely on the provisions of the trust, the question is what must be contained in an override provision for it to be effective.

[9] The UPIA is a "uniform law" drafted by the Commissioners on Uniform Laws. As such, it is not the law of any state, but is promulgated with the hope that all or most states will adopt it. This outline refers to the Minnesota version, with which this writer is familiar. There will be some variations from state to state in laws modeled on the UPIA.

A. Recent Case Law

1. The Lilly Annuity Trust Case – *Americans for the Arts, et al. v. Ruth Lilly Charitable Remainder Annuity Trusts*, 855 N.E.2d 592 (Ind. Ct. App. 2006).

   a. Facts

      i. In 2001, National City Bank ("NCB") the long-standing conservator of the estate of Ruth Lilly, petitioned the probate court for permission to draft a new estate plan for her. An Indiana statute permitted a conservator to do this. NCB sent notice of the petition to all interested parties, including the prospective remainder beneficiaries ("the RBs") of two charitable remainder annuity trusts ("CRATs") proposed by the plan.

      ii. The RBs, represented by sophisticated counsel, proposed changes to the plan and objected to some parts of it, but not to Paragraph 10(b) of each CRAT, which (A) gave the trustee power "to retain indefinitely any property received by the trustee" and (B) stated that "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk or lack of . . . diversification." The probate court approved the new estate plan late in 2001.

      iii. Early in 2002 NCB funded the CRATs with a total of roughly $286 million of Ely Lilly stock. With court approval NCB began diversifying the CRATs' assets. By late in 2002 all of the Lilly stock had been sold, and CRATs were fully diversified. Unfortunately, the Lilly stock had dropped significantly in value during the diversification process.

      iv. The RBs alleged that NCB had breached its fiduciary duty and had violated Indiana's version of the UPIA by failing to diversify more rapidly. They sought a surcharge of NCB for the alleged damages.

   b. Holdings

      i. The RBs had notice of Paragraph 10(b); they reviewed it extensively with advice of sophisticated legal counsel; yet they raised no objection when NCB proposed it and the probate court considered it. Therefore, they are not entitled to challenge it in hindsight. Although this looks like some sort of estoppel rationale, the court did not explain its legal basis.

ii. Paragraph 10(b) was effective to override the provision of the UPIA which normally requires a trustee to diversify trust investments:

- The UPIA allows a trust agreement to override the UPIA diversification requirement, and the UPIA authorizes a trustee to rely on such an override provision.

- *Restatement (Third) of Trusts* has a similar exception to its diversification requirement.

- There was no evidence of bad faith, and the stock of NCB was not involved.

- Paragraph 10(b) *explicitly* eliminated the duty to diversify.

iii. The exculpatory clause was valid and effective.

c. Comment

i. The Lilly court's statement that Paragraph 10(b) trumped the UPIA diversification requirement: holding or dicta?

ii. Even if this was a holding, would other states' courts follow it?

2. *Fifth Third Bank and Reagan v. First Star Bank, N.A.*, No. C-050518, 2006 Ohio App. Lexis 4456 (Ohio Ct. App. Sept. 1, 2006).

a. Facts

i. Reagan, a descendant of a founder of Proctor & Gamble, funded a charitable remainder unitrust ("CRUT") with $2 million of P&G stock. U.S. Bank was the trustee.

ii. The CRUT agreement authorized the trustee "to retain, without liability for loss or depreciation resulting from such retention, original property, real or personal, received from Grantor . . . although it may represent a disproportionate part of the trust."

iii. U.S. Bank began a systematic process of diversification, selling off shares of P&G monthly. At the end of the trust's first year it had lost one-half of its value.

iv. Reagan fired U.S. Bank, hired Fifth Third Bank and the two of them sued U.S. Bank for its failure to diversify rapidly enough.

b. Holding

The retention clause in the CRUT agreement did **not** exculpate U.S. Bank from liability for the loss in value of the trust assets. Citing *Wood v. U.S. Bank*, a 2005 Ohio case (see below), the court concluded that in order for a trust agreement to alter the statutory duty to diversify, it must "clearly indicate an intention to abrogate the . . . statutory . . . duty to diversify." The court concluded that the retention clause in the Reagan trust agreement did not clearly indicate an intention to abrogate that duty.

c. Comment

i. One might well ask what the Ohio court *would* consider a clear indication of intention to abrogate the duty to diversify.

ii. One difference between *Lilly* and *Reagan* is that the Lilly trust agreement exculpated the trustee "despite any . . . lack of *diversification*." [emphasis added] Perhaps the key is to use the word "diversification" when saying what is permissible.

3. *Wood v. U.S. Bank, N.A.*, 828 N.E.2d 1072 (Ohio Ct. App. 2005).

a. Facts

i. The settlor established a trust during his lifetime and funded it primarily with stock of Firstar Bank, which later merged into U.S. Bank. At the settlor's death, Firstar became the trustee. It estimated that administration of the trust and distribution to family members would take 18 to 20 months. It did not diversify out of the Firstar stock despite requests of the family beneficiaries. Needless to say, the stock plummeted in value during that time.

ii. The trust agreement included a retention clause:

> (i) to retain any securities in the same form as when received, including shares of a corporate Trustee . . ., even though all such securities are not of the class of investments a trustee may be permitted by law to make and to hold cash uninvested as they deem advisable or proper.

b. Holding

Noting the mangled grammar of the retention clause, the court held that its purpose was only to allow a corporate trustee to hold its own stock. It did not relieve the trustee of the statutory duty under Ohio's UPIA to diversify the trust assets. The court concluded by saying that the language of a trust does not alter the trustee's duty to diversity "unless the instrument creating the trust clearly indicates an intention to do so."

c. Comment

i. *Wood* is an example of what appears to be the inclination of courts to find a way to uphold the duty to diversify. The retention clause could have been interpreted as an authorization not to diversify, but the court was able to hang its hat on the fact that the trust had held a substantial block of Firstar stock during the settlor's life, and he modified the terms of the trust to include the retention clause with an eye toward the fact that Firstar would become the successor trustee at his death. Thus, there was some plausibility to the court's conclusion that the sole purpose of the retention clause was to allow Firstar as trustee to retain Firstar's stock in the trust.

ii. The court also said that the retention language "smacked of the standard boilerplate that was intended merely to circumvent the rule of undivided loyalty." It seems that a diversification override clause is more likely to be effective if it avoids boilerplate language and is individually crafted.

B. Implications

The recent cases cited above suggest that courts are unwilling to relieve a trustee of the UPIA-imposed duty to diversify unless the trust instrument evidences a very clear intent to do so. To be safe, drafters should seriously consider including all of the following or their equivalent:

1. A statement that the trust agreement overrides the UPIA default rule regarding duty to diversify, complete with citations to the UPIA default and override provisions.

2. A statement that the trustee can rely on the trust's provision which overrides the UPIA default rule on diversification.

3. A statement authorizing the trustee to retain indefinitely any property received by the trustee despite the fact that a lack of diversification will result.

4. A clause exonerating the trustee from any liability resulting from retention of an asset in reliance on the trust's override and authorization provisions, even if such a loss results because of a lack of diversification.

This material is based on the relevant law in effect on the date it was completed: January 28, 2008. It is only a summary of the subject matter it addresses, and it is intended to provide information of a general nature only. It should not be construed as a comprehensive treatment or as legal advice or legal opinion on any specified facts or circumstances. Readers are urged to consult with an attorney concerning their own situations and any specific legal questions they may have. Because this material deals with recent legal and legislative changes, an update will be handed out at the conference.

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Case Studies in Creative Gift Planning

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I. Case Studies

A. Jim B is a consistent $5,000 to $10,000 annual donor. He is an aggressive investor but is spooked by the market's violent volatility. Jim wants to reduce the debt portion of his highly leveraged margin account to a manageable size. Such selling, however, would entail recognizing significant capital gains and that he would not be able to offset with losing positions.

B. Doctor, aged 58, wants to create a flip CRUT (12-year triggering event) and fund it with $1,000,000 of very highly appreciated stock. He plans to sell stock right away (in December). Starting the following year he plans to margin the account to the hilt, do a lot of short selling, and trade vigorously (see *Deputy v. DuPont*, 308 US 488, 1940; Rev Rul 95-8)

C. Ruth C wants to set up a CRT funded with a combination of stocks, US treasuries and municipal bonds. Tax-free income is very important to Ruth.

D. Corporation matches only cash gifts up to a maximum of $50,000. Donor, employee of corporation, owns land valued at $187,000 that he would like to contribute to charity but also wants to have gift matched.

E. Allaying the Concerns of an Older Donor

Donor, aged 80, has been considering a gift annuity to be funded with appreciated securities worth $500,000, with a low cost basis. She appreciates all the benefits of this arrangement, (i.e., large charitable deduction, escape from a locked-in position, increased spendable income, lower estate taxes, and recognition of her good work).

Nevertheless, she has one concern that is still holding her back.

Value of transfer	$500,000	$500,000
Charitable deduction	$268,420	$182,425
Net tax savings (35%)	$ 93,947	$ 63,849

F. Beneficiary wants to collapse unitrust into a CGA that will pay him an annuity for three years. He will use the annuity distributions to pay off his outstanding pledge. He will also assign his post-three-year annuity interest to charity now.

G. Donor had planned to set up a substantial testamentary CRUT for the benefit of his slightly mentally challenged daughter. He then suggests setting up a NIMCRUT with some assets that will flip to a CRUT at his death. This way he will receive the benefit of an income-tax deduction. See Regs. Sec. 25.2702-1(c)(3)

H. Donor owns building and land free and clear and wants to transfer it to a CRAT. Donor also owns the leasing rights for 15 years to a contiguous parking lot owned by the city and pays an annual rent of $9,000. The original lease was for 25 years.

An appraiser has valued the Donor's right to lease the parking lot at $130,000.

Donor wants to transfer the right to lease of $130,000 to the CRAT.

II. Reading Between the Lines

A. Wealth profiles—*NY Times* 3/28/2006

1. 8.9 million households (10 million in 2006) with net worth greater than $1,000,000 excluding personal residence.

   $7.1 million in 1999

   12.5% annual increase—almost doubling every 6 years

2. More than 1 in 7 lived in just 15 counties—Calif., N.Y., and one in Ill.

3. Average $2.2 million

4. 29% owned **no** securities and 32% **no** mutual funds.
   half of heads of household under 58

5. In another *NY Times* article: Wealthy were far more concerned about the impact of terrorism on the value of their assets than their personal safety!!!

B. FET Returns

1. How many people die each year? Population is 300,000,000.

2. Of those, how many file FET returns?

3. What % included a charitable arrangement?

Federal estate Tax Returns 2001-2006

	2001				2003			
	Exempt Amt: $675,000				*Exempt Amt: $1,000,000*			
Size of Gross Estate	Gross estate for tax purposes		Charitable deduction		Gross estate for tax purposes		Charitable deduction	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
All returns, total...	**108,071**	**$215,592,994**	**18,718** 17.3%	**$16,150**	**73,128**	**$200,267,169**	**13,399** 18.3%	**$14,769**
Under $1.0 million	45,419	$36,897,394	6,463	$873	7,086	$3,741	908	$168
$1.0 million < $1.5 million	28,317	33,871,690	4,462	1,277	29,703	36,118	4,723	1,151
$1.5 million < $2.0 million	12,201	21,160,119	1,884	802	13,327	22,965	2,428	871
$2.0 million < $3.5 million	12,695	32,653,156	2,987	1,871	13,136	33,814	2,596	2,008
$3.5 million < $5.0 million	3,980	16,603,128	995	1,022	4,130	17,060	921	1,016
$5.0 million < $10.0 million	3,550	24,229,334	1,151	1,835	3,732	25,285	1,009	1,687
$10.0 million < $20.0 million	1,282	17,218,534	468	1,668	1,273	17,645	486	1,575
$20.0 million or more	628	32,959,638	301	6,802	720	41,637	329	6,294

	2005				2006			
	Exempt Amt: $1,500,000				*Exempt Amt: $2,000,000*			
Size of Gross Estate	Gross estate for tax purposes		Charitable deduction		Gross estate for tax purposes		Charitable deduction	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
All returns, total...	**45,070**	**$184,696,403**	**8,785** 19.5%	**$19,782,413**	**49,050**	**$211,460,077**	**9,522** 19.4%	**$17,590**
Under $1.5 million	5,590	$6,616,339	710	$218,462	2,009	$2,337	2,349	$662
$1.5 million < $2.0 million	13,955	24,047,230	2,334	822,742	14,856	25,611	2,255	742
$2.0 million < $3.5 million	14,842	38,162,443	2,814	1,687,401	18,857	48,672	3,571	2,162
$3.5 million < $5.0 million	4,445	18,386,313	1,037	1,084,509	5,629	23,282	1,144	1,058
$5.0 million < $10.0 million	4,122	28,001,268	1,107	1,969,189	5,053	34,142	1,259	2,067
$10.0 million < $20.0 million	1,358	18,629,863	455	1,587,237	1,708	22,984	538	1,793
$20.0 million or more	760	50,832,948	328	12,352,875	939	54,431	406	7,705

**** Dollar amounts in thousands***

C. Massive transfer of wealth, or as the *NY Times* said recently in the heading

"Inherit the Wind; There's Little Else Left"

1. This is unfortunate because baby boomers are going to need it: Social Security threatened, little retirement planning, and little savings.

2. According to **Economy.com**, 2004 median inheritance was $29,000 in today's dollars. 30 years ago it was $10,000 more in today's dollars.

   Inheritances will grow to $25 trillion by 2050.

   Average: $83,000

3. Woefully uneven distribution

   a. 1% of estates will get half of all bequests

      Rand Corp: half of children of 60-75 year olds would inherit less than $19,000, while top 5% would receive at least $237,000.

      Median **net worth** of those 75 and older grew by $50,000 to $163,000 but not translating into bigger inheritances.

   b. More siblings 3.5

      2.5 before 1945

   c. Longer life expectancy

   d. Soaring health-care costs

      Rand Corporation: Average person 60-70 would spend almost 60% of wealth, and 45% who own home at 70 would sell by 85

Form 5227

	1999	2000	2001	2002	2003	2004	2005	2006
CRATs Returns	20,137	21,630	22,669	22,958	22,783	22,626	21,667	21,296
Book Value (B)	8.3	9.1	9.94	9.88	9.45	9.2	9.4	9.0
CRUTs Returns	64,923	78,239	84,201	89,874	91,371	93,329	94,779	94,767
FM Value (B)	64.3	81.2	88.5	100.2	84.7	89.6	95.1	96.8
CLTs			4,571	5,292	5,481	5,658	6,168	6,298
Book Value (B)			10.1	14.0	12.2	11.6	15.1	16.5
Pooled Income Funds			1,634		1,675		1,677	1,676
Book Value (B)			1.44		1.5		1.5	1.6

Increase in Returns 2006 over 2005

	CRAT	CRUT	CLT
	<1.7%>	0%	0%
Average value of trusts in 2005	$424,548	$1,021,828	$2,617,602
Number of returns in excess of $10M in 2005	83 (0.04%)	746 (0.07%)	232 (3.6%)

IRS Projections for Form 5227 in Future Years

2005	2006	2007	2008	2009	2010	2011	2012
127,700	129,800	131,800	133,800	135,700	137,600	139,400	141,100

Table 7.--Charitable Remainder Unitrusts: Fair Market Value Balance Sheet Information, by Size of End-of-Year Book Value of Total Assets, Filing Year 2005

[All figures are estimates based on samples--money amounts are in thousands of dollars]

Item	Total	Size of end-of-year book value of total assets				
		Under $500,000 [1]	$500,000 under $1,000,000	$1,000,000 under $3,000,000	$3,000,000 under $10,000,000	$10,000,000 or more
	(1)	(2)	(3)	(4)	(5)	(6)
Number of returns	**94,779**	**66,517**	**15,070**	**9,781**	**2,698**	**713**
Total assets	**95,053,816**	**14,708,729**	**11,969,191**	**17,855,872**	**15,529,043**	**34,990,872**
Cash	1,327,634	274,017	138,189	283,363	196,632	435,433
Savings and temporary cash investments	4,706,316	678,086	618,912	999,461	767,573	1,642,285
Receivables due [2]	971,468	195,700	92,694	280,017	209,086	193,972
Inventories and prepaid expenses	22,568	* 366	* 13,054	4,767	4,251	130
Total investments	84,285,264	12,704,893	10,568,685	15,449,242	13,645,714	31,916,730
Securities	56,927,265	10,237,969	8,726,412	12,635,646	10,645,488	14,681,751
Government obligations	5,206,271	565,750	647,703	1,236,556	1,193,855	1,562,407
Corporate stock	43,988,926	8,057,037	6,860,479	9,664,279	8,142,281	11,264,851
Corporate bonds	7,733,068	1,615,183	1,218,230	1,735,811	1,309,352	1,854,492
Land, buildings, and equipment	1,228,650	456,318	125,644	306,131	225,504	115,053
Other investments	26,129,348	2,010,605	1,716,629	2,507,466	2,774,722	17,119,926
Charitable purpose land, buildings, and equipment	542,361	140,443	* 40,323	109,936	120,834	130,825
Other assets	3,197,972	715,201	497,240	729,082	584,952	671,497
Total liabilities	**1,223,051**	**140,151**	**142,888**	**235,483**	**261,978**	**442,551**
Accounts payable, accrued expenses, and deferred revenue	281,517	48,452	34,874	54,945	71,022	72,223
Other liabilities [3]	941,534	91,699	108,013	180,538	190,956	370,328

* Estimate should be used with caution because of the small number of sample returns on which it is based.

[1] Includes returns that report the end-of-year book value of total assets (Form 5227, Part IV, line 37, column (b)) from the balance sheet as zero. Often, this amount is reported as zero for trusts filing a final return. In those cases, the trusts reported having assets at the beginning of the year, but nothing at the end of the year.

[2] Calculated as the sum of "accounts receivable" (Form 5227, Part IV, line 27), "receivables due from officers, directors, and other disqualified persons" (line 28), and "other notes and loans receivable" (line 29).

[3] Includes "loans from officers, directors, trustees, and other disqualified persons" (Form 5227, Part IV, line 40), "mortgages and other notes payable" (line 41), and "other liabilities" (line 42).

NOTE: Detail may not add to totals due to rounding.

SOURCE: IRS, Statistics of Income Division, November 2006.

Table 8.--Charitable Lead Trusts: Book Value Balance Sheet Information, by Size of End-of-Year Book Value of Total Assets, Filing Year 2005

[All figures are estimates based on samples--money amounts are in thousands of dollars]

Item	Total	Size of end-of-year book value of total assets				
		Under $500,000 [1]	$500,000 under $1,000,000	$1,000,000 under $3,000,000	$3,000,000 under $10,000,000	$10,000,000 or more
	(1)	(2)	(3)	(4)	(5)	(6)
Number of returns	6,168	2,757	1,383	1,246	560	222
Total net assets [2]	15,100,846	520,849	1,000,597	2,112,605	2,816,920	8,650,075
Total liabilities and net assets [3]	15,600,073	539,704	1,043,073	2,178,351	2,871,669	8,967,276
Total assets [4]	15,600,073	539,704	1,043,073	2,178,351	2,871,669	8,967,276
Cash	176,966	19,123	23,631	21,819	24,492	87,900
Savings and temporary cash investments	962,786	25,782	67,897	147,218	195,379	526,511
Receivables due, inventories, and prepaid expenses [5]	237,272	* 1,635	* 25,307	36,339	2,457	171,532
Total investments	13,495,200	435,257	901,436	1,920,752	2,489,476	7,748,277
Securities	7,603,694	349,032	616,000	1,425,026	1,355,051	3,858,587
Government obligations	763,214	35,459	81,015	144,175	46,502	456,063
Corporate stock	6,162,253	294,950	477,343	1,161,606	1,148,517	3,079,838
Corporate bonds	678,227	18,623	57,642	119,245	160,032	322,686
Other investments [6]	5,891,505	86,226	285,436	495,726	1,134,425	3,889,690
Other assets [7]	627,847	57,905	* 24,800	52,222	159,864	333,056
Total liabilities [8]	399,226	19,054	* 42,476	65,746	54,749	217,201

* Estimate should be used with caution because of the small number of sample returns on which it is based.

[1] Includes returns that report the end-of-year book value of total assets (Form 5227, Part IV, line 37, column (b)) from the balance sheet as zero. Often, this amount is reported as zero for trusts filing a final return. In those cases, the trusts reported having assets at the beginning of the year, but nothing at the end of the year.

[2] Taken from Form 5227, Part IV, line 46, column (b). This is the excess of total assets over total liabilities.

[3] Taken from "total liabilities and net assets" (Form 5227, Part IV, line 47, column (b)). This amount may not equal "total liabilities" (line 43, column (b)), plus "total net assets" (line 46, column (b)) due to taxpayer reporting discrepancies.

[4] Taken from Form 5227, Part IV, line 37, column (b).

[5] Calculated as the sum of "accounts receivable" (Form 5227, Part IV, line 27, column (b)), "receivables due from officers, directors, and other disqualified persons" (line 28), "other notes and loans receivable" (line 29), "inventories for sale or use" (line 30), and "prepaid expenses and deferred charges" (line 31).

[6] Calculated as the sum of "investments -- land, buildings, and equipment" (Form 5227, Part IV, line 33, column (b)) and "investments -- other" (line 34, column (b)).

[7] Calculated as the sum of "charitable purpose land, buildings, and equipment" (Form 5227, Part IV, line 35, column (b)) and "other assets" (line 36, column (b)).

[8] Taken from Form 5227, Part IV, line 43, column (b).

NOTE: Detail may not add to totals due to rounding.

SOURCE: IRS, Statistics of Income Division, November 2006.

III. Dynasty Trust, Generation-Skipping Transfer Tax, and HEET

"The secret of success: Own nothing and control everything."

John D. Rockefeller

A. A dynasty trust is designed to last in "perpetuity," subject to the rule against perpetuities of the jurisdiction where it is established—at least many generations beyond the lifetime of the children and grandchildren of the grantor.

It can be created during life or death and is designed to use the maximum available gift-, estate-, and generation-skipping exemptions and then remain exempt from these taxes for the duration of the trust.

C. Beneficiaries

1. Rights limited to ascertainable invasion standards.

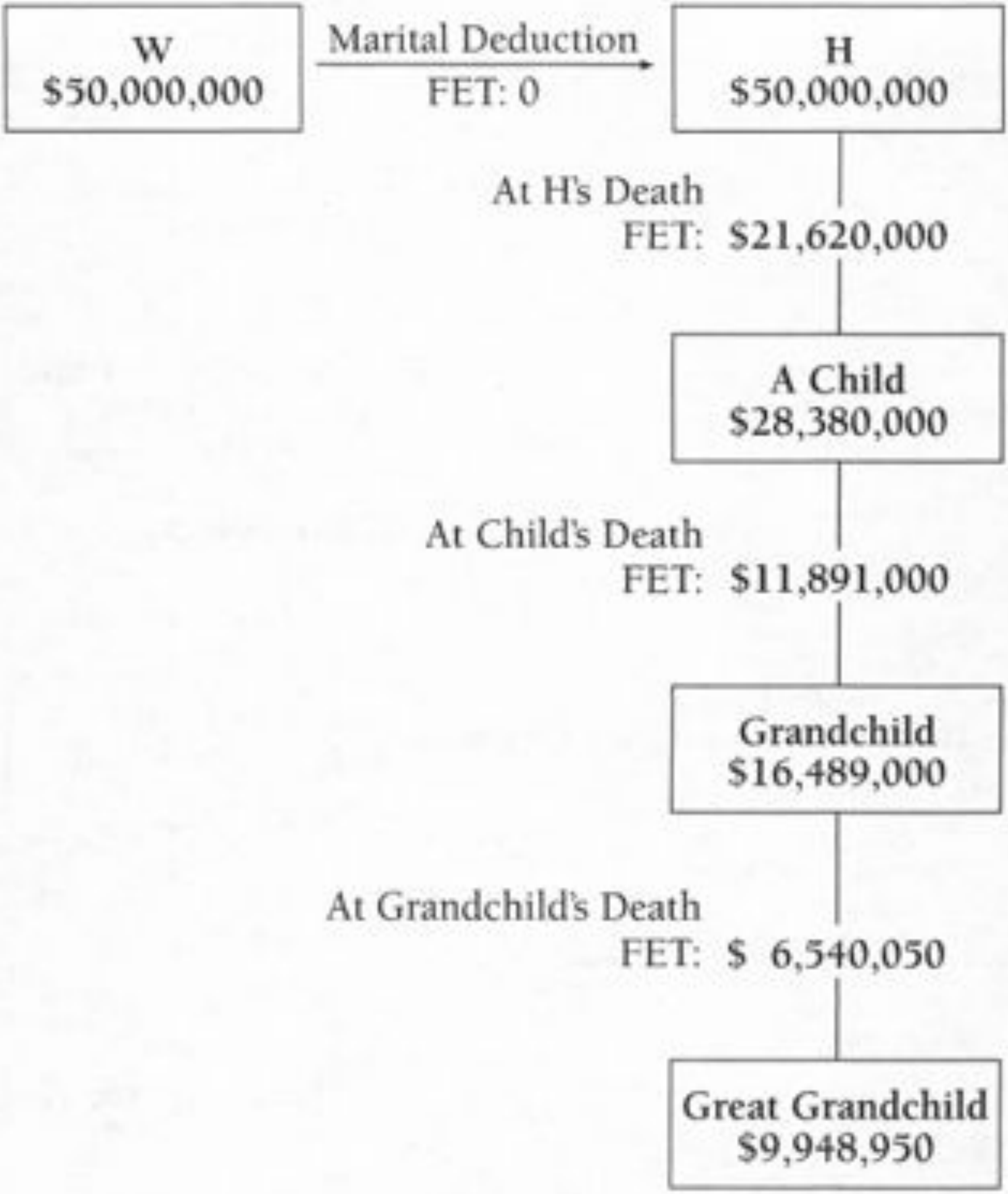
2. Limited powers of appointment.

3. Spendthrift clause

4. Flexibility for trustee

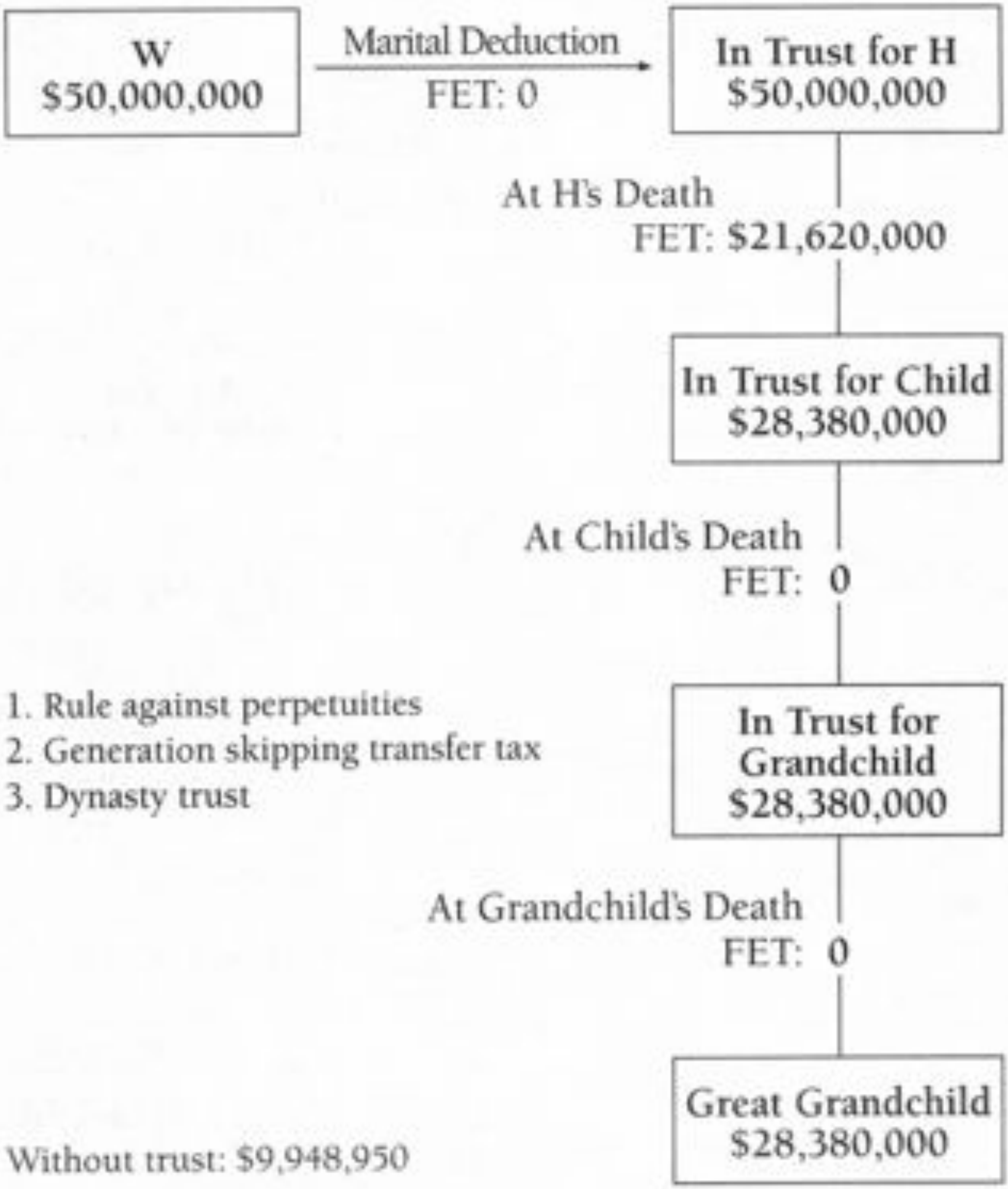
5. Trust terminates with death of last beneficiary or trustee elects to terminate.

D. The Way the Transfer Tax System Is Supposed to Work



Case Studies 2-08

E. Transfer Tax Savings Through Use of Trusts



1. Rule against perpetuities
2. Generation skipping transfer tax
3. Dynasty trust

Without trust: $9,948,950

F. Generation-Skipping Tax (GST)

A trust, including a CRAT or CRUT, with grandchildren as remaindermen is a generation-skipping transfer. Whether any tax is actually payable depends on the size of the trust and the availability and application of exemptions.

1. Definition of generation skipping

   The generation-skipping tax is imposed on transfers of property to a "skip person," defined as a person belonging to a generation that is two or more generations below the transferor.

2. Generation-skipping events

   a. **Direct skip**: a gift or bequest directly to a skip person or a trust consisting only of skip persons. The transferor or his/her estate is liable for the tax.

   b. **Taxable distribution**: distribution of income or principal (other than a distribution resulting from a taxable termination) from a trust to a skip person. An example would be regular payments from a trust. The recipient is liable for the tax.

   c. **Taxable termination**: receipt of trust property by a skip person, upon termination of another beneficiary's interest in the property. But no taxable termination if a **nonskip person still has an interest** in the property. The trustee is liable for the tax, which is paid from trust assets.

   If a grandfather establishes a charitable lead trust, naming his grandchildren as remaindermen, a **taxable termination** would occur at the end of the trust term, and any tax due would be paid from trust property.

G. Generation-Skipping Transfer Tax—Taxable Termination and Distribution

W
$50,000,000

Marital Deduction
FET: 0

QTIP Trust for H
$50,000,000

At H's Death: No GSTT because no skip
FET: **$21,620,000**

If trustee makes distributions to grandchild (or other skip person) during child's life, then **taxable distribution*** & GSTT incurred

In Trust for Child
$28,380,000

At Child's Death: No FET because in trust
But **taxable termination**** GSTT 45% **$12,771,000**

Grandchild
$15,609,000

At Grandchild's Death
FET: **$ 7,024,050**

Great Grandchild
$8,584,050

* Paid by recipient
** Paid by trust

H. Exemptions from GST tax:

1. Gift tax annual exclusion of $12,000 per donee.

2. Unlimited gift tax exclusion for educational and health expenses paid directly to providers of services.

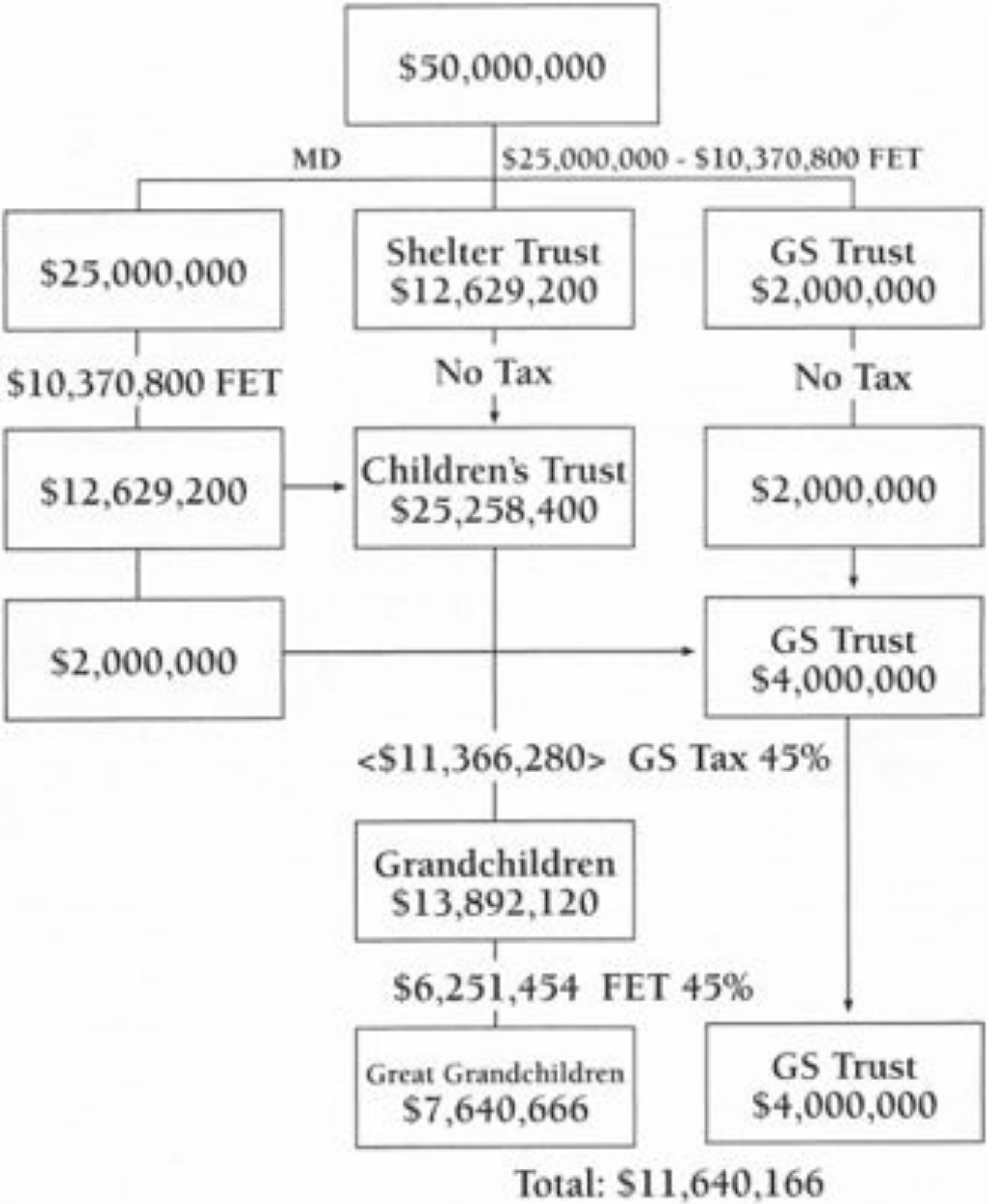
   a. applies to tuition only,

   b. prepaid tuition qualifies,

   c. health and medical expenses that are covered by deductible items under IRC section 213(d).

3. Each taxpayer is entitled to a $2,000,000 exemption from the GST.

I. Estate Splitting Plus GS Trust



Case Studies 2-08

J. Health and Education Trust (HEET)

1. In addition to the $12,000 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.

   a. Educational expenses limited to tuition.

   c. Only medical expenses deductible under IRC §213(d) qualify.

   c. Prepaid tuition expenses for two grandchildren qualified. If they failed to attend payments would be forfeited to school. (TAM 199941013)

   d. Relationship between donor and donee not relevant.

2. 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.

3. Distributions from a trust to grandchildren to cover such expenses would be treated as "**taxable distributions**" subject to GST.

4. Distributions from a HEET directly to a qualified charity for tuition and medical expenses are **excluded from GST**.

5. 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.

6. The HEET is **immune from GST** so long as there is a **nonskip person floating around.**

   a. 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.

   b. To prevent this from happening, the HEET must always have a nonskip person to prevent a taxable termination event from happening.

7. Charity is the perfect candidate.

   a. By including charity as a beneficiary of a HEET, there will always be a nonskip person and a **taxable termination cannot happen.**

   b. Make sure to provide for successor charities as beneficiaries in the event the initial charity or charities cease to exist.

8. Charity must be a **meaningful beneficiary**, otherwise HEET will be discarded under IRC §2652(c)(2) as a ploy to avoid GST, and the plan will collapse. To avoid such treatment:

   a. Charity as a beneficiary from the inception of HEET.

   b. Annual 10% unitrust distributions, or 50% of income and 5% of principal distributions have been suggested.

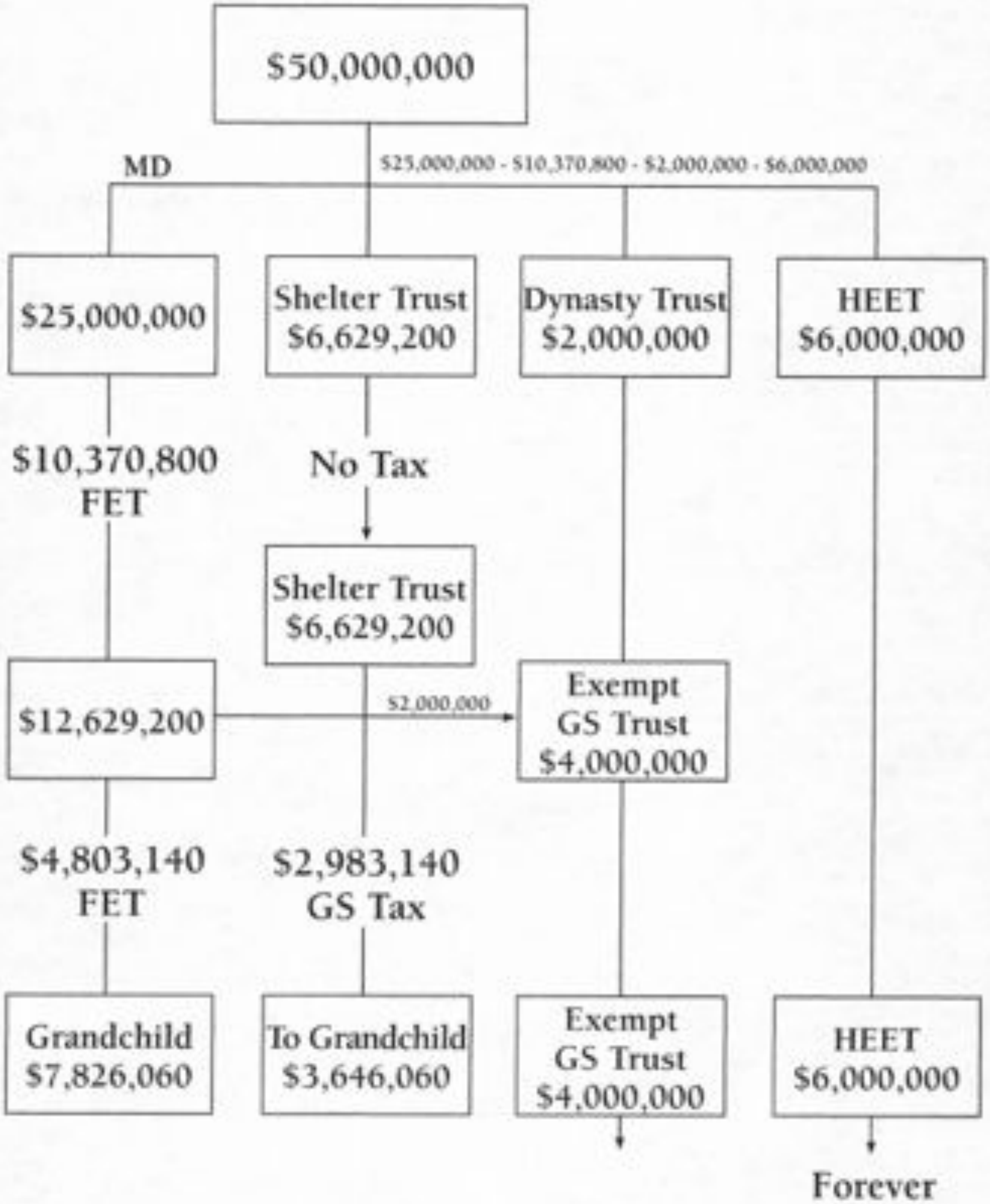
   c. HEET as reminder beneficiary of a CLAT.

9. 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.

K. Estate Splitting, Plus Dynasty Trust Plus HEET



Philanthropy: Going the Magnificent Mile

28th Conference on Gift Annuities • April 2-4, 2008

Investing the Gift Annuity Pool

Presented by:

David G. Ely
Vice President, Portfolio Manager
State Street Global Advisors
Boston, MA

28th Conference on Gift Annuities
Thursday, April 3, 2008

Agenda

1 Setting the strategic asset allocation
2 Regulatory issues surrounding allocations
3 How the liabilities impact the allocation
4 Involving all the constituencies in a CGA program
5 Conclusions

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Not on the Agenda

1 Marketing
2 Stewardship
3 Reinsurance
4 Initial Filing Requirements or "How to File"

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Setting the Strategic Asset Allocation

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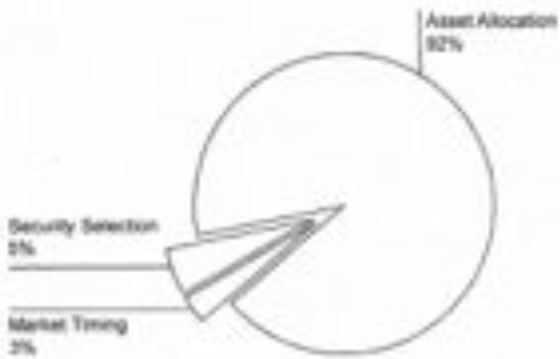
Importance of the Right Mix



Source: Brinson, Hood, and Beebower, "Determinants of Portfolio Performance", July 1986.

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Broad Investment Universe

Risk/Return Spectrum

- Emerging Markets
- International Small Cap
- Commodities
- Long/Short
- Real Estate
- International Equity
- US Equity
- International Bonds
- US Bonds
- Cash

Core Asset Class: International Equity, US Equity, International Bonds, US Bonds, Cash

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"We're expecting stocks to rally
but we don't know which ones and when."

Diversification: Which Asset Class is Next?

Source: FactSet, SSgA

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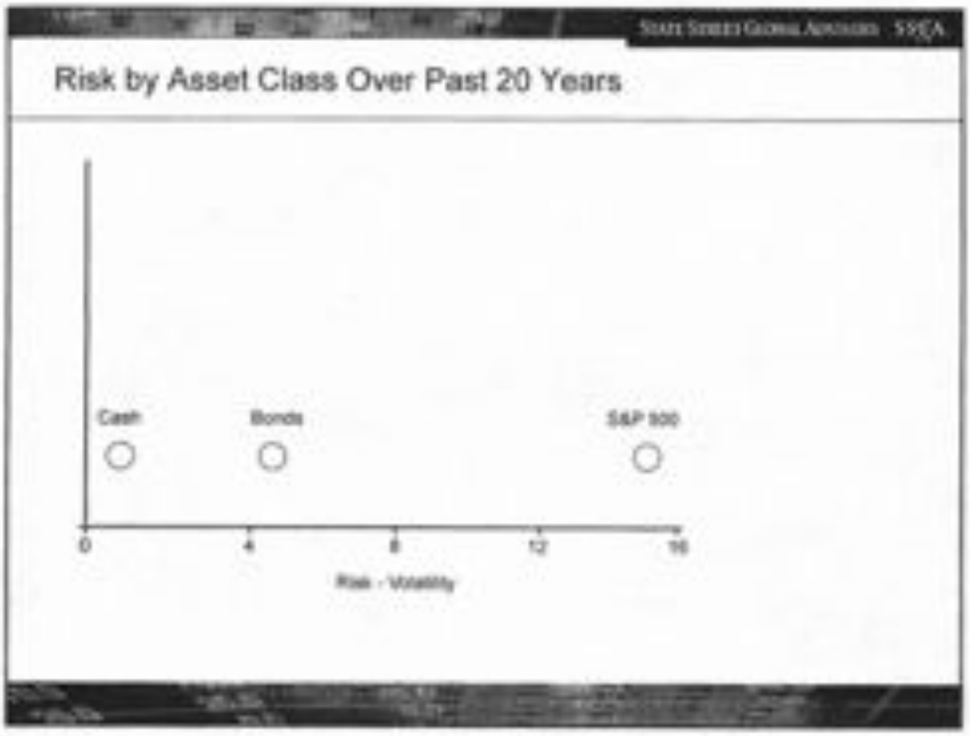
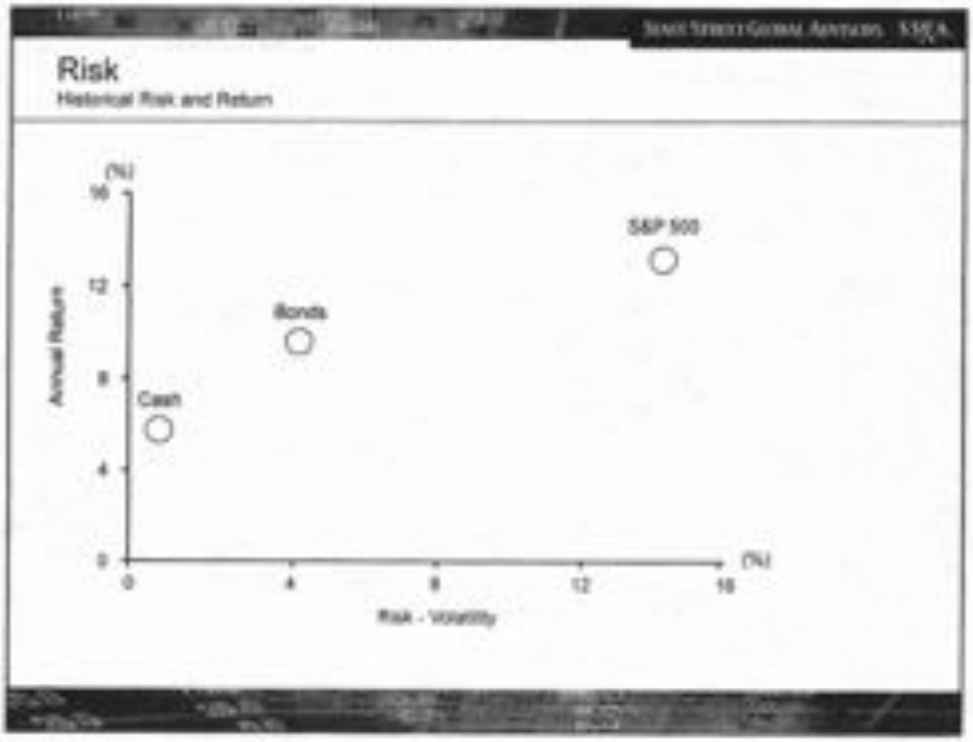
Annual Return Over Past 20 Years


Risk by Asset Class Over Past 20 Years
Cash
Bonds
S&P 500
0
4
8
12
16
Risk - Volatility


Risk
Historical Risk and Return
(%)
16
12
8
4
0
Annual Return
S&P 500
Bonds
Cash
(%)
0
4
8
12
16
Risk - Volatility

Correlation Example

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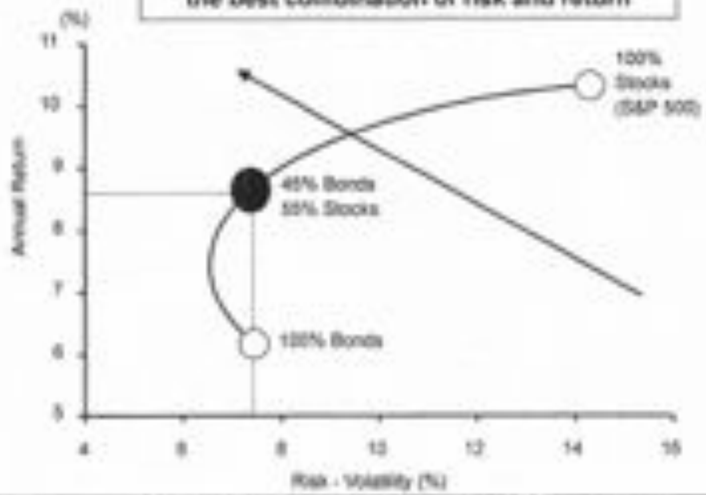
Asset Allocation
An example

The goal of asset allocation is to provide the best combination of risk and return



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Sample Allocation

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Understanding Your Goals and Objectives

$$\sigma \neq \sum_{n} \text{fear}$$

- How organizations define risk
  - Losing money
  - The unknown…unfamiliar investments
  - Past experience…previous losses in familiar investments
  - Herd mentality…feel better following the crowd
  - Loss averse, not risk averse
  - Liability Risk
- Level of Risk Aversion and Return Objectives changes with wealth

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"Everybody wants to go to heaven, but nobody wants to die."

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Regulatory Issues Surrounding Asset Allocations

Investment Implications

- Only 3 States have restrictions on reserve assets:
  - California
  - Florida
  - Wisconsin
- 6 States invoke the Prudent Investor Standard
  - Arkansas, Maryland, New Hampshire, New Jersey, New York, and Washington
  - No strategy is inherently imprudent
- All other states are silent on reserve investments

Investment Implications

- California
  - Requires separate account
  - 50% of reserve must be in government bonds other 50% may be in mutual funds
  - Surplus may be invested as organization chooses
- Typical allocation
  - After including the surplus, the overall allocation is usually 60% equities and 40% fixed income

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Investment Implications

- Wisconsin
  - 80% of reserves must be in bonds
  - 10% of reserve or $100,000 whichever is greater must be in bonds as surplus reserve
  - Surplus may be invested as organization chooses
- Typical allocation
  - After including the surplus, the overall allocation is typically 20% equities and 80% fixed income

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Investment Implications

- Florida
  - 50 % of reserves must be in bonds
  - Limitations on mutual funds
  - Surplus may be invested as organization chooses
- Typical allocation
  - After including the surplus, the overall allocation is typically 60% equities and 40% fixed income

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How the Liabilities Impact the Allocation

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The Risks
Actuarial Risks

- Payout Risk

  The risk that the guaranteed payouts become too high, especially if market value of gift annuity declines

- Longevity Risk

  The risk that income beneficiaries outlive life expectancies, especially as people live longer, medical care advances

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The Risks
Gift Annuity Risks

- Timing Risk

  The risk that investment returns are weak in the early years, making it difficult to recover market value (especially with continuing payouts).

- Individual Contract Risk

  The risk that individual contracts "go negative," payouts exhaust gift value and leave no remainder value. This is a particular concern for unusually large or illiquid gifts relative to overall gift annuity assets.

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Single Contract — Projections

Traditional Beneficiary

- 72 year old beneficiary; 15 year life expectancy
- $200,000 contract
- $13,400 payout (6.7%)

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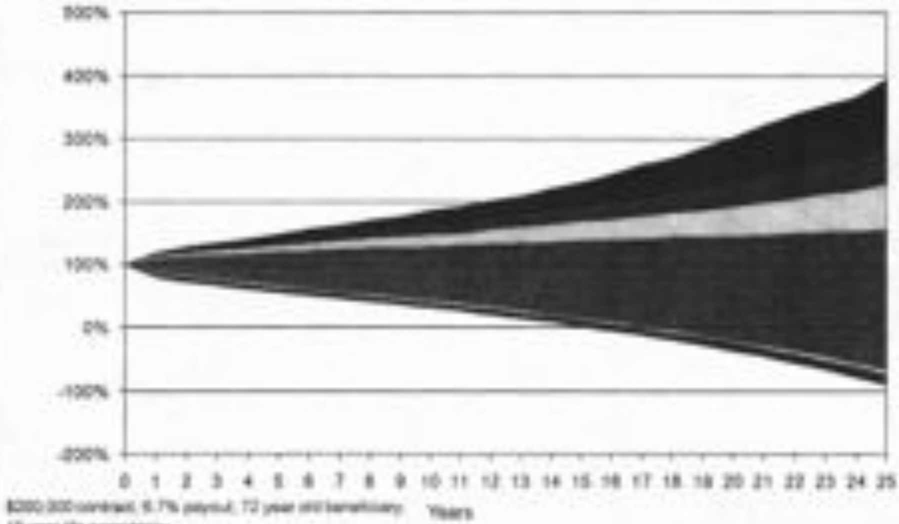
Monte Carlo Results — Traditional Beneficiary



$200,000 contract; 6.7% payout; 72 year old beneficiary;
15 year life expectancy

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Single Contract — Years Until Contract "Goes Negative"

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	Never	Never	Never	Never
50% Probability	34 years	32 years	30 years	28 years
Worst Case (5% Probability)	17 years	17 years	18 years	18 years

$200,000 contract; 6.7% payout; 72 year old beneficiary;
15 year life expectancy

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Single Contract — Residuum at Life Expectancy

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	244%	198%	172%	140%
50% Probability	78% (PV=38%)	71% (PV=36%)	67% (PV=34%)	60% (PV=31%)
Worst Case (5% Probability)	-0.3%	6%	9%	12%

$200,000 contract, 6.7% payout, 72 year old beneficiary,
15 year life expectancy

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Single Contract — Residuum at Age 95 (+8 years)

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	395%	287%	228%	157%
50% Probability	47%	37%	30%	18%
Worst Case (5% Probability)	-85%	-73%	-67%	-61%

$200,000 contract, 6.7% payout, 72 year old beneficiary,
15 year life expectancy

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Conclusions — Traditional Beneficiary

- Through life expectancy
  - High probability that contract worth more than 50% of gift value at life expectancy
  - Benefit to more aggressive allocation
  - Highly unlikely to go negative
- Through age 95
  - Increased change of going negative
  - Risk/return favors more aggressive allocation

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Single Contract — Projections

Younger Beneficiary

- 60 year old beneficiary; 25 year life expectancy
- $200,000 contract
- $11,400 payout (5.7%)

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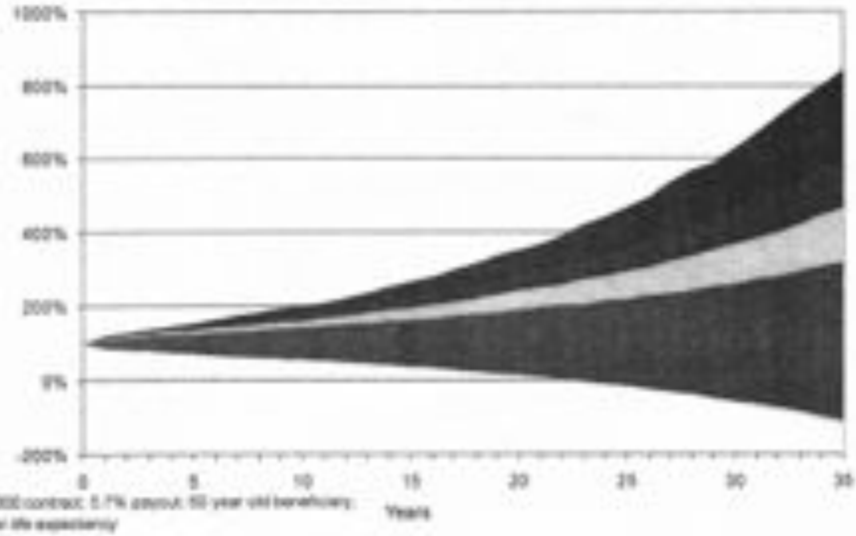
Monte Carlo Results — Younger Beneficiary



$200,000 contract; 5.7% payout; 60 year old beneficiary;
25 year life expectancy

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Single Contract — Years Until Contract "Goes Negative"

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	Never	Never	Never	Never
50% Probability	40+ years	40+ years	40+ years	40+ years
Worst Case (5% Probability)	21 years	23 years	23 years	24 years

$200,000 contract; 5.7% payout; 60 year old beneficiary;
25 year life expectancy

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Single Contract — Residuum at Life Expectancy

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	468%	352%	292%	216%
50% Probability	108% (PV=32%)	95% (PV=28%)	86% (PV=25%)	71% (PV=21%)
Worst Case (5% Probability)	-31%	-19%	-16%	-11%

$200,000 contract; 5.7% payout; 60 year old beneficiary;
25 year life expectancy

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Single Contract — Residuum at Age 95 (+10 years)

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	841%	594%	463%	318%
50% Probability	111%	87%	70%	43%
Worst Case (5% Probability)	-144%	-120%	-108%	-98%

$200,000 contract; 5.7% payout; 60 year old beneficiary;
25 year life expectancy

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Conclusions — Younger Beneficiary

- Through life expectancy
  - High probability that contract worth more than 50% of gift value at life expectancy (but lower present value)
  - Benefit to more aggressive allocation
  - Lower possibility of going negative
- Through age 95
  - Low payout favors chances of beating 50% residuum
  - Worst case scenario much less attractive
  - Risk/return favors more aggressive allocation

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Single Contract — Projections

Older Beneficiary

- 90 year old beneficiary; 5 year life expectancy
- $200,000 contract
- $22,600 payout (11.3%)

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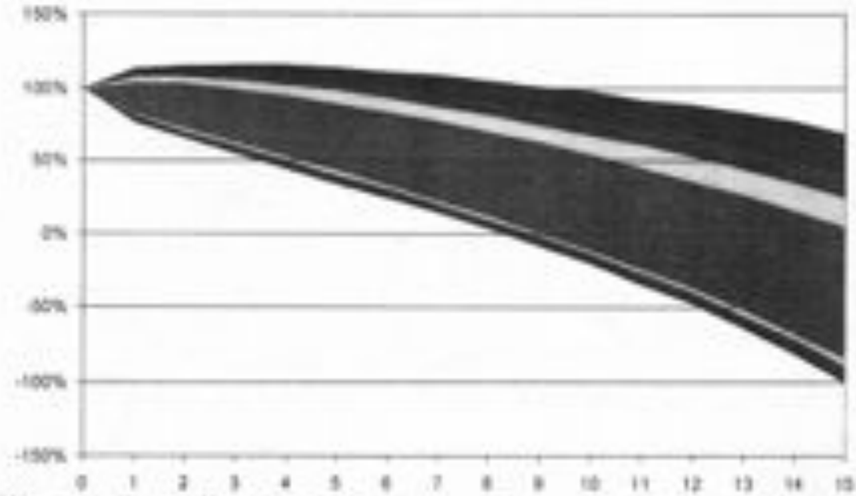
Monte Carlo Results — Older Beneficiary



$200,000 contract; 11.3% payout; 90 year old beneficiary;
5 year life expectancy

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Single Contract — Years Until Contract "Goes Negative"

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	23 years	20 years	18 years	16 years
50% Probability	13 years	12 years	12 years	12 years
Worst Case (5% Probability)	9 years	9 years	10 years	10 years

$200,000 contract; 11.3% payout; 90 year old beneficiary;
5 year life expectancy

Single Contract — Residuum at Life Expectancy

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	114%	104%	98%	89%
50% Probability	67% (PV=53%)	66% (PV=52%)	65% (PV=51%)	64% (PV=50%)
Worst Case (5% Probability)	37%	40%	43%	45%

$200,000 contract, 11.3% payout, 90 year old beneficiary
5 year life expectancy

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Single Contract—Residuum at Age 100 (+5 years)

	Asset Allocation			
	65% equity 35% bonds	50% equity 50% bonds	40% equity 60% bonds	25% equity 75% bonds
Best Case (5% Probability)	98%	78%	67%	54%
50% Probability	23%	21%	19%	17%
Worst Case (5% Probability)	-18%	-14%	-12%	-9%

$200,000 contract, 11.3% payout, 90 year old beneficiary,
5 year life expectancy

Conclusions — Older Beneficiary

- Asset allocation less important than longevity
- Through life expectancy
  - High probability of more than 50% residuum at life expectancy
  - Less dramatic benefit to more aggressive allocation
- Through age 100
  - Very small chance of achieving 50% residuum
  - Increased change of going negative
  - Risk/return favors less aggressive allocation

Other Constituencies

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Finance's Concerns

- Initial registration
  - Available to be out-sourced for modest charges
- Ongoing administration
  - Available to be out-sourced for modest charges
- Investment committee and board reporting
  - New York is especially concerned about oversight
  - Bringing Board Members up learning curve
- Creation of state specific accounts?
  - California, Florida, and Wisconsin allow segregated accounts
  - Hawaii rules require $200,000 to be in Hawaii

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Conclusions

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Conclusions

- No clear answer on where and when to register
- Finance concerns are real but not overwhelming
- Risks of not filing are real yet manageable
- Professional assistance is available

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Thank You

Keeping your Charity Clean while Accepting Planned Gifts of Dirt

Presented by:

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28th Conference on Gift Annuities
Thursday, April 3, 2008

Basic Tax Rules

Deduction Limits

If real estate is given to a public charity, the donor can offset up to 30% of adjusted gross income if the donor claims the deduction for the fair market value of appreciated real estate. If the donor limits the deduction to the donor's basis in the real estate, the donor can offset up to 50% of adjusted gross income for a contribution of the real estate to public charity.

If the donor contributes real estate to private foundation, the donor will be required to limit the deduction to the donor's basis in the property. The deduction for that basis will be limited to 30% of the donors adjusted gross income.

In all cases, if at the time of the contribution, the fair market of the real estate is less then the donor's basis in the property, the donor will be limited to deducting the fair market value of the property. Generally, in such cases, the donor would be better off to sell the real estate for the loss to offset other income and contribute the cash proceeds of the sale to the charity.

Appraisal Rules

If the value of the donated real estate exceeds $5,000, the donor will be required to obtain an appraisal to substantiate the deduction. The appraisal must be obtained not more than 60 days before the date of the gift and not later than the due date with extensions for the donor's income tax return. The charity will be required to sign a Form 8283 acknowledging receipt of the real estate. If the value of the real estate is less then $500,000, the donor should attach a summary of the appraisal to the 8283. If the value of the real estate is $500,000 or more, the entire appraisal must be attached to the 8283 on the donor's tax return. In the event that the charity sells the real estate within 3 years of receipt, the charity will be required to file a Form 8282 disclosing to the IRS the sale price for the real estate. Like all other charitable gifts in excess of $250, the donor will need to receive a receipt from the charity to substantiate the deduction. The tax court has been unforgiving on the formalities of the appraisal and substantiation requirements. So donors and their advisors must make certain that all the appraisal and substantiation formalities are observed.

Partial Interest

In general, a donor is not entitled to a charitable contribution deduction for a gift of a partial interest in property. With respect to real estate, there are two important exceptions. The donor is entitled to a deduction for an undivided fractional interest in the entire property. Accordingly, a donor could make a gift of an undivided 50% interest in property and qualify for a charitable contribution deduction. The donor's deduction for that gift will be discounted to reflect the lack of marketability and lack of control of the partial interest. A donor may also reserve a life estate and make a gift of the remainder interest in a personal residence or farm.

Capital Gains

If donor contributes appreciated property to a charitable organization, the donor generally is not taxable on the gain from the sale of the property by the charitable organization. The exception to this rule is that if at the time of the gift the donor was already subject to a binding obligation to sell the property, under the assignment of income doctrine, the donor will be taxable on the gain and treated as having made a gift of the cash proceeds of the sale to the charity.

Bargain Sales

If the donor contributes real estate to a charity that is subject to a debt, the donor will be treated as having made a bargain sale to the charity for the outstanding balance of the debt. The donor will be entitled to a charitable income tax deduction equal to the difference of the fair market value of the property and the debt. The donor will be required to allocate basis between the gift portion of the property and the portion of the property sold to the charity for the assumption of debt. Accordingly, in most circumstances, the donor will realize gain even if the donor's basis is equal to the amount of the debt.

Risks of Accepting Gifts of Real Estate

Carrying Costs

Once a charity accepts a gift of real estate, the charity will be responsible for the carrying costs of the real estate. This can include property taxes, debt service, maintenance and repair of improvements. If the property produces little or no income, the carrying costs could exceed the income of the property, forcing the charitable organization to use other funds to satisfy those costs.

Prior to the acceptance of a gift of real estate, a charity should be sure that is has an accurate calculation of the carrying costs of the property. While the donor's historic carrying costs are a good place to start that analysis, the charity should be aware that for a variety of reasons, its carrying costs may be different from those of the donor. The charity must also make an analysis of the marketability of the property so that it can ascertain the likely duration of the carrying costs. If the property generates income, the charity will need to carefully evaluate the income to determine whether it will cover the carrying costs of the property. If the income will not be sufficient to carry the costs of the property, the charity may wish to ask the donor to make an additional cash contribution sufficient to cover the carrying costs for the period of time that the charity reasonably expects to be paying those costs.

Premises Liability

As the owner of real property, the charitable organization will be liable for injuries that occur on the property such as a person slipping in an entryway to the building.

The charity should obtain liability insurance with respect to any donated property or riders on its existing general liability policies to cover claims arising out of the donated property. Whether a separate policy is needed or a rider will be sufficient will depend upon the size and scope of the charity's existing coverage and the nature of the operations of the property. For large commercial or residential property, the charity will likely want to maintain a separate policy with coverage amounts and limits independent of the charity's general liability policy. To further protect the charity's assets, the charity may wish to hold the real estate in a limited liability company. Ideally, the donor would form the limited liability company prior to contributing the property to the charitable organization. The limited liability company should not be considered a substitute for insurance, but an additional protection. Some charitable organizations form related charities, typically a supporting organization, to hold and accept gifts of real estate.

Environmental Liability

An owner of real property can be responsible for the costs of cleaning up toxic chemicals on the site.

As appropriate, charities should conduct phase one and phase two environmental studies of property prior to accepting a gift of the property. A

Phase one study is primarily a review of records of the property and adjoining properties for signs of sources of potential contamination. A phase two study involves taking soil samples of the property and testing them for contamination. It is possible to purchase insurance for environmental liability in some circumstances. It may also be appropriate to ask the donor to provide indemnification of the charity. This indemnification, however, is only as strong as the donor's financial strength. It can be difficult from a practical matter to structure an indemnification that continues after the death of the donor. Some charities also reduce their exposure to environmental liability by having the property transferred to a limited liability company prior to its contribution to the charity and by creating a related charitable corporation to hold contributed real estate.

Management Responsibility

When a charity receives a gift of real property, the charity will be responsible for the management of that real property. Even vacant land requires payments of insurance and payment of taxes. Commercial or residential rental property can entail significant management responsibilities, and a charity must be certain that it has mechanisms in place to carryout these responsibilities before receiving a gift of real property.

Charities that accept and manage large volumes of real estate or have large real estate operations related to their exempt purpose may have in house expertise to evaluate and manage donated real estate. A charitable organization that does not have the resources to manage real estate gifts should either retain a management company with that expertise or work with another charitable organization that has the expertise and is willing to accept gifts of real estate on behalf of the charity.

Real Estate Donation Partners

There are a number of charitable organization that have been established for the sole purpose of helping charities accept difficult assets such as real estate. Some charities may find these organizations an attractive alternative to developing the resources in house necessary to accept gifts of real estate. Even a large organization with real estate expertise may want to work with one of these organizations for gifts that present significant uncertain liabilities that the organization does not wish to expose its deep pockets to.

Charitable Remainder Trust

A one year 5% payout charitable remainder trust can sometimes be used to manage risk. Assuming that the real estate sells within the year that it is held by the charitable remainder trust, the donor will continue to hold legal title as trustee. The charity will never have title to the property or any entity that owns the property.

Gift Acceptance Policy

A charitable organization that is going to accept gifts of real estate needs to have a gift acceptance policy that sets forth the process for reviewing, approving and accepting real estate gifts. The policy should describe the steps that will be taken to review a proposed gift including site visits, financial analysis, market analysis and environmental analysis. The policy should identify who has the authority to agree on behalf of the organization to accept a gift of real estate and under what circumstances. The policy should set forth the various risk management steps that the organization will implement in its acceptance of gifts of real estate. An organization that does not have a gift acceptance policy should review the gift acceptance policies of several different organizations to determine the steps and procedures that will be appropriate for the charity.

Use of Real Estate in Exchange for Gift Annuities

Basic Tax Rules

A donor can contribute real estate in exchange for a gift annuity. If the real estate has appreciated in value, the donor's basis will be allocated between the gift portion and the annuity portion of the transaction. Based on the relative value of the annuity to the fair market value of the property and the relative amount of the gift to the fair market value of the property. If the donor is the beneficiary of the annuity and it is nonassignable, the donor will report the gain allocated to the annuity over the donors life expectancy. If there is debt on the property, then the basis must be allocated three ways following the bargain sale rules among the debt, the gift and the annuity. The donor will recognize the gain from the debt immediately even if the gain for the annuity portion is reported over the donor's life.

If real estate is the donor's residence, then donor can apply the $250,000/$500,000 capital gain exclusion to the transaction. The exclusion can be applied to annuity payments every year. In some cases, however, it may be advantageous to make the annuity not qualify for deferral by making it assignable so that the gain be recognized all at once and the exclusion applied at one time.

Valuation and Reserve Issues

In states that charities are required to maintain reserves for gift annuities, a charity that accepts real estate for a gift annuity may be required to find liquid assets that it already holds in order to fund the reserve for the gift annuity since real estate generally is not an acceptable asset to hold in a reserve. In accepting the real estate in exchange for the gift annuity, the charity also must consider the risks that the real estate will not sell for the appraised value or that it will take considerable time to sell the real estate during which the charity is required to make annuity payments. Charities that accept real estate for gift annuities often discount the value of the real estate by as much as 20% to provide for a margin of error on the valuation of the property and to allow for the payment of costs of sale. A charity can use a deferred annuity to minimize the likelihood that it will be required to make payments while it is still holding the real estate.

Unrelated Business Income

A charity that accepts property subject to a debt in exchange for a gift annuity will need to determine whether the income or sales proceeds from that property will be unrelated business income. If the donor has held the property for 5 years, and the debt has been on the property for 5 years, the property will not be treated as debt financed for the 10 year period following the date of the gift if the charity has not assumed the debt.

Part Sale Transaction

Its important to remember that a gift annuity transaction is a part sale transaction. This may trigger transfer tax, document tax, property tax or income tax consequences that would not occur in an outright gift transaction.

Charitable Remainder Trust

Basic Tax Rules

Assuming the donor has not already entered into a sales agreement, a gain on the sale of the real estate contributed to the charitable remainder trust is taxable to the charitable remainder trust. If the property is debt financed or otherwise generates unrelated business income, the unrelated business income is subject to a 100% tax. Any gain from the sale of the property may be distributed to the beneficiary under the 4 tier rule after distribution of the current year's and prior year's ordinary income and any forms of capital gain that are taxed more heavily then the gain from the sale of the property.

Grantor Trust Issue

Even if the donor has held property for 5 years and has had the debt on the property for 5 years, it may not be possible for the donor to transfer the property to the charitable remainder trust. The IRS has ruled in a private letter ruling that if the debt is recourse debt, the transfer of property that is subject to that recourse debt to the charitable remainder trust will cause the charitable remainder trust to be a grantor trust. A grantor trust is a trust for which the income is taxable to the grantor. A charitable remainder trust does not qualify if it is treated as a grantor trust.

Flip Trust

A charitable remainder trust that is funded with real estate that does not produce income or that does not produce efficient income to make the required payment to the beneficiary will encounter difficulties if the property is not sold before the first payment is required to be made. Because of this issue, generally, an annuity trust simply is not used with real estate. In the case of a unitrust, the donor has the option of using the net income unitrust that limits the required payment to the income of the trust. Most donors will want to receive the full unitrust amount once the property has been sold, and these donors can use a flip trust that changes from a net income unitrust to a standard unitrust on the January 1 following the sale of the real estate contributed to the trust.

Planned Giving: The Secret to a Successful Campaign

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PLANNED GIVING: THE SECRET TO A SUCCESSFUL CAMPAIGN
Bruce E. Bigelow and Carol A. Kolmerten

Campaigns have changed dramatically since the days when they surfaced for a short time in the life of a charity to build a specific building and then disappeared until the next capital project came along. As campaigns became more comprehensive in nature, charitable organizations recognized that donors can and do make gift commitments through a variety of mechanisms, some of which defer the charitable benefit of a gift until some future date. Planned giving, in other words, has come to play an increasingly important role in the success of today's campaigns, no matter what their size. As a general rule, from 25 to 40 percent, and in some cases even 50 percent or more, of the total dollars committed to a campaign come from planned gifts. Integrating planned gifts into campaigns planning has become, therefore, a key element of the strategic thinking that generates success.

The Importance of Planned Giving for Campaigns

As we think about planned giving, we would suggest that it goes far beyond the traditional definition of deferred gifts—life income and estate commitments. Rather, planned giving encompasses all gift transactions that involve anything other than outright gifts of cash. Planned giving is, in our definition, a process, not a set of technical vehicles. It is about finding ways donors can use all their assets as potential gifts. It is also a way—or really an broad set of ways—of solving donor problems while also allowing donors to make the charitable gifts they want to make. Planned giving is not only about "deals," although there are often tax and financial benefits to planned gift transactions. Planned giving can often change what donors may perceive as a forced choice between philanthropy and personal or family priorities into a process whereby they can accomplish both their philanthropic goals and their personal goals at the same time.

As the charitable world has over the last decade eagerly anticipated at the tremendous transfer of wealth that is now beginning, the role of planned giving has become even more critical. Whether that transfer is $10 trillion or $100 trillion is less important than that it will be large and varied. Many economists predict that only 10-15% of the transfer will be in cash or cash equivalents—still a great deal of money, but small in comparison to the wealth locked up in other assets, such as real estate, closely held family businesses, or qualified retirement plans. Planned giving can often help to unlock those other assets, both for philanthropic purpose and for personal priorities. Therein lies the importance of planned giving for the campaigns that so dominate the landscape of the charitable planning community.

The Evolution of Campaigns

Campaigns themselves are not new. But the character of campaigns has changed considerably over the past fifty years. And in the process, the role of planned giving has grown.

One of the first campaigns one of us observed first-hand as a child was a campaign to build a new gymnasium for the local YMCA, an organization for which one of our fathers served as a member of the board. In that campaign, as in so many in the 1950s and 60s, the principles and processes were clear and relatively simple. The campaign was funded with cash only. It was short—several months, as we recall—and had a single focus: the construction of the gym. It was conducted by outside counsel—a professional fundraiser who came from somewhere else who resided locally for the months he ran the campaign (and the "he" was always a "he") while he organized the volunteers who actually solicited the gifts. And this campaign, successful as it was, was an unusual event in the life of the charity. After the cash was collected, the guy from out of town left to do the same thing in another community, the YMCA built the gym, and everything went back to "business as usual," which did not include raising money.

Since those days, campaigns have evolved dramatically. Although some campaigns remain single focused and seek only cash, most have become far more complex. Now, campaigns solicit gifts of all sorts—cash, as it is available, to be sure, but also gifts that focus on many complementary projects, gifts that represent a broad range of resources, gifts that transfer through a complex or even convoluted set of legal instruments, and gifts that will benefit the charity only after a period of time, sometimes even far into the future. The traditional short time window for campaigns has been replaced by efforts that span years (even decades) and that build long-term endowment as well as short term capital projects. Outside campaign counsel still is important to many campaigns, but that traditional "guy from out of town" who took up residence and ran things on a daily basis has been replaced by counsel who provides guidance and perspective and who often will be providing that guidance to many campaigns at once. The daily management of campaigns, meanwhile, has fallen to a growing set of professional fundraisers on the staffs of charities themselves, both large and small. While volunteers remain critical players, they are directed by the professional staff, who often will undertake the solicitations, especially of the more complex gift arrangements. As a result, constant fundraising has now become the order of the day and rarely will a charitable organization return to its pre-campaign status.

All these changes have brought planned giving far more into the forefront of campaign planning and campaign success. As an example of the impact of planned giving on charities, we analyzed the fundraising results of a set of 21 top tier liberal arts colleges over the past seven years (see Appendix A). Almost all of these colleges were in formal campaigns during this time, although the specific years of their campaigns varied. We measured only new life income gifts and matured bequests against their total fundraising results, leaving out other types of planned gifts like current gifts of real estate or other non-cash assets. Even with this rather conservative definition of planned giving, we found that life-income gifts and matured bequests brought in an average of 28% of all the revenue for these colleges over these years. Among these institutions, the average of planned gift income ranged broadly, from a low of 11% to a high of 50%, with some colleges in some years receiving as much as 80% of their revenue from these kinds of planned gifts. The range of results notwithstanding, the important message of these data is that planned giving has become ubiquitous to serious fundraising. Few organizations will consider leaving planned gifts unsolicited and more and more, as organizations think about the ways they can assure their own financial future, they have to think about how to incorporate planned gifts into their active portfolios

Counting Planned Gifts in Campaigns

As campaigns have become more complex and especially as deferred gifts or even current planned gifts of hard-to-value assets have become more and more a part of the focus of campaigns, the issue of how to count these gifts has emerged as a critical component of campaign credibility. Skeptics from faculty members to volunteers to boards to media representatives challenged the old notion that an organization could just lump all kinds of gifts together, put a value on them, and report the total. More and more outside observers asked for details, wanting to know what these totals meant, when the money would be available, and how the results were tabulated.

This growing emphasis on transparency and clarity dovetailed with an equally growing emphasis on donor perspective, as more and more planned giving professionals began to think of helping to solve donors' problems rather than offering a series of "vehicles" to them. These two processes led many organizations—both charities themselves and the umbrella professional organizations to which charities belong—to ask if new ways of counting gifts and of organizing campaigns were now in order.

Both NCPG and CASE have taken on this task, and volunteers from both organizations have spent many hours over the past few years deliberating new donor-friendly guidelines for counting gifts in a campaign. In doing so, they have all asked the same essential questions: Is there an alternative paradigm that might acknowledge the complexity of our work without itself becoming mired in complexity? As both organizations sought to address the issue of counting, both have also reminded themselves that counting is not the same as valuing, that reporting is basically an arithmetical activity, in which we summarize the results of our activity. Counting is simply the process of reporting to a lay audience clearly and transparently what has happened during a specific time period. Similarly, both NCPG and CASE have come to appreciate that donor commitments are the key focus of our reporting and that our methodology and the organizing principles on which campaigns are developed stem from donor intent.

In the fall of 2003, NCPG appointed a national Task Force on Reporting and Counting Charitable Gifts to try to respond to this question. Comprised of 17 charitable gift planning professionals from across the country representing a wide range of non-profit and for-profit experience, the Task Force wrestled for over a year with these questions before issuing its final report in February 2005. (see a summary of this report in Appendix B)

The essential message of the Task Force report and the conclusion of countless hours of collective conversation is that we cannot report the results of our activity under a single numerical category and still remain true to the ever-growing need for accountability, clarity, and comparability in these reports. Rather, the Task Force suggests, charities should report results in three different, but complementary, categories, using face value figures:

- **An outright goal,** for gifts that are usable or will become usable for institutional purposes during the "campaign" period (whether one or more years).
- **Irrevocable deferred gift goals**, for gifts committed during the "campaign" period, but usable by the organization at some point after the end of the campaign period.
- **Revocable gift goals,** for gifts solicited and committed or pledged during the "campaign" period, but in which the donor retains the right to change the commitment and/or beneficiary.

CASE also recently addressed this concern. by appointing its own Task Force in 2005 to reassess the standards and guidelines that CASE has offered to the charitable public in a series of reports covering nearly fifteen years. That Task Force has just issued its preliminary guidelines and it too emphasizes reporting both current, deferred, and revocable gifts at face value, separating the three categories into clear and distinctive sets of numbers. While the CASE recommendations remain preliminary at this point, they reflect a common thinking process that underscores the new direction for counting gifts in campaigns and for recognizing the increasing role that planned gifts will play in campaigns.

Creating understandable and modern counting guidelines that reflect the realities of today's campaigns and that acknowledge the role of commitments that will benefit charities in the future is a key element of planning a successful campaign. The other key element in planning a successful campaign is to consider what kinds of planned gifts are likely to appeal to the varied constituencies of each organization. Knowing one's donors and prospects and understanding what appeals are most likely to resonate with them is just as critical to success as providing clear guidelines for measuring success and staying on top of the technical and legal details of the planned giving world.

How To Integrate Planned Giving into a Successful Campaign

Each campaign has its own character, its own personality, if you will. And the role planned gifts play in each campaign will differ, in large part depending on the organization, the constituency, and the focus of the campaign. Accordingly, we would like to illustrate the widely varied ways planned giving can help campaigns reach their goals by looking at four successful examples from our own recent experience.

<u>Example #1: The Classic Campaign at a Liberal Arts College</u>

Like many such institutions, this first tier liberal arts college has broad and expanding needs, covering everything from building a new science center to increasing endowment focused on scholarships, faculty development, and program support. The campaign has been truly comprehensive and the projects multi-faceted. The needs were both immediate and long-term.

In this instance, as in so many such campaigns, the college approached its most dedicated and philanthropic donors first, especially for outright gifts to fund the immediate capital needs of the campus. Donors responded generously and the campaign moved forward at first with great success. However, deferred gifts languished and the development staff believed, rightly, that many potential donors were being left out of the campaign because the college had not offered them a broad enough range of giving options. Accordingly, we worked with the staff to emphasize two types of deferred giving:

- charitable gift annuities (both current and deferred)
- a 50th reunion "special" campaign gift.

We helped the staff prepare a set of marketing materials that centered on real life stories of people—"regular people"-- associated with the college. We also undertook a multi-year series of small group sessions, with audiences ranging from regional campaign committees to reunion planning committees, in which we posed questions about various gift opportunities, explaining in the process how people could make gifts far larger than they expected they could. Based solely on stories and case studies, these group sessions generated a number of gifts from people in the audience, who then told their friends about the gifts they had made. The ripple effect of these sessions continues to build a planned giving program that now complements the outright giving program in ways that the college envisioned and that donors appreciate.

Example #2: A Campaign with a Focus on Current Non-Cash Gifts

Blessed with a wealthy and committed set of donors, a high quality independent school recently undertook an ambitious campaign designed to revamp the look of the campus and enhance the endowment in a relatively short period of time. Like many independent schools, this one has a donor base considerably younger on average than many charities. Alumni play a smaller role than they do with most institutions of higher education, and parents are a stronger set of leaders.

As we considered the role of planned giving in this campaign, we looked at a number of donors who had done quite well in the marketplace, had a high level of income but an even higher level of asset accumulation. Accordingly, many of these donors responded to the campaign with generous commitments of cash. But they left other, far more valuable assets untouched.

The development staff understood basic planned giving strategies, but no one on staff felt comfortable talking with the bevy of financial planners and commercial lawyers that surrounded many of the board members. Thus, one of our central roles in this campaign was to act as a philanthropic advisor. We did the following:

- We began a series of one-on-one conversations with members of the board, (and their advisors), often accompanied by a staff member. These meetings, offered as a part of the professional services of the development office, resulted in a series of increased gifts and a growing breadth of thinking within the school's most important philanthropic constituents. For many wealthy individuals, philanthropy often was separated from their financial and investment decisions. Real estate entrepreneurs had not considered gifts from their real estate holdings, and highly successful investment counselors had overlooked gifts of appreciated securities or partnership interests. Some of the potential gifts of non-cash assets were complicated, but even in cases in which discussions did not result in a gift of a non-cash asset, the broad discussion enhanced the credibility of the school and its development staff and sometimes resulted in a larger *cash* gift than the donor had initially anticipated.
- After meeting with the board members, we met with other major donors, and with major prospects, to discuss the broad range of giving options and how they might use some of the assets they had in their portfolios to enlarge the commitments they had already made. As a result, a number of gifts have doubled or more in size, donors as young as 40 have made seven-figure commitments, and the campaign has increased its goal by 50% over its initial projections. As deferred gifts also enter the picture, those projections may increase still further.
- Finally, we worked on a few selected deferred commitments, focusing on those individuals who could set a valuable example by their gifts. This focus was especially valuable as the school sought to bring its own current and retired faculty and staff into the campaign.

A few of the specific gifts that have come from these discussions include:

- $1 million gift from a retiring faculty member, who set up a Charitable Remainder Trust into which he will reinvest the income and which he will probably terminate early, based on the internal growth in the trust and on his ability to add to it in the future.. The trust has already attracted donors not only from among his former students but also from among other retired faculty.
- A series of gifts, ranging in the mid-five figures and potentially growing well into six figures, from a successful medical professional who had given minimally to the school in the past, have provided a challenge to a

major reunion class and made donations to the school an integral of this doctor's annual tax planning.

- A $1 million commitment from a young investment broker, using some of the special bonuses he receives from his business, increased his initial gift by ten-fold and set a standard for a new generation of donors, some of whom have now begun to reexamine the size and character of their own commitments to the campaign.

Example #3: A First Campaign with an Inexperienced Constituency and with No Staff

Every charity has to have a first campaign. And when a small charity realizes that it needs to undertake such an effort, its leaders can approach the project with much anxiety. Such was the case with a small church with which we work, a congregation comprising mostly lower middle income families, devoted to the church but without large cash assets on which to draw. None of the church leaders had professional development or fundraising experience and no one in its volunteer leadership had experience on campaign committees at other organizations. Faced with a $1 million repair and renovation bill and with an annual budget of only $200,000, the church leaders thought they had an impossible task ahead of them.

To their credit, the church leaders decided to seek professional guidance. One of our first tasks was to acquaint the campaign committee with the broad range of options, all of which were new them. Specifically, we held workshops on a variety of gifts, including

- CGAs,
- Interest-free loans,
- Appreciated securities, and
- Bequests (for the church's long-term health).

By coupling deferred gifts like CGAs and bequests with a series of interest-free loans, we were able to help the campaign committee provide cash immediately for the repairs. These loans were from parishioners who were unable to give up their assets, but who were able to give up the interest on their assets for a period of years,

One of the members of the committee, an 80-year-old woman who initially professed her reluctance to talk to anyone about money, found a CGA offered her more income than her current certificates of deposit and she was thus able to make a commitment far larger than she had thought she could. She became a vocal advocate among her friends in the church for these new ways of participating in the campaign. In short, after 18 months of work, the campaign committee members have raised roughly $850,000 and the church has been able to complete the urgent repairs.. The campaign committee, and through them the entire congregation, now see themselves in a new light. Rather than the trepidation with which they had approached the campaign at the beginning, they now meet with a sense of promise, of accomplishment, and of community.. Planned gifts opened those doors.

Example #4: A Campaign with No Lead Donors and Few Liquid Assets among the Key Prospects

Even though the retirement community conducting this campaign had a beautiful facility and a caring staff, the community had no way of providing the specialized care required for residents with severe memory loss. That gap in their program left them unable to provide the life-long continuing care that was an important part of their mission. Accordingly, they wanted to construct the facility they needed and to bring in a program that would not only provide a safe environment for their patients with Alzheimer's but would also create a setting in which families could visit and in which the physical design, the special care, and the programmatic innovations would mutually reinforce the "home-like" and resident-centered care.

Every resident responded positively to the case. But, other than seeking small annual gifts and selling tickets to special auctions, the one development staff member at the community had never asked the residents or their families for financial support of any magnitude. Many residents had sold their former homes and had divested themselves of other assets in order to make the very significant deposit required to enter the community. As a result, they had relatively few cash assets on which to draw. Thus in our feasibility study, we kept hearing "I support the idea, but I have no money to give to it; I have to think of my future needs." Furthermore, we were unable to find in the feasibility study an individual with the capability and inclination to make the traditional "lead gift," and we knew, going into the campaign, that the residents would have to make up for that open spot at the top of the classic campaign pyramid with a larger than normal set of modest commitments.

We decided to create a series of non-cash options. After a number of small group sessions, in which we asked the residents themselves what assets they had and how they might respond to various kinds of campaign appeals, we prepared a list of six ways people might participate in the campaign without using cash:

- Giving up right to receive their deposit back
- Transferring funds from an IRA to the retirement community
- Donating non-cash assets such as real estate
- Distributing part of a donor advised fund
- Using employee matching gifts from a former employer
- Offering a no-interest loan.

(See Appendix C for a complete list of these recommendations.)

By far the most popular method of giving to the campaign was for a resident to give up the right to receive his or her deposit back when he or she left the community (either by moving or by dying). The residents no longer relied on these deposits for their cash flow and, even though some of the amounts were quite substantial, the deposits were already—at least psychologically—out of the donors' portfolios. Giving those deposits, however, had a direct impact on families—especially children--who might stand to benefit in the long term. Accordingly, we began a series of conversations not only with donors themselves but also with their children about making a family gift of a deposit. And some of those children not only endorsed their parents' generosity but made additional gifts of their own.

Many residents at first expressed an interest in the "no-interest loan" option. We found, though, that without exception, the residents who at first asked about no-interest loans eventually gave either outright gifts or offered all or part of their entrance deposit to the campaign. This suggests to us (and this idea has been confirmed in several other instances) that initial discussions about a "safe" gift (such as a gift of interest rather than the asset itself) is an excellent way to open a conversation with a prospective donor, especially one who is used to supporting a charity with cash gifts. The conversations that can develop once a donor learns about planned gift options often lead to a much larger gift than the donor ever imagined him or herself being able to give.

Given the timing of this campaign (2007), and given that almost all of the residents were over 70 and a half, transferring funds from an IRA was also a popular method of giving to the campaign. It was a time-sensitive donation of course, as late 2006 and 2007 was the only time during which such a transfer was possible without tax consequences.

The campaign is now over 90% completed after only ten months, with over 75% of the commitments coming from planned gifts. Again, the spirit of success and accomplishment that this effort has engendered will pay dividends not only in the new memory support facility but also in the next fundraising projects that will surely follow in future years.

Conclusion

What can we conclude from these examples? First, planned giving comes in many forms. In all these cases, planned gifts came as a direct response to donor stories, to the assets donors were able to bring to the table, and to the experience and character of the organizations conducting the campaigns. No single model will provide the base of success for every campaign. But, if we can use planned giving in creative ways to respond to the specific opportunities of each campaign, we are far more likely to succeed than we would be otherwise.

APPENDIX A: PLANNED GIVING AT SELECTED LIBERAL ARTS COLLEGES

APPENDIX B: SUMMARY OF THE NCPG COUNTING AND REPORTING GUIDELINES

APPENDIX C: RECOMMENDATIONS FOR USING ASSETS OTHER THAN CASH IN A CAMPAIGN FOR A NEW ALZHEIMER'S UNIT AT A RETIREMENT COMMUNITY

PLANNED GIVING COMPARISONS AT 21 HIGH QUALITY LIBERAL ARTS COLLEGES

COLLEGE	PERCENTAGE OF TOTAL DOLLARS FROM BEQUESTS AND LIFE INCOME VEHICLES																
	FY00		FY01		FY02		FY03		FY04		FY05		FY06		PER YEAR AVERAGE OVER SEVEN YEARS		
	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	BEQ	IRR DEF	TOTAL
BRYN MAWR	50.46%	9.11%	32.84%	5.32%	43.47%	20.54%	45.15%	14.35%	44.11%	2.07%	28.06%	17.61%	32.73%	1.69%	40%	10%	50%
POMONA	42.55%	23.81%	7.28%	19.37%	54.85%	7.86%	37.15%	19.58%	35.54%	11.32%	21.46%	6.62%	10.49%	26.28%	30%	16%	46%
OBERLIN	21.66%	40.49%	22.50%	5.31%	10.91%	33.74%	46.98%	13.18%	25.21%	2.89%	26.37%	5.19%	24.70%	3.69%	25%	15%	40%
MT HOLYOKE	23.10%	21.68%	19.20%	15.15%	17.65%	6.84%	28.67%	8.73%	44.92%	3.65%	38.05%	2.88%	25.42%	8.91%	28%	10%	38%
WILLIAMS	2.13%	38.16%	4.59%	45.94%	43.73%	6.12%	6.10%	43.30%	20.33%	11.76%	8.08%	4.07%	7.11%	2.64%	13%	22%	35%
GRINNELL	25.06%	1.12%	68.26%	4.58%	13.36%	0.74%	16.47%	38.36%	22.99%	3.70%	31.62%	1.48%	11.19%	0.49%	27%	7%	34%
WELLESLEY	22.69%	20.18%	10.28%	8.40%	19.06%	10.20%	20.80%	12.19%	19.32%	4.86%	40.96%	1.63%	25.56%	4.31%	23%	9%	32%
SMITH	23.60%	7.62%	18.08%	8.45%	22.73%	8.33%	17.98%	11.98%	20.57%	25.21%	19.46%	7.39%	18.75%	1.93%	20%	10%	30%
BATES	4.12%	40.48%	5.40%	14.38%	10.84%	28.19%	5.15%	21.60%	11.72%	18.66%	18.21%	5.70%	5.89%	13.31%	9%	20%	29%
CARLETON	29.39%	15.09%	22.59%	13.69%	30.70%	7.14%	18.69%	6.74%	9.47%	7.64%	8.73%	4.93%	6.48%	12.44%	18%	10%	28%
SWARTHMORE	21.29%	15.67%	14.61%	3.67%	19.76%	6.00%	11.09%	14.65%	26.36%	1.23%	19.18%	7.17%	6.92%	2.69%	19%	7%	27%
VASSAR	10.81%	14.29%	10.97%	7.59%	30.33%	1.66%	28.90%	5.85%	24.92%	0.82%	20.38%	1.73%	25.68%	2.89%	22%	5%	27%
AMHERST	3.68%	28.01%	50.49%	38.21%	11.41%	11.81%	6.37%	11.31%	12.65%	1.37%	3.81%	6.62%	8.57%	6.92%	11%	15%	26%
HAMILTON	4.60%	8.78%	8.36%	14.02%	7.75%	31.94%	19.67%	7.48%	19.26%	0.20%	26.84%	2.86%	21.97%	6.31%	15%	10%	25%
COLGATE	19.03%	3.40%	11.30%	11.30%	14.07%	18.98%	17.78%	28.04%	13.69%	1.90%	19.10%	1.49%	5.19%	1.53%	14%	10%	24%
TRINITY (CT)	8.57%	18.82%	8.79%	3.23%	51.95%	0.34%	46.77%	1.21%	2.27%	0.90%	1.18%	1.40%	2.53%	1.61%	18%	4%	22%
BOWDOIN	4.51%	3.77%	14.89%	9.28%	32.56%	7.72%	9.38%	15.30%	14.58%	5.23%	13.32%	7.79%	6.53%	1.63%	14%	7%	21%
MIDDLEBURY	2.95%	8.18%	10.41%	18.68%	16.74%	6.00%	5.86%	8.10%	10.61%	4.86%	6.19%	1.49%	4.89%	0.79%	8%	7%	15%
COLBY	8.46%	8.88%	4.29%	7.62%	17.30%	4.63%	5.91%	2.78%	7.24%	3.70%	10.55%	1.09%	14.36%	2.28%	10%	4%	14%
DAVIDSON	3.87%	25.81%	7.10%	10.84%	15.48%	8.19%	7.01%	5.45%	1.99%	0.72%	2.99%	1.25%	1.38%	2.90%	6%	8%	14%
WESLEYAN	2.87%	3.98%	8.55%	12.19%	16.57%	3.44%	9.12%	2.21%	3.38%	2.27%	1.77%	5.23%	5.41%	0.54%	7%	4%	11%
AVERAGE	**16.12%**	**17.09%**	**16.17%**	**13.13%**	**23.87%**	**10.96%**	**19.58%**	**13.84%**	**18.24%**	**5.47%**	**17.40%**	**4.56%**	**13.18%**	**5.04%**	**18%**	**10%**	**28%**

Source: CAE Annual Reports

National Committee on Planned Giving®

Executive Summary: Guidelines for Reporting and Counting Charitable Gifts

2nd edition

Introduction

The full text of this revised and expanded edition of the NCPG Guidelines for Reporting and Counting Charitable Gifts will be available on the web in PDF format at:

www.ncpg.org/ethics_standards/NCPG%20counting%20guidelines.pdf

Recommendations

Fundraising campaigns of whatever duration will be better structured, clearer in their expectations, more transparent in their reporting and more truly comparable among organizations if they begin with three complementary goals:

1. **Category A: An outright goal** for gifts that are usable or will become usable for institutional purposes during the goal-defined campaign period (whether one or more years).
2. **Category B: An irrevocable deferred gift goal** for gifts committed during the goal-defined campaign period, but that may become usable by the organization at some point after the end of the period.
3. **Category C: A revocable deferred gift goal** for gifts solicited and committed during the goal-defined campaign period, but in which the donor retains the right to change the commitment and/or beneficiary.

These three categories should guide *both* the goals charitable organizations set at the beginning of the period, and the reporting of results during the period. In this way, organi-zations can measure results against aspirations, and can articulate clearly and definitively that all three types of gift commitments are crucial to achieving charitable mission. By setting clear goals in each of these categories from the beginning, organizations can move more directly to conversations with donors about potential gifts to each of the three complementary goals. The "three-tiered" ask becomes a natural part of the fundraising effort.

Charities should report progress toward these goals using **face value data**. Because these guidelines focus on reporting and not valuation, the specifics of each gift, like the age of the donor or the payout rate from a life income arrangement, are not relevant factors. Charities should report the numbers as a record of activity. So long as charities associate the reported numbers with the comparable goal or category of activity, there should be no confusion about the meaning of the data.

By establishing three goals, confusion about counting will diminish, staff and volunteers alike will have a clearer sense of their focus, and reports will not attempt to mix gifts that are intrinsically difficult to combine into a single accurately reportable number. These guidelines specifically do not offer a method-ology that purports to compare commitments from different categories that are inherently different in character. Categorical goals reflect, much better than a single goal, the true nature of annual fundraising efforts and multi-year campaigns as they currently exist.

"Counting" is the process of comparing fundraising results to a set of goals, and in that context, charities should count a particular gift only once. If a gift changes character (e.g., is made irrevocable or matures to cash distribution) ***during the goal-defined campaign period***, that change will be reflected by moving the gift amount from one category to another.

If a gift changes character *from one goal-defined campaign period to another* it should not be counted again when it matures as a new gift. For example, abequest commitment that has been counted toward the goal for revocable deferred gifts in one campaign should not be counted again when it matures as a new gift in the outright category during a later campaign. These guidelines do allow organizations to "report" the maturation of commitments that have been counted toward goals for a previous campaign. These are not treated as *new* gifts, but are reported separately to articulate the total impact of the development effort on the organization.

Practical Considerations

These guidelines enable organizations to count and report *ALL* gifts and commitments.
A complete fundraising operation focuses offers many options to donors, including irrevocable outright and deferred gifts. The only way to recognize and encourage such gifts is to set goals and report progress toward those goals. All gifts should be part of any campaign and all should, therefore, be reported. This is true whether the organization is looking at an annual fundraising plan or a multi-year campaign.

These guidelines improve the ability to report clearly the results of fundraising activity.
One of the most difficult tasks for development offices in recent years has been to report results clearly to boards, to others within the organization and to the public. By trying to force all development activity into a single number, fundraisers have faced a challenge of credibility by either oversimplifying their activities or creating layers of complexity that look to many like obfuscation. These guidelines will enable charities to articulate clearly what resources are available in what timeframes and thus eliminate the increasing confusion that clouds a uninumeric system of reporting.

These guidelines establish a method of comparability among nonprofits.
"Counting" is an external process that should enable comparability across institutional lines. A straight-forward focus on reporting, making sure that the results are categorized appropriately, achieves comparability by setting a structure and multiple goals at the beginning of the process, so it is easy to see how many annuities were written, at what face value this year, as opposed to last, or as opposed to other organizations.

These guidelines acknowledge the perspective of the donor.
Most donors focus more on the dollar value of their gift at the time they make it, rather than on the ultimate net present value to the charity. All gifts, revocable and irrevocable, current and deferred, should, therefore, be reported.

These guidelines aid charities in establishing public goals for fundraising, and provide the maximum opportunity for charities to offer giving options to donors.
Many charities currently employ what has become known as the "triple ask" in their regular interaction with major donors. With these guidelines, the "triple ask" becomes part of the charity's regular appeal. Donors are less likely to feel harassed by multiple appeals, and more likely to understand the ways in which these three methods of giving complement rather than compete with one another.

These guidelines will report a gift only once as a commitment to a specific goal-defined campaign. Organizations may wish to report the maturation of commitments counted in a previous campaign, not as new gifts, but rather to articulate the total impact of the development effort on the organization.
We all recognize that gifts sometimes come to a charity through a series of steps: bequest intention to matured distribution or charitable trust to trust maturation, etc. The report of activity should reflect each gift only once in a given goal-definied campaign. With these guidelines, charities will convey all the information about the ways development activity affects the financial state (both present and future) of the institution without appearing to count the same gift twice.

Definitions

Counting and Reporting: Counting and reporting are arithmetic activities. Counting is the numeric summary of activity, results and progress toward goals. Reporting is the process of conveying to a lay audience clearly and transparently what has happened during a specific timeframe.

Accounting: Accounting is a process of keeping financial books based on a set of generally accepted guidelines and principles, in order to present a fair, comparable and understandable picture of an organization's financial state at any given time.

Valuation: Valuation is an assessment of the actual value of an item to the person or organization that possesses it. Value may be determined by any number of methods and may reflect net present value, the future purchasing value, or even a subjective value based on non-financial considerations, such as the impact on marketing or the ability of a specific gift to attract others in its wake.

Crediting: Crediting is institution-specific and represents the way each organization grants recognition to its donors. It is up to each institution to set its own standards and requirements for documenting commitments. For example, some organizations require written confirmation of a bequest provision while others rely solely on a donor's verbal commitment. Such recognition need not stem from any of the factors of counting and reporting, accounting or valuation, although a given organization may use any of these calculations as the basis of its donor recognition policies.

Endorsements

These guidelines are endorsed by the following organizations. Additional endorsements will be listed in the online edition of the Guidelines. If your organization would like to formally endorse the Guidelines, please contact Barbara Yeager.

Association of Philanthropic Counsel (www.apcinc.org)

National Capital Campaign Counting Guidelines Committee (gdgearh@uark.edu)

To learn more

If you have questions or comments about these guidelines, please contact:

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CREATIVE OPTIONS FOR GIVING TO THE CAMPAIGN

1. Non-cash assets: Although most people think about giving a gift to a charity by writing a check some people could give more if they gave non-cash assets, such as real estate and closely held business interests.

2 IRA assets: The August, 2006 Pension Protection Act (PPA) allows those people aged 70 and a half and over to give up to $100,000 this year (2007 only) from an IRA transfer to the campaign. For those who must withdraw a certain amount each year and then pay taxes on that amount, this new Act will allow them to transfer the money directly to the community without paying taxes on their distribution.

3. Entrance deposit: Residents of the community have the option, for this campaign, to give all or part of their entrance deposit to this project. Such a gift will allow the community to begin construction and will also give the donor a tax deduction.

4. Distributions from Donor Advised Funds: Those people who have already given to charity through a Donor Advised Fund might wish to direct all or some of their 2007 distributions to the community.

5. **A GE Match**: Those people who were employed by General Electric (or who were married to an employee) have an opportunity to have their gift to the campaign matched (up to $5,000).

Legal Fiduciary Investment Management Requirements Every Nonprofit Needs to Be Aware of, Including the New 2006 UPMIFA Act

Presented by:

Richard P. Triolo J.D.
Senior Vice President
Allianz Global Investors
San Rafael, CA

28th Conference on Gift Annuities
Thursday, April 3, 2008

Fiduciary Investment Management Requirements under The Tax Reform Act of 1969, UMIFA, ERISA, UPIA, UPAIA, UTC, and UPMIFA

Richard P. Triolo, J.D.

Scope of Presentation

- History of Fiduciary Responsibilities
- Who is a Fiduciary Under Which Act?
- What are your responsibilities as a Fiduciary?
- How can you best manage those responsibilities?

Current Landscape

- Senate Finance Committee - June 2004
- Senator Charles Grassley – Former Chairman
- "Today the Finance Committee considers a very serious matter-ensuring that charities keep their trust with the American people. We will hear testimony today that is troubling. Testimony…that far too many charities have broken the covenant between taxpayers and nonprofits – that charities are to benefit the public good, not fill the pockets of private individuals."

Current Landscape

- Mark W. Everson, Commissioner IRS
- "As I will discuss, there are abuses of charities that rely on the tax advantages conferred by the deductibility of contributions to those organizations…If these abuses are left unchecked, I believe there is the risk that Americans not only will loose faith in and reduce support for charitable organizations, but that the integrity of our tax system also will be compromised."

Current Landscape

- 2005 IRS Budget - $10.6 B
- $490M Increase - $300M Enforcement
- 2005 - 17% Increase in Examination of Non Profits
- IRS Announces Audits of 2000 Non Profits as to Fairness of Executive Compensation

Current Landscape

- California Non Profit Integrity Act of 2004 - SB 1262 - Effective Jan.1,2005
- $2M Gross Revenue – Requires

- Independent Audit
- Independent Audit Committee
- Compensation Review of CEO and CFO

- Tax Reform Act of 1969
- UMIFA 1972
- ERISA 1974
- UPIA 1994
- UPAIA 1997
- UTC 2000
- UPMIFA 2006

Fiduciary History

- Based on English Common Law
- 1830 Harvard College vs. Amory (1830) (Mass) 9 Pick . 446
- "All that can be required of a trustee... is that he conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested."

Fiduciary History

- Prudent Person Standard
- Adopted in 1st, 2nd, & 3rd Restatements of the Law of Trusts (1935, 1959, 1992) American Law Institute

Fiduciary History

- Tax Reform Act of 1969
- Minimum Distribution Requirements
- Excise Taxes
- Jeopardy Investments

Fiduciary History

- UMIFA 1972
- Applies to Most 501c3 Charitable Organizations
- Applies to Public Charities, Private Operating and Non Operating Foundations Structured as a Corporation
- Endowment Funds – Donor Restricted – Cannot be Spent in the Current Year

Fiduciary History

- UMIFA does not apply to a 501c3 Structured as a Trust if Bank, Corporate or Individual Trustee - UPIA
- Applies to Trust only if Non Profit is acting as Trustee

Fiduciary History

- ERISA 1974 - Pension Trusts
- Absorbs Trust Investment Law Through the Prudence Standard of { 404 (a) (1) (B), 29 U.S.C. { 1104(a)
- Firestone Tire & Rubber Co. Vs. Bruch (1989) (Penn) 489 U.S. 101
- ERISA's legislative history confirms that the act makes applicable to ERISA fiduciaries certain principals developed in the law of trusts

Fiduciary History

- UPIA 1994
- Although the UPIA by its terms applies to Trusts and not to Charitable Corporations, the standards of the act can be expected to inform the investment responsibilities of directors and officers of charitable corporations.

Fiduciary History

- UPMIFA 2006 - Uniform Prudent Management of Institutional Funds Act
- Standards on Investments are Merging for Non Profit Corporations (UMIFA) and Trusts (UPIA)

UMIFA

- Uniform Law Commissioners 1972
- Adopted in 46 States & District of Columbia
- Purpose - To Establish Guidelines for the Management of Investments By Non Profit Institutions
- Default Act – UPMIFA No Change

Public Charities

- 501c3 - Activity or Support Test
- Activity- Medical, Educational or Religious
- Support – More than 1/3 from General Public And
- Support – Less than 1/3 from Investment Income

Public Charities

- No Minimum Distribution Requirements
- No Excise Tax on Investment Income
- Higher Tax Deductions for Contributions

Private Operating Foundations

- Libraries or Museums
- Funds used for their own activities
- Income Test <u>and</u> either Asset, Endowment or Support Test <u>Annually</u>

Private Operating Foundations

- Minimum Distribution 3 1/3%
- No Excise Tax on Investment Income
- Higher Tax Deductions for Contributions

Distributions

Private Non Operating Foundations

- Funded by Single Source, Individual or Family
- Funds Used to Support Other Qualified Charitable Organizations

Private Non Operating Foundations

- Minimum Distribution Requirement 5%
- Excise Tax on Investment Income
- Lower Tax Deductions for Contributions

Tax Deductions for Contributions

- Public Charity <u>and</u> Operating Foundations
- Cash - Up to 50% of AGI
- Long Term Capital Gain Assets
  Public traded stock, closely held stock or real estate
- Up to 30% of AGI <u>at Current Fair Market Value</u>
- 5 Year Carry Forward

Tax Deductions for Contributions

- Private <u>Non</u> Operating Foundations
- Cash up to 30% of AGI
- Publicly traded appreciated stock - up to 20% of AGI at fair market value
- Closely held stock & real estate - up to 20% of AGI at adjusted cost basis
- 5 Year Carry Forward

UMIFA - Enforcement

- Fiduciaries Have Personal Liability
  Named trustees - Highest Standard
  Officers & Directors - Willful Disregard
- Common Law - State Attorney General
- Federal Statutes – IRS
- UPMIFA – No Change

UMIFA - Key Provisions

- Permissible Investments
- Total Return
- Delegation of Authority
- Releasing Restrictions
- Standard of Care

Permissible Investments

- Any Real or Personal Property Deemed Advisable by the Board <u>Whether or Not it Produces a Current Return</u>
- Stocks, Bonds, Mortgages, and other Securities
- UPMIFA – No Change
- Jeopardy Investments

Jeopardy Investments

- IRC { 4944 Private Foundations
- Investments that jeopardize charitable purposes
- Each investment relative to whole portfolio
- Following are closely scrutinized:
  - Trading on Margin
  - Commodity Futures
  - Working interests in oil and gas wells
  - Puts, calls, straddles
  - Warrants & selling short

  Reg. { 53.4944-1(a) (2) (i)

Jeopardy Investments

- 1998-Expanded to include
- Junk Bonds
- Risk Arbitrage
- Hedge Funds
- Derivatives
- Distressed Real Estate
- Emerging Markets Stocks

Jeopardy Investments

- **Initial Tax 5%**
- **Additional Tax 25% if investment not removed**
- **Penalties**
- **Legal opinion <u>or</u> reliance on investment counsel may excuse liability**
  Reg. { 53.4944 1(b)(2)(i)

Total Return

- Net Appreciation May be Spent, However
- Trustees Must Consider:
- Long & Short Term Needs of the Institution
- Expected Total Return
- Subject to Historic Value – for Endowment Funds
  UPMIFA – No Historic Value Restriction

Historic Dollar Value

- UPMIFA - Does Not Apply
- Default Act – Subject to Gift Instrument and Donor Intent
- If Donor Says You can only Spend "X" That Controls

UPMIFA Historic Dollar Value

- If Donor says you can only spend "Income"
- The Charity can Spend as much as they feel is:
- "Prudent for the Uses, Benefits, Purposes, and Duration for which the Endowment Fund is Established"
- Current Expenditures - Permanent Duration

Minimum Distribution Requirements

- **Do not apply to public charities**
- **Do apply to operating foundations**
- **Do apply to private non-operating foundations**

Minimum Distribution Requirements

- Minimum investment return which is 5% of fair market value of <u>all</u> assets of foundations (other than those used directly in carrying out the foundations exempt purpose) less acquisition indebtedness

- Less any excise taxes paid 2% (or 1% if distributions are in excess of required amount) on net investment income

Minimum Distribution Requirements

- 5 Year Carry Forward on Excess Distributions
- Newly Established Foundations
- 5 year leeway to make set aside distributions

Tax on Failure to Distribute Income

1986 Tax Code { 34,040 Code Section 4942

- 1 year to distribute income
- 15% tax on amount undistributed by private foundations
- 100% tax if still not distributed by end of correction period (usually 90 days) or 2nd year

Delegation of Authority

- The Act Provides that a Board May Delegate Day to Day Investment Management Responsibilities
- Duty to Delegate if no Investment Expertise
- Board Must Evaluate & Monitor Investment Managers – UPMIFA No Change

Releasing Restrictions – UMIFA

- Restrictions May Become Outdated, Wasteful or Unworkable
- Obtain Permission of the Donor
- Petition the Court

Modification of Restrictions - UPMIFA

- If Restriction on Investment or Use becomes Impracticable or Wasteful
- Modify Consistent with Purposes in Gift Instrument (Cy Pres) – As Close as Possible to Original Donor Intent
- Notify Attorney General and Obtain Court Approval

UMIFA - Standard of Care

- Ordinary Business Person (Higher Standard)
- Comparable to a Business Director rather than a Private Trustee

Standard of Care ERISA

- Prudent Expert Standard
  - ERISA { 404A
  - Martin vs. Tower Ins. CO., Inc.
  - (1984) (WIS) 119 Wis. 2d 48
  - Prudent + Experienced Man Rule

Standard of Care
UPIA

- The development of M.P.T. was the primary force in eroding the prudent person standard for investment functions
- Prudent Investor Standard - familiar with M.P.T.
- Considering Certain Economic and other Factors

Standard of Care for Investments

- UPMIFA – Merges the Standards
- UPMIFA – "In good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances"

Factors to Consider

- General Economic Conditions
- Inflation or Deflation
- Tax Consequences
- Role of Each Investment in Overall Portfolio
- Expected Total return
- Other Resources
- Needs of Institution to make Distributions and Preserve Capital

More Factors to Consider

- Donor Intent – Always Controls
- Reasonable Costs
- Overall Investment Strategy
- Duty to Diversify

Optional Section # 1

- What is Prudent to Spend?
- Rebuttable Presumption of Imprudence
- 7% of Fund Value, Computed over a Rolling Three Year Period

Arguments in Favor

- Charities want Guidelines
- Attorneys General want Guidelines
- Needed to Protect Donor Intent
- Would Limit Overspending
- Already in Statues in MA,NM,NH

Arguments Against

- Could be viewed as a Safe Harbor and Lead to Overspending
- Does not take into account Economic Conditions
- Does not provide for Differences among Charities

Optional Section # 2

- Endowment Funds < $2,000,000
- If Spending will take Funds Below Historic Dollar Value
- Charity Must Notify Attorney General

UPMIFA

- Approved by Uniform Law Commission- July, 2006
- Being Considered by State Legislatures this Session
- Retroactive Application

UPMIFA

- Copy of Act with Comments:
  www.nccusl.org
  Link to Final Acts

Summary

- ❖ Take Refuge in the Process

Successful Solicitation: The Art of Negotiation

Presented by:

Dyan Sublett
Executive Vice President, Financial Development
YMCA of Metropolitan Los Angeles
Los Angeles, CA

28th Conference on Gift Annuities
Thursday, April 3, 2008

THE ART OF NEGOTIATION

DYAN SUBLETT

i. WHERE DOES NEGOTIATION OCCUR?

Everywhere: Negotiation is used every day to resolve differences and allocate resources

ii. WHAT HAPPENS WHEN YOU DON'T NEGOTIATE?

A. Others set terms of agreement
B. Your response possibilities are limited and extreme: Yes or No
C. You may affect outcomes long-term

OR NEGOTIATE IRRATIONALLY?

A. Can't arrive at best agreement
B. Decisions could be catastrophic for you and others

iii. HOW DOES NEGOTIATION RELATE TO OUR WORK?

Helps us:

A. Understand and structure problems in donor motivation or solicitation
B. Identify the information we need about a donor and our project, and process it properly
C. Frame the situation (cultivation & solicitation)
D. Evaluate alternatives, either to the ask approach or to the timetable

iv. COMMON MISTAKES MADE IN NEGOTIATION

A. Irrationally escalating your commitment to an initial course of action, even when it is no longer the most beneficial choice
   i. Allocation of resources in ways that justify previous choices, whether or not they now appear valid
   ii. Confirmation trap

B. Assuming your gain must come at the expense of the other party, and missing opportunities for trade-offs that benefit both sides

i. Distributive negotiation: Only one issue at stake; one person gains at the expense of the other
ii. Integrative negotiation: Multiple issues, each party values the issues differently

The win-lose assumption in the distributive model is the most critical barrier to creative problem solving

C. Anchoring your judgments upon irrelevant information, such as an initial offer
   i. The value of your object is an anchor. Anchoring often inhibits adjustment and leads to irrational negotiation
   ii. Consider using a goal as an anchor

D. Being overly affected by the way information is presented to you
   i. The way in which a proposal is framed can dramatically alter its perceived value
   ii. If a proposal is presented in terms of a gain, a positive outcome is far more likely

E. Relying too much on readily available information, while ignoring more relevant data
   i. Habit of evaluation based upon easily available facts while ignoring others
   ii. Failure to distinguish between what's emotionally familiar from what's reliable and relevant

F. Failing to consider what you can learn by focusing on the other side's perspective
   i. Understanding the donor's perspective makes us better able to predict the donor's behavior

G. Being overconfident about attaining outcomes that favor you
   i. Most likely to occur when your knowledge is limited
   ii. When people hold certain beliefs they tend to ignore information that contradicts them

v. SOCIAL INFLUENCE BEHAVIORS

Social Influence: The use of behavioral strategies to shape others' perceptions, values, moods, attitudes, beliefs, goals

A. Verbal Behavior
   i. Evocative, emotional imagery
   ii. Exploit "pre-conscious" associations

b. Verbal Strategies
    i. Strategic framing
    ii. Strategic re-framing

c. Effective Influence Tactics
    i. Feather Ruffling
    ii. Humor
    iii. Perceptual Contrast
    iv. Identity Association
    v. Hanging a Lantern on your Problem
    vi. Moral High Ground

d. Influence Factors for Success
    i. Create productive settings for influence
    ii. Frame
    iii. Be conscious of—and use to your advantage—non-verbal behavior
    iv. Use language rich in imagery

"People may be persuaded by reason,..but they are moved by emotions."
Lyndon Johnson

"Johnson studied, analyzed, catalogued, and remembered the strengths and the weaknesses, the likes and dislikes of fellow politicians as some men do stock prices, batting averages, and musical compositions. He knew who drank Scotch and who bourbon, whose wife was sick, who needed new post offices,...who was in trouble with organized labor,...and who owed him for a past favor."
Heath (1975, p.179)

"It may seem all the more surprising that a person with Johnson's towering ego should have climbed to such heights by studying the inner as well as the outer needs of others. Yet it was his willingness to focus on other people and their concerns, no matter how small, that contributed to the near total communication or at least access that Johnson achieved with those he sought to influence."
Matthews (1988, p.27)

VI. QUESTIONS FOR AVOIDING COMMON MISTAKES

A. Are you pursuing a solicitation strategy only to justify an earlier decision?
B. Are you considering several issues and elements of the proposal rather than just a yes or no to a question?
C. Is the initial solicitation target irrationally affecting you?

D. Is there another frame that would put a different perspective on the discussion?
E. Are you being affected by readily available information, and ignoring other less accessible facts?
F. Are you placing too much confidence in your own judgment, or your relationship with your donor?

VII. SUMMARY

For Success:

A. Create a problem-solving dialogue (versus a bargaining relationship)
B. Assess where your trade-offs exist
C. Assess what you will do if you don't reach an agreement
D. Assess the true issues—concede on less important issues to gain on more important ones
E. Think like your donor (your strongest competitive advantage)
F. Do not believe that a solicitation is a question and answer proposition

NEGOTIATION ↓ **SOLICITATION** ↓

RELATIONSHIP

SOURCES

Max Bazerman and Margaret Neale. Negotiating Rationally. Simon and Schuster, 1992.

Rod Kramer. *"Exerting Effective Influence."* Standford University Graduate School of Business, 1997.

FURTHER READING

Warren Bennis. Organizing Genius. Simon and Schuster, 1997.

Max DePree. Leadership is an Art. Dell Publishing, 1989.

Roger Fisher and William Ury. Getting to Yes. Penguin Books, 1991.

eTapestry

On Demand Software – from eTapestry

eTAPESTRY IS DIFFERENT from traditional fundraising software you may be used to. It doesn't require you to install, maintain and update software, or backup your data. It doesn't require new hardware, additional disk space, or specific operating systems. It doesn't require days of training, expertise in database operations or a multi-volume user guide to operate. It doesn't even require you to be at the office to use.

What eTapestry does is even more impressive. In its simplest form, eTapestry is software you run over the Internet, allowing you to access your data from anywhere. It tracks donors, prospects, members, or alumni while managing gifts, pledges and payments. In its full form, eTapestry adds advanced executive analysis, contact management, advanced email, ecommerce, event registration, and complete website development.

eTapestry can even be accessed via your mobile devices such as a PDA, Blackberry, or other Smart-Phone.

Because eTapestry is web-based, all upgrades, maintenance, backups, and data security are managed and monitored for you. It's also easy to learn and use, meaning you can focus on your mission, and not your software. Best of all, it will save you money – year after year – compared to traditional software.

One Stop Shop

One of the great challenges faced by nonprofits is the successful implementation of the key tools needed for their fundraising programs – a donor database, an attractive website, online giving /ecommerce, and advanced email capabilities. Even more difficult is integrating them to work together and share data.

At eTapestry, we can help you build, maintain, and integrate all of these tools. No conflicting technologies and no redundant data. Best of all, you can add services when you need them, expanding your options as your fundraising program grows.

Cost Effective – Today and Tomorrow

It sounds too good to be true. eTapestry can do more but costs less than other software applications, not just upfront, but in cost savings year after year. Our goal is to give every nonprofit organization the opportunity to use the latest and most efficient tools for fundraising – that's why it's free to nonprofits with less than 500 records. Even if you have thousands of records, eTapestry usually costs less than the annual maintenance fees associated with typical in-house systems.

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Bequests: A Fresh Take on an Old Staple

Presented by:

Grant H. Whitney
Senior Associate Director of Gift Planning
Harvard University
Cambridge, MA

28th Conference on Gift Annuities
Thursday, April 3, 2008

Bequests: A Fresh Take on an Old Staple

Three Segments of Presentation

- The Old Staple: Common Attributes of Successful Bequest Programs
- Fresh Take: Enforceable Pledges
- Fresh Take: The Potential of Donor Advised Funds

The Old Staple: Takeaways

- A general sense of where established programs are directing their energies regardless of size, regardless of mission
- Something that you can use, or confirm your experience
- If starting new or starting afresh, a sense of where to invest

Why Focus on Legacy Gifts?

- Defined: Bequests technically defined as gift by will. Legacy Gifts are a euphemism for gifts that come into being upon the death/passing/expiration of the donor.
    - Examples of Legacy Gifts: revocable trust, retirement plan, life insurance policy all triggered by death.

- Current landscape
- Opportunity: ground game
- Opportunity : Transformational

Bequests by Men

Gender	*Amount*	*Cumulative Current Gift*
m	$18,001,414	$4,000
m	$3,657,300	
m	$3,109,349	$1,565
m	$2,101,549	$150
m	$1,867,153	$160
m	$1,257,800	$100
m	$1,185,000	$460,525
m	$857,309	$50
m	$838,647	$800
m	$838,096	
m	$801,844	
m	$685,397	$202,235
m	$611,139	$25,000
m	$574,678	$3,150
m	$153,634	

Bequests by Women

Gender	*Amount*	*Cumulative Current Gifts*
f	$7,674,736	$2,065
f	$5,409,765	
f	$4,360,532	
f	$3,375,503	$1,700
f	$3,174,256	$13,600
f	$2,444,867	$25
	$2,297,085	$368,826
f	$2,093,475	
f	$1,965,590	
	$1,484,406	
f	$1,135,000	
f	$1,131,411	
f	$1,114,059	
f	$920,868	$7,680
f	$871,616	$1,200

Organizational Culture: Harbinger for Success or Frustration

- Pragmatic concerns: Budget, staff etc.
- What is your constituency what are their demographics
- How does your organization's culture influence what works and what might not?
- Does the age of your organization influence the choice of techniques strategies?
- Does the age of the Development/fundraising effort make a difference?
- For your organization what is a realistic expectation?.
- What comes first the chicken or the egg? Or more specifically what comes first the budget to build a program or the bequest that transforms your organization?
- How and why do you need to break through the cash culture that all non-profit organizations face. If you are only focused on the day to day you will never break out of the cycle in the intermediate term and the longer term.

Attributes of Successful Programs: An Attempt at Quantification

- Online survey Planned Giving Group of New England (PGGNE)
- Survey themes:
    - *Tell me every technique your organization relies on?* -- **The kitchen sink questions**

- *What five strategies work best for <u>your</u> organization.* -- **Letterman's List**
  - For those top five how frequently are they put in front of your prospect database, your constituency each fiscal year (**frequency**);
  - How many years has your organization been using this technique year in and year out (**consistency**).
- *Bequests for the Long Haul: Starting from Scratch*-- **Hind sight is 20/20**

What Organizations Do Across Sectors

Most Common Picks

- ☐ Bequest Recognition Society
- ☐ Check off box -- AF Solicitation
- ☐ Web Site
- ☐ Organization's General Magazine
- ☐ Staff Visits

What Organizations Do: Most Successful Strategies

Top 5 Most Successful Strategies

- ☐ Bequest Recognition Society
- ☐ Check off Box
- ☐ Staff Visits
- ☐ Bequest Appeals
- ☐ Organization's General Newsletter

Most Successful Strategies: Frequency and Consistency

- For those top five how frequently are they put in front of your prospect database, your constituency each fiscal year (**frequency**);
- How many years has your organization been using this technique year in and year out (**consistency**).

Drill Down to Frequency and Consistency

- Bequest Recognition Society
- Check off Box
- Staff Visits
- Bequest Appeals
- Organization's General Newsletter/Magazine

Recap: Most Frequently Employed and Most Successful

Technique	Most Common Picks	Top Picks
Bequest Recognition Society	X	X
Check off box on Annual Fund Solicitation	X	X
Web Site	X	
Organization's General Newsletter/Magazine	X	X
Staff Visits	X	X
Bequest Appeals		X

Starting from Scratch: What Would You Do?

- Bequest Recognition Society
- Staff Visits
- Specialized Estate Planning PG Newsletter
- Check off Box
- Organization's General Newsletter/Magazine

Technique	Most Common Picks	Top Picks	"Investment" Picks
Bequest Recognition Society	X	X	X
Check off box	X	X	X
Web Site	X		
Organization's General Newsletter	X	X	X
Staff Visits	X	X	X
Bequest Appeals		X	
Estate Planning Newsletter			X

Fresh Take: Binding Enforceable Pledges

Q: How do you treat a donor who has given you $100,000 outright?
Q: How do you treat a donor who is leaving you a $100,000 testamentary gift?

Current Landscape: Revocability vs. Irrevocability

- Cases in the News
- Mission Accountibility
- Fiduciary Acountability FASB Rules/Auditing Rules
- Campaign Counting
- Recognition Purposes

When is a Commitment Enforceable?

- Different State Law Approaches
    - Traditional Contract Requirements - Offer, Acceptance, Consideration
    - Detrimental Reliance.

- Examples:
  - Pledge for specific purpose
  - Pledge that induces charity to spend money or incur obligations
  - Pledge that induces others to make contributions
- Public Policy. Some states enforce pledges purely as a matter of public policy
- Writing

Tax Aspects of an Enforceable Pledge

- Income Tax

  - No income tax deduction on the pledge itself.
  - Deduction when the payments are actually made. Rev. Rul. 55-410, 1955-1 C.B. 297; Rev. Rul. 64-240, 1964-2 C.B. 172.
  - Pledges do not create a debt for income tax purposes

- Gift and Estate Taxes

  - An enforceable charitable pledge creates a debt for federal gift tax purposes. Rev. Rul. 81-110, 1981-1 C.B. 479.
  - An enforceable pledge also creates a debt for federal estate tax purposes. Treas. Reg. §20.2053-5 and see Code Section 2055.
  - Conversely a non-legally binding pledge is not a debt under Code Section 2053.

- Excise Taxes.

  - An enforceable pledge is treated as a debt for federal excise tax purposes.

  - If the person making a pledge is a disqualified person with respect to a private foundation, and if the private foundation pays that person's pledge it is a prohibited act of self-dealing. Treas. Reg. § 53.4941(d)-2(f)(1).

    - To avoid this problem, the foundation can make the pledge. A disqualified person may guarantee a pledge that is made by the foundation without any excise tax issues. Or if an individual wants the flexibility to pay a pledge with foundation assets, the pledge might instead be structured as a non-binding gift-intention statement.

- An enforceable pledge can not be satisfied by a distribution from a donor-advised fund. Further, the Pension Protection Act of 2006, imposes an excise tax when an advisor recommends a distribution that results in more than an incidental benefit to the advisor, the donor or other family members.

How Must the Charity Treat a Pledge?

- FASB has required charities to book pledges in certain circumstances. Those rules become effective in the mid-1990s.
- Under SFAS No. 117, all unconditional pledges must be accrued as balance sheet assets at their current value (reflecting appropriate discounts for delayed payment).
- Under SFAS No. 116, all unconditional pledges must be recorded as revenue in the period the pledges are made, again on a discounted basis. In addition, bad debt reserves must be created to reflect that portion of such pledges that may not be paid.
- Conditional promises do not need to be recorded under either standard, until the condition is satisfied. The condition must specify a future and uncertain event on which the contribution depends.
- Similarly, if a pledge is not legally enforceable, it should not be recorded.

Combination Gifts: Outright Gift Coupled with a Binding Testamentary Commitment

- Williams College 25/250 plan
- Harvard Legacy Pledge
    - Initiated by Alumni Advocates
    - Reunion Setting
    - Driven by class credit
        - Gift Commitment of at least $50,000
        - 20% down payment
        - Pledge to be paid no later than death of surviving spouse

The Legacy Pledge: A New Giving Opportunity

Traditionally, Harvard College and Radcliffe have allowed payment of reunion pledges to extend only a few years from the date of the reunion. Now, classes in their 50th reunion and beyond will have the option of obtaining reunion credit for a longer-term pledge (extended to the end of the donor's life). This pledge would be paid in full through provisions in the donor's estate plan, to the extent that it is not paid during the donor's lifetime.

Members of the Harvard College and Radcliffe 50th reunion and older classes can qualify for this new "legacy pledge" option with a total commitment of $50,000 or more. At least 20 percent must be paid outright within three years of the pledge, either through cash or marketable securities. The balance must be secured with a signed, enforceable pledge agreement that will be binding against the donor's estate if the pledge is not paid in full during the donor's lifetime. The donor may pay the remaining pledge amount during his/her lifetime, or through a provision in his/her estate plan.

CASE EXAMPLE

John and Ann Harvard acknowledge that Harvard has played an important role in their personal and professional lives, and they have discussed making a gift of $20,000 to their reunion. They would like to make a larger gift but feel the need to hold as much as possible in reserve for their continued retirement needs.

With the "legacy pledge," they can make a commitment of as much as $100,000. John and Ann can make a gift of $20,000 in cash or securities to Harvard College or the Radcliffe Institute, payable over three years, and leave the balance of the pledge through their estate plans.

***Step 1:* John and Ann execute an irrevocable and binding pledge agreement for the total commitment of $100,000.** Harvard will provide John and Ann with the appropriate form for the pledge, which they should review with their own attorney or other adviser.

***Step 2:* John and Ann make a current outright gift of $20,000, at least 20 percent of the total commitment.** John and Ann may take up to three years to transfer this amount to Harvard. Cash or appreciated securities may be used to pay this part of the commitment. Normally, this current outright gift (and the pledge as a whole) will be directed for the unrestricted use of the College or Radcliffe. For restricted gifts, however, the current outright gift portion of the pledge must meet the minimum amount established for restricted gifts.

***Step 3:* They fulfill the balance, either by lifetime gifts or by estate plan provisions taking effect at their deaths.** All or any part of the remaining balance may be paid during John's and Ann's lifetimes. John and Ann also add appropriate language to their estate plans to ensure that any unpaid balance of the pledge will be fulfilled at the death of the survivor of them. For example, they may include bequests to Harvard College in their wills or other estate planning documents, or they may choose to designate the College as the beneficiary of a retirement plan and/or insurance policy to satisfy the pledge after they have both died. (If sufficient provisions are not made, the unpaid balance will be treated as a debt payable from their estates.)

***Step 4:* John and Ann receive reunion class credit for $100,000, the total of the outright gift and legacy pledge commitment.** To receive gift recognition, they send a copy of the beneficiary designation and/or the relevant portion of their estate planning documents to the Office of Gift Planning at the address on the reverse.

(continued on back)

"Don't you think it's time you started thinking about your legacy?"

For additional information, please contact:

Office of Gift Planning
124 Mount Auburn Street
Cambridge, MA 02138

Sarah M. Carothers
Peter K. Kimball
Anne T. Melvin
Grant H. Whitney

ogp@harvard.edu
(617) 496-3205
(800) VERITAS

SAMPLE BEQUEST CLAUSE

I give [Amount in Words] Dollars ($__________) OR [Amount in Words] Percent (_____%) of the residue of my estate OR that amount equal to the unpaid balance of my pledge dated ________ to the President and Fellows of Harvard College, in Cambridge, Massachusetts, a Massachusetts educational charitable corporation ("Harvard"), for the benefit of Harvard College (or the Radcliffe Institute) for its general purposes. The amount so distributable to Harvard shall be satisfied, to the extent possible, out of assets that constitute items of income in respect of a decedent for federal income tax purposes.

BENEFICIARY DESIGNATION

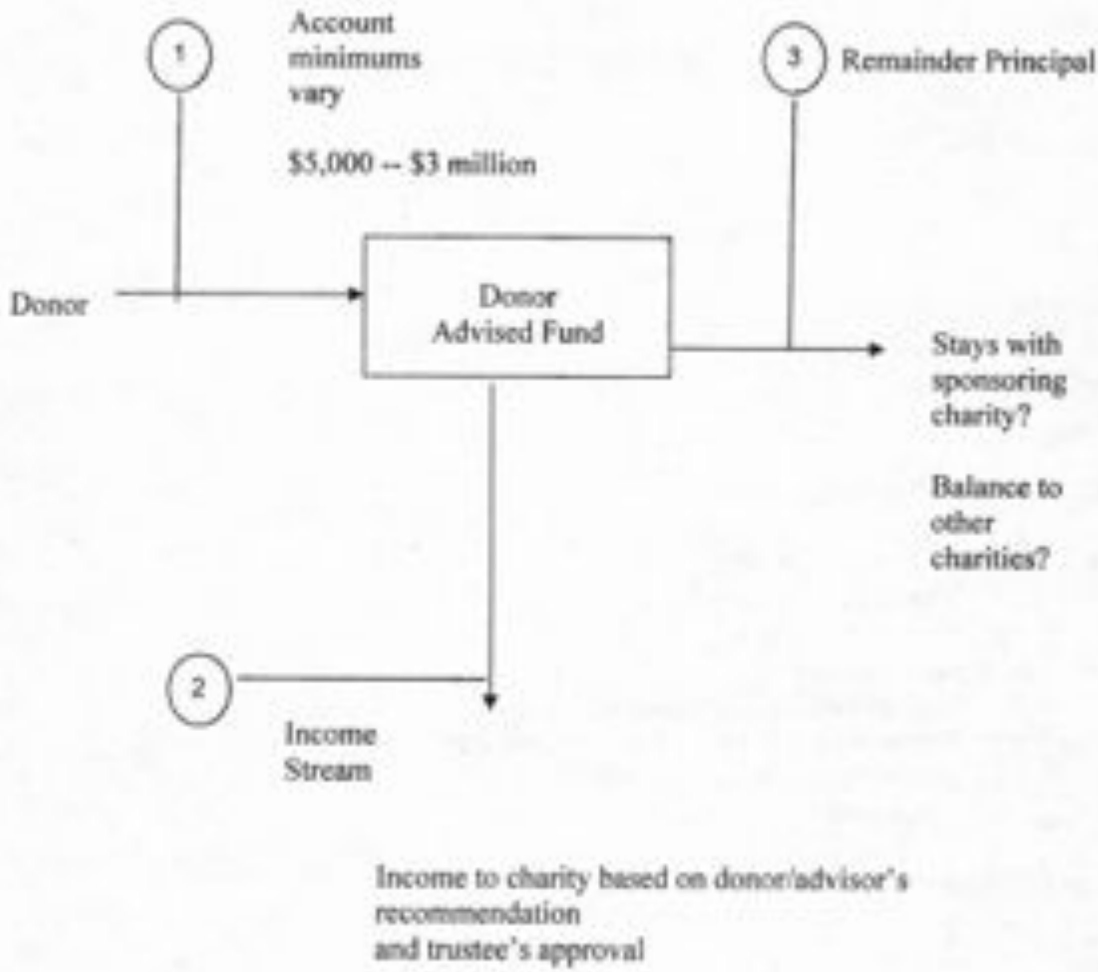
To the extent that the College or the Radcliffe Institute is named as the recipient of your IRA or qualified retirement plan, the assets of the plan should be eligible for the estate tax charitable deduction and should not be subject to any income tax at your death. Contact the plan administrator and request a beneficiary designation form.

SAMPLE LANGUAGE FOR IRAS AND QUALIFIED RETIREMENT PLANS

I hereby designate my spouse, [spouse full name], as the primary beneficiary of my interest in the account at my death, if he/she survives me. If my said spouse does not survive me, or if at his/her death after mine any amount remains of my interest in the account, or to the extent that my spouse survives me and disclaims all his/her interest in all or any portion of the account, I hereby designate the President and Fellows of Harvard College, in Cambridge, Massachusetts, a Massachusetts educational charitable corporation, as the beneficiary of my interest in the account, such interest to be used for the benefit of Harvard College (or the Radcliffe Institute) for its general purposes.

The information (including sample language) in this document is not offered as tax or legal advice. Any donors and potential donors should consult with a qualified attorney or other tax advisor regarding their own specific circumstances and the tax and estate considerations and consequences associated with the pledge structure described in this document.

Donor Advised Funds: Potential for "Bequest-like" Gifts



What is it?

- A separately identified fund owned <u>and</u> controlled by a sponsoring charitable organization;
- In which the donor or someone the donor appoints has advisory rights to make charitable distributions <u>as well</u> as the underlying investment of the fund. (PPA 2006).

Who would want one?

- Someone who wants to support charity
- May have a time table for charity to receive money. (no immediate distribution required)
- Centralized, streamlined investment, administration and distribution of gift assets

Tax Benefits to Donor

- Capital gains tax avoidance on transfer of appreciated property into fund
- Charitable deduction for full value of contribution
- Gift and Estate Tax deduction

DAF Basics

- Historical context
- Evolution – 1990's the rise of sponsored DAFs
- Status today

Relevance to Fundraising Programs

- Do you receive DAF gifts?
  - Tips for identification
  - Acknowledgement
- The bequest potential
  - Irrevocable charitable purpose
  - Opportunity to discuss charitable passions
  - Opportunity to build relationship
  - "Three peat" gift potential – one vehicle

Recap and Summary

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Best Practices in Charitable Gift Annuity Programs

Presented by:

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28th Conference on Gift Annuities
Thursday, April 3, 2008

Introduction

In 2004, The American Council on Gift Annuities (ACGA) conducted its third survey of charitable gift annuities and received responses from approximately 829 charities across the country.[1] Other information gathered during the survey indicates that over 4,000 organizations are offering gift annuities.[2] There are many more organizations offering charitable gift annuities than responded to the survey, so the gift annuity is an immensely popular way of making a gift to charity while retaining an income stream.

Most organizations offering charitable gift annuities are doing so in a responsible manner and to the great benefit of their donors and organizations, but gift annuities and the charities that offer them have faced a number of challenges in recent years. Between 2004 and 1999, which was when the last survey was conducted, the country experienced one of the worst bear markets in history.[3] This substantially decreased the value of many charities' gift annuity reserves and caused charities to focus on the financial risk they incur when issuing gift annuities. Not only was there risk in the financial markets, but a lawsuit in Texas that threatened to destroy the issuance of charitable gift annuities focused attention on the legal risks to institutions offering gift annuities.[4]

State regulators have increased their scrutiny of gift annuities and the organizations that issue them because of concerns over scams targeted at senior citizens by issuers more interested in financial gain than the charitable giving opportunity that gift annuities present. In 2002, The North American Securities Administrators Association (NASAA) issued a press release listing charitable gift annuities as one of its "Top Ten Scams, Schemes & Scandals" of the year.[5] The ACGA responded and it appears that NASAA has backed off from that assertion.[6] Gift annuities were also dropped from subsequent NASAA top ten lists. In 2002, The Arizona Commission Corporation's Security Division also identified gift annuities as one of its top ten scams.[7] Much of this regulatory activity in Arizona was a result of the conduct by Mid America Foundation, which amounted essentially to a $54 million Ponzi scheme in which the principal used the donated funds to buy homes, to pay child support, and to support a lavish lifestyle.[8]

In 2003, The Securities Administrator in Maine issued a cease and desist order against a Maine insurance agent and the Tennessee based "New Life Corporation" for representing gift annuities as "guaranteed, no risk investments.[9] The insurance agents selling these gift annuities also received a 6% commission.[10] The Administrator's action prevented the sale of one annuity valued at over one $1 million.[11] In the summer of 2003, Arizona State regulators secured judgments totaling $4.3 million against an Arizona company and two insurance agents for fraudulently selling gift annuities, again representing them as secure investments.[12]

Despite these recent events, gift annuities remain a well respected and excellent way for many people to make gifts because the vast majority of organizations are acting responsibly and donors are satisfied with their gifts and the income they receive. The responses to challenges and pro-active activity by ACGA, by NCPG, and by many charitable organizations have met the regulatory challenges head-on and for the most part have been successful in preserving gift annuities as a viable gift option and alleviating regulators' concerns. ACGA must continue to promote its mission to ensure future success; its mission is:

> The American Council on Gift Annuities actively promotes responsible philanthropy through actuarially sound gift annuity rate recommendations, quality training opportunities, and the advocacy of appropriate consumer protections.

In furtherance of those efforts and ACGA's mission, ACGA recommends the following best practices and encourages charitable organizations to utilize as many of them as possible.

Gift Annuity Best Practices

1. Make sure the donor understands the gift
   Proposal modeling
   It's irrevocable and not guaranteed
   Disclosure statement (required by law)
   Explain the contract in detail
   Meet with the donor in person if possible

2. Have the donor sign the contract
   Helps to insure donor understands the agreement
   Protects the institution
   Required by law in some states

3. Follow the ACGA Rates
   Risk is minimized
   Larger residuum (assuming the alternative is rates higher than ACGA rates)
   Don't need own actuarial work
   The focus is on the gift

4. Establish minimum amounts for a gift annuity
   $10,000 is the most common in Higher Education; $5,000 in religious and environmental – this ensures the charity will realize a minimum in exchange for the effort in setting up the gift and its stewardship

5. Establish minimum ages for immediate and deferred annuities
   The most common minimum age is between 60 and 65 years old; approximately 30% of institutions issuing gift annuities have a 55 age minimum; the average age is 78. The younger the donor, the smaller the benefit to the donor of the arrangement because of the effects of inflation on the annuity distributions and the smaller the benefit to the charity because of the work required over a longer period of time to maintain and steward the gift

6. <u>Develop a gift policy that specifies what assets will be accepted</u>
Cash, appreciated securities
Other assets – real estate, tangible personal property, intangible property
Process for making exceptions

7. <u>Invest the entire face amount of the annuity</u>
Assumption built into the ACGA rates, if it's not done the investment return needed to reach the 50% residuum goes up
Self insures against the liability, protects the institution
Reduces risk
Increases donor confidence

8. <u>Invest the assets appropriately given the fact that the gift annuity assets back the issuing charity's obligation to make annuity payments</u>
Reserve assets should generally be invested more conservatively than general endowment and should remain more liquid than the general endowment
It may be appropriate for institutions with larger endowments to invest more aggressively
ACGA assumed returns are based on a conservative and relatively low risk portfolio
Monitor the investment performance on a quarterly basis
Formally rebalance annually, informally as you raise cash to make distributions

9. <u>For purposes of the distribution to the charity from the annuity at the end of the income beneficiary's lifetime, establish a method for determining the balance of each gift annuity</u>
Will ensure that the donor's purpose is realized if specified in the contract
Will enable your institution to determine which annuities are in the red and the extent of the risk of each annuity to the entire pool and to the issuing organization
Use commercially available software, or in-house systems to track the value of each contract based on the annuity payments and the value of the pool
For those institutions that do not use such software or another method of fund accounting, determine a method to track the value of each annuity contract

10. Develop a good working relationship with your finance and administrative staff
Will ensure the program is administered in the best interests of the donor and the Of the institution
Will help the gift process go more smoothly
When issues arise with payments or tax work, they will be easier to resolve
Exceptions when you need them will be easier to obtain

11. Communicate regularly with your gift annuity income beneficiaries

12. Educate your colleagues about the benefits and liabilities of gift annuities

Endnotes

[1] The "Report and Comments on the American Council on Gift Annuities 2004 Survey of Charitable Gift Annuities" is available at www.acga-web.org/orderform06.pdf. If the past survey schedule is continued, the next survey would occur in 2009.

[2] *Supra*, See the ACGA 2004 Report's Introduction

[3] *Supra*

[4] *Supra*, and Ozee, et al. v. The American Council on Gift Annuities, Inc., et al., www.pgdc.com/usa/item/?itemID=30453

[5] See Charitable Gift Annuities Make Regulator's Top 10 Scam List, Planned Giving Design Center, September 19, 2002, www.pgdc.com/usa/item/?itemID=54550.

[6] See comments by the ACGA at www.acga-web.org/scams.rhtml

[7] See Commission News, www.azcc.gov/divisions/securities/news_releases/2002/Apr01c-02.pdf

[8] See Tax Analyst Summary on the Planned Giving Design Center's website at www.pgdc.com/usa/item/?itemID=54550

[9] See Testimony of Christine A. Bruenn, NASAA President and Maine Securities Administrator, U.S. Senate Committee on Banking, Housing and Urban Affairs, May 7, 2003, http://www.nasaa.org/Issues___Answers/Legislative_Activity/Testimony/555.cfm

[10] *Supra*

[11] *Supra*

[12] See, the press release by the North American Securities Administrators Association, September 4, 2003, "State Securities Cops: Senior Investors Facing a Perfect Storm for Investment Fraud" http://www.nasaa.org/NASAA_Newsroom/News_Release_Archive/1552.cfm


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Converting Deferred Gifts to Current Gifts

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28th Conference on Gift Annuities
Thursday, April 3, 2008

Introduction

Most "planned gifts" are "deferred gifts," meaning that the arrangement is made now, but the charity's use of the funds is delayed until a future date, normally the death of the donor and/or any other individual beneficiary of the gift arrangement.

Unfortunately, the donor never sees the gift in action, and the charity is unable to address pressing current needs. Converting a future gift to a present gift can be both emotionally satisfying to the donor and immensely beneficial to the charity.

This session concerns various ways future gifts can be transformed, wholly or in part, to present gifts. In each instance, it discusses the results for the charity, explains the tax aspects, cites some examples, and describes the procedures to be followed.

I. Outright Gift of All or Part of the Income Interest in a Charitable Remainder Trust or in Pooled Income Fund Units

A. Results for Charity

Charity receives for current use all or a portion of trust assets.

B. Tax Aspects

1. Allowance of income tax deduction.

Generally, a charitable gift of a partial interest in property is deductible only if (a) the interest is a remainder in a charitable remainder trust, pooled income fund, or personal residence or farm (IRC Sec. 170(f)(3)(A)) or (b) the contribution is "an undivided portion of the taxpayer's entire interest in property" (IRC Sec. 170(f)(3)(B)(ii)). An income tax deduction is allowed for a gift of all or part of the income interest in a charitable remainder trust because the income interest constitutes the income beneficiary's entire interest, and he or she would either be giving all of that interest or an undivided portion of it. However, the deduction will not be allowed if the property was divided to avoid the partial interest rules (Reg. Sec. 1.170A-7(a)(2)(i)).

2. Type of income tax deduction.

An assignment of an income interest in a trust is treated as a gift of a capital asset with a zero basis, so the reportable deduction will be limited to 30 percent of the donor's adjusted gross income. See IRC Sec. 1001(e)(1). Provided the beneficiary's holding period for the income interest exceeds one year, the deduction will indeed be for the present value of the interest contributed, rather than its cost basis.

3. Allowance of a gift tax deduction.

A gift tax deduction is allowed for an assignment of an income interest in a CRAT or SCRUT in all cases, and in a NIMCRUT or NICRUT, except when (1) two people have contributed jointly-owned or community property and they are joint and survivor beneficiaries or (2) the trust is funded with the donor's separate property and another person is named as successor beneficiary.

The problem with NIMCRUTs and NICRUTs in these instances arises from the fact that the Regulations pertaining to the gift tax deduction do not include the income-exception type of unitrust. Thus, the income beneficiaries are not giving a unitrust interest in accordance with the Regulations. Neither are they giving their entire interest, for in instance (1) each has already transferred to the other a contingent life interest in his or her share of the property, and in instance (2) the donor has already transferred to the successor beneficiary such a contingent life interest. This problem can be overcome by having each beneficiary (instance (1)) or the successor beneficiary (instance (2)) disclaim his or her successor interest prior to the assignment (PLR 9529039).

4. Rulings pertaining to gifts of income interests.

Numerous rulings pertaining to gifts of all or a portion of the income interest of a charitable remainder trust have been issued. Following are some of them:

Rev. Rul. 86-60, 1986-1CB302

PLRs 9409017, 9529039, PLR 9712013, 9712031, 9721014, 200010035, 200124010, 200140027, 200207026, 200310024, 200525014, 200802024.

5. Gifts of income interests in pooled income funds.

The tax implications of a gift of an income interest in a charitable remainder trust should also apply to a gift of an income interest in pooled income fund units. An income and gift tax deduction would be allowed for the present value of the income interest in the units ascribed to the beneficiary. Following the gift, the charity could sever from the fund an amount equal to the value of the beneficiary's units.

C. Examples

1. Contribution of the entire income interest of a unitrust for a charity's capital campaign.

In 1996, Mr. and Mrs. L contributed $500,000 to a standard charitable remainder unitrust with a 6-percent payout rate that made payments at the end of each calendar quarter. Realizing that they did not really need the trust income, and wanting to make a present gift to their charity's capital campaign, they decided to assign their entire income interest in the trust to the charity. On January 10, 2008, the date of the assignment, the fair market value of trust assets was $780,000, and they were each nearest age 74.

They received an income tax charitable deduction of $451,628. Considering that they were subject to a 35-percent income tax rate, their tax savings from the gift was $158,070. Upon the merger of the income and remainder interests, the trust was terminated and the charity received $780,000, which it used to establish an endowed fellowship in their names.

2. Contribution of part of the income interest in a unitrust to establish an endowment now.

Ten years ago Mr. T established a standard charitable remainder unitrust and named his alma mater as remainder beneficiary. He stipulated that the remainder was to be used to create an endowed scholarship fund in his name. Wanting to have the satisfaction of seeing awards made during his lifetime, and realizing that he doesn't need all of the trust income, he decided to assign one-half of his income interest to the college. The one-half income and remainder interests were merged under local law, and the charity received $300,000, which it used to create the endowed scholarship in Mr. T's name.

Mr. T also realized a material benefit. The assignment of part of his income interest generated an income tax charitable deduction of $139,836, which given his 35-percent income tax rate, will result in a tax savings of $48,943. (The trust had a 6.5-percent payout rate and made payments at the end of each calendar quarter. Mr. T was age 75 at the time of the assignment, and the CMFR used in calculating the deduction was 5.0 percent.)

3. Distribution from an overfunded annuity trust.

Mr. and Mrs. G established a charitable remainder annuity trust in 1993 with a contribution of stock having a fair market value of $250,000 and named a favorite charity as remainder beneficiary. The annuity trust paid them $15,000 per year. Because of great investment performance during the 1990s and in recent years, the fair market value of the trust's assets had grown to $620,000.

Since the value of trust assets was well in excess of what was needed to assure the annuity payments, they authorized a distribution of $250,000 for their charity's building fund. They were not entitled to an income tax deduction because their income interest was unaffected by the distribution. They continued to receive $15,000 per year as stipulated in the trust agreement. They merely accelerated part of what would have gone to the charity at the end of their lives.

D. Procedures

1. Procedures for giving the entire income interest.

a. When there is one remainder beneficiary.

In the case of a charitable remainder trust, if the charity is not already irrevocably designated as the sole remainder beneficiary, it is best for this to be done before the gift is made so that there will be no doubt about whether some other charity may have been named as a remainder beneficiary pursuant to a retained right to alter the beneficiary designation from time to time. If required, this step is ideally taken at least a day before the gift is made, in order to make clear that the irrevocable designation was in effect at the time of the gift.

When the charity is satisfied that it is entitled to all of the remainder interest, the donor and the charity enter into a relatively simple agreement in which the donor assigns the income interest to the charity and the charity acknowledges its acceptance of the assignment. Once executed, the document should provide the trustee of a charitable remainder trust with an adequate basis for terminating the trust and distributing all its assets to the charity. In the case of a pooled income fund, the trustee would be distributing to the charity the fund principal associated with the number of units in question.

Of course, with respect to either a charitable remainder trust or a pooled income fund, the trustee should be informed of the contemplated gift well in advance of the effective date. This will give the trustee the time needed to arrange for any final prorated payment to the donor, as well as to liquidate trust assets to the extent desired by the parties. Indeed, in the case of a charitable remainder trust there is often considerable merit in having the trust hold nothing but cash by the time the gift is made, in order to simplify the process of determining the net value of trust assets on the date the gift is made. The trustee of a charitable remainder trust will also need to file final income tax returns for the trust, so allowance should be made for this and other expenses associated with termination.

In advance of any of these steps, the donor, the charity, and any third party trustee should satisfy themselves that the desired merger of trust interests will take place under applicable state law. Moreover, it should be noted that a gift of the income interest may not be possible, or may at least require additional steps, if the trust agreement contains a spendthrift provision such as the following:

"The interest of any beneficiary in the corpus or income of the trust created hereunder shall not be subject to assignment, alienation, pledge, attachment or claims of creditors, and shall not otherwise be voluntarily or involuntarily alienated or encumbered by such beneficiary."

b. When there are two or more beneficiaries of a charitable remainder trust.

Here again, each charity should first be irrevocably designated as beneficiary of whatever portion of the remainder interest the donor determines is appropriate. Then, preferably by means of separate yet simultaneously effective documents executed by the donor and by the charities, the donor would assign to each charity a share of the income interest in proportion to its share of the remainder interest. If the assignments are not effective simultaneously, then the donor is essentially making a series of assignments of part of the income interest.

2. Procedures for giving part of the income interest.

In the various private letter rulings, three procedures have been used when a donor wishes to contribute only a portion of the income interest to the charitable beneficiary.

a. One possibility is to divide the charitable remainder trust into two trusts, identical to the original trust except in the amount of assets, and give the entire income interest in one of the trusts. That trust would then be terminated and the assets distributed to the charity, and the other trust would continue its existence. See PLR 200140027.

b. A second possibility is to assign a portion of the income interest (20 percent, for example) to the remainder beneficiary, or to one of the remainder beneficiaries. A reservation of the right to change remainder beneficiaries would, of course, maximize the donor's flexibility. (Confirm that under applicable state law the income and remainder interests of the fractional portion of the trust will merge and that the fractional portion of trust assets will become payable to the charitable remainder beneficiary.) See PLR 200207026 and PLR 200310024.

c. A third possibility is to include language in the trust agreement that allows the trustor to instruct the trustee to distribute a portion or all of the trust assets to qualifying charitable remainder beneficiaries. Alternatively, the trustee could be empowered to make such distributions in its discretion. See PLR 9712013.

3. Substantiation.

Certain substantiation requirements apply to all of the techniques described in this paper. See the Appendix for a discussion of those substantiation requirements.

II. OUTRIGHT GIFT OF THE ANNUITY INTEREST IN A CHARITABLE GIFT ANNUITY TO THE ISSUING CHARITY

A. Results for Charity

Charity is relieved of future payment obligations, and thus is free to use currently the amount that was being held in reserve to cover the obligation.

B. Tax Aspects

1. Allowance and type of income tax deduction.

The amount of the gift is the present value of the remaining annuity payments computed as of the date of assignment. However, in the case of an assignment of an annuity interest to the charity, the income tax charitable deduction will often be less than the amount of the gift.

Suppose, for example, that a few years ago Ms. A contributed $100,000 cash for a gift annuity. At this point the present value of the annuity payments is $60,000, the unreturned capital is $45,000, and the gain (interest) is $15,000.

If the assignment of a gift annuity interest is analogous to the assignment of a commercial annuity, the annuitant would have to recognize $15,000 of ordinary gain. That is because the owner of a commercial annuity is taxed on the gain in the annuity when transferring it to either an individual or a charity. Since the gain will have already been recognized, the annuitant will be entitled to an income tax charitable deduction of

$60,000. The net deduction, $60,000 less $15,000 of ordinary gain offset by the deduction, is $45,000.

If the assignment of a gift annuity interest is analogous to the forgiveness of a loan, then the deduction would be limited to the unreturned investment in the contract ($45,000 in this instance) because of the reduction under IRC Sec. 170(e) for gain that would be other than long-term gain. General Counsel Memorandum 39826 (1990) dealing with IRC Sec. 501(m) states that the issuance of gift annuities has historically been treated "as a borrowing of money by the issuing organization," and that is why gift annuities that qualify under IRC Sec. 514(c)(5) are exempted from being considered acquisition indebtedness. Thus, it would follow that the assignment of a gift annuity interest is to be treated like the forgiveness of a debt owed by the charity. By this line of reasoning, the assignment would not result in any taxable gain.

Although there are no revenue or private letter rulings specifically on point, it seems reasonable to conclude (1) that the assignment would not result in taxable gain and (2) the income tax charitable deduction would be limited to the investment in the contract (i.e., the remaining capital that would have been returned tax-free over remaining life expectancy if the annuity interest had not been assigned). This gift should be subject to a 50-percent-of-adjusted-gross-income contribution limitation because the interest transferred to the charity by virtue of the forgiveness of the annuity obligation is cash.

Suppose, in the above example, that Ms. A had originally contributed appreciated stock. At the time of the assignment, the present value of the annuity payments, the unreturned investment in the contract, and the ordinary gain are again, respectively, $60,000, $45,000, and $15,000. However, the unreturned investment in the contract consists of $33,000 of unreported capital gain that would have been so taxed, and $12,000 of basis that would have been returned tax-free. The annuitant would not be taxed on the $33,000 of gain, for Reg. Sec. 1.1011-2(a)(4)(iii) says that unreported capital gain is not included in the gross income of the transferor when the transferor relinquishes the annuity to a charitable organization. The income tax charitable deduction would remain the same at $45,000. However, it would be subject to a 30-percent-of-adjusted-gross-income contribution limitation because the interest transferred to the charity by virtue of the forgiveness of the annuity obligation is a long-term capital asset.

2. Allowance of gift tax deduction.

A gift tax charitable deduction would be allowed for the amount of the gift to charity.

C. Examples

1. Assigning an annuity interest and funding research now.

Ms. H contributed $100,000 cash to a hospital foundation for a gift annuity on October 1, 2002, and received an annuity of $6,000 paid in installments of $1,500 at the end of each calendar quarter. She had intended that the residuum from the annuity be used to fund diabetes research. Realizing that she would not need the payments and wanting to make money available for research now, she assigned her annuity interest to the foundation, and the foundation granted the remaining portion of her contribution to the hospital for research in diabetes.

At the time of her contribution on October 1 of 2002, when she was 64 years old, her income tax charitable deduction was $34,954. On July 1, 2007, when she assigned her annuity interest, the present value of the annuity payments to which she was entitled was $55,175 based on the May Charitable Midterm Federal Rate (CMFR) of 5.6 percent. Her income tax charitable deduction was $50,112, which was the unreturned capital as of the date of the assignment.

2. Getting a very small annuity off the books and putting the money to work.

A charity wrote a letter to annuitants who were receiving very small payments asking them to consider making gifts of their annuity interests. A number accepted the offer since payments were of little consequence in their budgets. Typical of them was Ms. J, whose payments from the $5,000 annuity she funded on March 31, 1998, when she was 65, were a mere $325 per year paid in installments of $81 at the end of each calendar quarter. At the time of the assignment on July 1, 2007, the present value of her annuity payments was $2,548 (based on the May CMFR of 5.6 percent). The unreturned capital at the time was $1,539, and this is the amount she can claim as an income tax charitable deduction, assuming she itemizes her deductions.

D. Procedure

1. Procedure when the entire annuity interest is contributed.

As with a gift of the income interest in a charitable remainder trust, a determination must first be made that the proposed gift of an annuity interest is not prohibited by the gift annuity agreement. Such agreements will typically include language such as the following: "This annuity is irrevocable and non-assignable, except that it may be assigned to the charity." Clearly, this wording would allow an annuitant to assign his or her interest to the charity. If, however, the agreement were to say simply, "This annuity is irrevocable and non-assignable," then an assignment likely would not be possible, unless legal counsel for the annuitant and for the charity concluded that an exception permitting assignment of the annuity interest to the charity could be inferred or would at least be legally defensible.

Assuming the gift can proceed, it is typically made by means of a simple assignment agreement signed by the donor and acknowledged by the charity. This terminates the payment obligation and frees the charity to withdraw the residuum from its gift annuity reserve fund for use as specified in the gift annuity agreement.

2. Procedure when a portion of the annuity interest is contributed.

Though there is no ruling on point, it should be possible to give the charity only a portion of an annuity interest. One way this might be accomplished is to substitute two new gift annuity agreements for the original agreement. For example, one might provide for payments equal to 40 percent of those in the original agreement, and the other for payments equal to 60 percent of the original payments. In all other respects the two new contracts would be identical with the old one. Having divided the annuity into two annuities, the annuitant could contribute to the charity his or her entire annuity interest in one of the annuities and retain the other.

An alternative would be for the donor simply to assign to the charity an undivided fractional portion of the annuity interest. In general, a charitable deduction is not allowed for a contribution that is less than the donor's entire interest in the property transferred to the charity. See IRC Sec. 170(f)(3)(A). Nevertheless, provided the gift annuity was not established in the first place to avoid this partial interest rule, a gift of an undivided fractional portion of the annuity interest should fall within the exception to the partial interest rule found in IRC Sec. 170(f)(3)(B)(ii).

3. Substantiation requirements.

See Appendix.

III. TERMINATION OF CHARITABLE REMAINDER TRUSTS AND GIFT ANNUITIES RESULTING IN CASH DISTRIBUTIONS TO BENEFICIARIES

A. Results for Charity

Upon the termination of a charitable remainder trust, the charity receives cash equal to the present value of the remainder interest, and the income beneficiary(ies) receive(s) cash equal to the present value of the income interest. Upon the termination of a gift annuity, the annuitant(s) receive(s) cash equal to the value of the annuity interest, and the charity, having been relieved of the payment obligation, may use for present needs the rest of the money that had been held in reserve.

B. Tax Aspects

1. Self-dealing.

There have been a number of letter rulings permitting an early termination of a charitable remainder trust and a distribution of the trust's assets to the income and remainder beneficiaries. The amount received by the income beneficiaries is equal to the present value of their payments. It is clear from the rulings that the termination and distribution of assets will not be a prohibited act of self-dealing, provided the remainder beneficiary is not a private foundation. In PLR 200525014, a termination was approved when the remainder beneficiary was a private foundation, but in PLR 200614032 the IRS reversed itself and declared early termination would constitute self-dealing if the remainder beneficiary were a private foundation.

2. Taxation of distributions to income beneficiaries.

The proceeds the donor receives are all taxable as capital gain because, per IRC 1001(e)(1), the income interest is regarded as having a zero basis. Provided the beneficiary's holding period for the income interest exceeds one year, the gain will be long-term capital gain.

3. Valuation of the income interest.

According to PLR 200725044 and PLR 200733014, if the trust being terminated is a net-income charitable remainder unitrust, the income interest must be valued using as the payout rate the lesser of the CMFR in effect at the month of termination or the stated payout rate. For example, if the trust payout rate is 9 percent, but the CMFR during the time of termination is 6 percent, the calculation would be done entering 6 percent as the payout rate. In the judgment of the IRS, this prevents an inflation of the present value of the income interest. See PLR 200725044 and PLR 200733014.

4. Health of the beneficiaries.

It is advisable for the beneficiaries of charitable remainder trusts or annuitants of gift annuities to obtain from their physician a statement that they have no health condition that would reduce their normal life expectancy.

5. Tax aspects of termination ("cash-out" of a gift annuity).

In certain private letter rulings dealing with the so-called "college annuity" (PLR 200233023, for example), the IRS approved an annuity contract under which an annuitant would "sell or assign" his or her annuity interest to the charity "or to a third party in return for a lump sum payment or installment payments over several years."

If the annuity had been funded with cash, the amount of the lump sum payment in excess of the unreturned capital would be ordinary income. If it had been funded with appreciated property and the gain was being ratably reported, the lump sum payment would be capital gain to the extent of gain not yet reported and tax-free return of capital to the extent of capital that had not yet been paid, with the balance treated as ordinary income.

C. Examples

1. Termination of a unitrust to generate cash to cover business losses.

Mr. N suffered some financial reverses in his business, and he asked the charitable remainder beneficiary of his unitrust if it would be willing to join him in terminating the trust. The charity was the sole remainder beneficiary, and Mr. N did not reserve the right to make any changes in the beneficiary designation. At the time of the termination, the present value of the income interest was $720,000, and the present value of the remainder interest was $380,000. Mr. N received the former amount, which was taxed to him as capital gain. If he had capital losses, the amount of tax could have been considerably reduced. The charity received $380,000 for current use.

2. Termination of a gift annuity to generate cash for the down payment on a retirement unit.

Ms. W funded a gift annuity with $100,000 cash a few years ago, and she has been receiving $7,000 per year. The present value of her annuity payments is now $55,000, and her unreturned capital is $35,000. The charity agrees to a cash-out, whereupon she receives $55,000, of which $20,000 is taxed as ordinary income. She applies her settlement towards the down payment on a unit in a retirement community.

D. Procedure

1. Procedure in general.

With the termination of a trust, much will depend on whether the transaction is structured as a purchase of the donor's interest by the charity or as a division of trust assets between the two parties. In the event the former route is taken, documentation in the nature of a bill of sale or an assignment would be created and executed by the donor and the charity only, whereas the latter would likely entail documentation executed by the trustee as well as by the two parties. Of course, even if the former approach is taken, the parties should advise the trustee well in advance regarding what they have in mind, as the trustee will need to begin making arrangements for termination of the trust.

With the termination of a gift annuity, the charity is simply purchasing the donor's annuity interest, and a document executed by both parties reciting that the donor is assigning that interest to the charity in exchange for a single lump sum payment should suffice. The substance of such a document might be as follows:

"The undersigned irrevocably assigns and transfers to ABC Charity (hereinafter "the Charity") all of the undersigned's interest in the Charity's Gift Annuity Number ___, the terms of which are set forth in the Gift Annuity Agreement made [date] between [name of donor] and the Charity, in exchange for a lump sum payment of $_________, which is equal to the present value of the future payments, determined as of the date of this assignment.

"In making this assignment, the undersigned understands that periodic payments from the Gift Annuity will cease, that a portion of the lump sum payment to be made in lieu of future payments may be taxed as ordinary income [if appreciated property was used to fund the annuity and all of the gain has not yet been reported ratably, add: , that another portion may be taxed as capital gain], and that the undersigned is responsible for the payment of any taxes arising therefrom."

2. Advisability of a physician's statement about life expectancy.

PLR 200725044 and PLR 200733014 are simply the latest of several indications the IRS has provided in recent years that a charitable remainder trust beneficiary who proposes to terminate the trust and receive the present value of its income interest should substantiate the fact that his or her life expectancy is not less than that of the average person of the same age. The following excerpt from PLR 200733014 summarizes succinctly what needs to be documented:

"[The donor's] personal physician has conducted a physical examination and has stated under penalties of perjury that he [i.e., the physician] finds no medical condition expected to result in a shorter-than-average longevity (under section 1.72-9 of the Regulations)."

The letter ruling goes on to indicate that the donor also signed a similar statement, implying that this would be a wise additional step even once the statement of a physician has been obtained. Moreover, the same steps should be taken if an annuitant of a gift annuity intends to liquidate his or her annuity interest.

3. Permission of attorney general.

In the case of a charitable remainder trust, state law may require that the attorney general approve the early termination of the trust if it will result in the charitable remainder beneficiary(ies) receiving less than all of the trust's assets. Such approval, in turn, may need to be obtained through a court process, although perhaps the attorney general's written assent alone would suffice.

4. Substantiation requirements.

See Appendix.

IV. Conversion of Income Interests in Charitable Remainder Trusts to Gift Annuities

A. Results for Charity

The charity may use currently an amount equal to the present value of the remainder interest.

B. Tax Aspects

1. Allowance of an income tax deduction.

In PLR 200152018, the IRS permitted the trustor (who was also the income beneficiary) of a charitable remainder unitrust to transfer his income interest to the charitable remainder beneficiary in exchange for a gift annuity. The annuity payments were to be made from the charity's general funds, the donor of the income interest was to be the sole annuitant, the annuity would be non-assignable except to the charity, and a commutation, prepayment, or refund would be prohibited by the gift annuity agreement.

The annual annuity will be the annuity rate offered by the charity multiplied by the present value of the income interest in the trust, not by the fair market value of trust assets. Suppose that at the time the income interest in the trust is contributed, the fair market value of trust assets is $600,000, the present value of the income interest is $400,000, and the present value of the remainder interest is $200,000. The annual annuity would be $400,000 multiplied by the annuity rate.

The donor will be allowed an income tax deduction for the amount by which the date-of-gift present value of the income interest of the trust exceeds the present value of the annuity payments. Again, the income interest in the trust must not have been created to avoid the partial interest rules of IRC Sec. 170(f)(3)(A).

2. Allowance of a gift tax deduction.

The donor will be entitled to a gift tax deduction under IRC Sec. 2522(a), to the extent the date-of-gift present value of the income interest of the trust exceeds the present value of the annuity payments. In the case of a NIMCRUT or NICRUT where a couple have contributed jointly-owned or community property and are joint and survivor beneficiaries, or where a donor has contributed separate property and named a successor beneficiary, each beneficiary should disclaim his or her successor interest prior to the assignment, as discussed above.

3. Taxation of annuity payments.

The income interest will be treated as a capital asset with a zero basis per IRC Sec. 1001(e)(1). Accordingly, the donor of the income interest (assuming he or she is the annuitant) will have long-term capital gain equal to the present value of the income interest, and it can be ratably reported as provided in Example 8 of Reg. Sec. 1.1011-2(c).

This means that the payments will be partly ordinary income and partly capital gain for the duration of the donor's life expectancy. Then they will become entirely ordinary income. No part of the payments will be tax-free. When operating a planned giving software program, enter the present value of the income interest of the trust as the amount contributed and "0" as the cost basis.

C. Examples

1. Transforming a "crashing CRAT" into an arrangement with smaller yet sustainable payments.

In 2000, Ms. K contributed $1,000,000 for a charitable remainder annuity trust that would pay her $80,000 annually, in $20,000 installments at the end of each quarter, for the balance of her life. The trust was invested heavily in equities and suffered significant losses during the bear market. The fair market value of the trust assets had shrunk to $600,000, so the annual payment was 13.33 percent of current market value. If the net return on trust assets were a constant 6 percent, the trust would run dry in 10 years. Even if the net return were a constant 7 percent, the time to exhaustion would be only 10.7 years. Ms. K worried that the trust might become exhausted and payments cease while she was still alive, and she was also concerned that nothing might remain for the endowed fund she wanted to establish. She was willing to receive less money if the payments would be sustainable for life and a charitable gift could be preserved.

On July 1, 2007, when she was age 79, Ms. K contributed her income interest in the annuity trust to the charitable remainder beneficiary in exchange for a gift annuity.

Total trust assets	$600,000
Value of income interest	$505,880
Value of remainder interest	$94,120

The income interest ($505,880) multiplied by the ACGA rate (7.8 percent) was $39,459. This was only about half of what she had been receiving. However, the payments will continue to the end of her life, however long she lives. Moreover, she received an income tax charitable deduction of $256,046, which can significantly reduce her income tax over the next six years. The charity could establish the endowed fund now with the $94,120 representing the remainder interest, and at the end of Ms. K's life the residuum of the gift annuity could be added to the endowment.

2. Increasing income from a NIMCRUT that did not flip.

Several years ago, Mr. and Mrs. Y transferred some of their community property for a NIMCRUT and named themselves as joint and survivor income beneficiaries and a national health organization as the remainder beneficiary. The trust was not "flipped," and their income had been approximately 3.0 percent of trust assets, well below the 6-percent payout rate.

On July 1, 2007, when they were both age 70, they assigned their entire income interest to the remainder beneficiary in exchange for a gift annuity. Before doing so, however, each of them disclaimed his or her successor interest to assure a gift tax charitable deduction. At the time of the assignment the fair market value of trust assets was $620,000. (According to PLR 200725044 and PLR 200733014, when valuing the income interest of a net income unitrust, the payout rate used in the calculation should be the lesser of the actual payout rate or the current CMFR. See below for details. In this particular example the trust payout rate and the current CMFR are the same.)

The present value of the income interest they assigned was $395,895, and the charity agreed to pay them an annuity rate of 6.9 percent. Thus, their annual annuity is $27,317 ($395,895 x 6.9 percent), which was well above the $18,600 they were receiving from the trust.

Although the annual annuity as a percentage of the income interest is higher than the ACGA rate, the annual annuity, as a percentage of trust assets actually received by the charity, was only 4.41 percent ($27,317 ÷ $620,000), which was well below the 5.9-percent ACGA rate. Upon the merger of the income and remainder interests, the trust terminated, and the charitable organization added $520,000 to the gift annuity reserve fund and used $100,000 for current needs. It could have used currently as much as $157,000, which was $620,000 minus the normal amount that would have to be contributed to produce an annual annuity of $27,317 based on the ACGA rate of 5.9 percent.

Mr. and Mrs. Y, in addition to increasing their annual payments, received an income tax charitable deduction of $102,299.

Note: In certain regulated states where the charity has advised the insurance department that it will follow the ACGA rates, it may not be possible to offer a rate higher than the ACGA rate. However, permission may be granted if the charity advises the department that the rate, as a percentage of the amount being added to the reserve fund, is actually below the ACGA rate and that the donor, with full disclosure, has consented to the transaction.

3. Terminating a moribund pooled income fund by having participants contribute their income interests for CGAs.

Charity Z had a pooled income fund with only eight participants that it wanted to close. It asked income beneficiaries if they would be willing either to make an outright gift of their income interests or to convert their income interests for gift annuities. Five of the beneficiaries, who were receiving small amounts of income, were willing to make outright gifts of their income interests. The other three were willing to convert their income interests to gift annuities, provided the payments would be approximately equivalent to what they were receiving.

One of these three beneficiaries was Mr. E, age 70, whose pooled income fund units were valued at $40,000. He was receiving in quarterly payments $1,600 per year. The highest annual adjusted rate of return on the pooled income fund during the past three years was 4.6 percent.

The following plan was proposed to Mr. E. He found it to be acceptable, so similar plans will also be proposed to the other two beneficiaries who want to continue to receive payments.

Value of pooled income fund units	$40,000
Value of income interest	$17,319
Value of remainder interest	$22,681

The income interest ($17,319) multiplied by the ACGA rate (6.5 percent) was $1,126, which was well below the $1,600 per year that Mr. E had been receiving. However, Mr. E was willing to accept a lower payment because he would receive an income tax charitable deduction of $6,990, the payments would be taxed more favorably, and he wanted to help the charity now. The charity had available for current use $22,681, which was the value of Mr. E's pooled income fund units ($40,000) minus the value of the income interest ($17,319) which funded the gift annuity.

D. Procedure

The following steps would be taken:

1. In the case of a charitable remainder trust, if the donor has named more than one remainder beneficiary, or has named a remainder beneficiary other than the charity with which he or she wishes to establish the gift annuity, and has reserved the right to change charitable beneficiaries, the donor must execute documentation

irrevocably designating the charity that will issue the gift annuity as the sole remainder beneficiary of the trust. As noted above, this is best done at least a day before the gift is made.

2. The donor and the charity execute a document by which the income interest is assigned to the charity.

3. The gift annuity agreement is drafted and signed per the charity's standard procedure. The agreement should specifically state that "X Charity shall pay from the general fund of X Charity an annual annuity of $_____." Also, the agreement should contain a statement indicating that in no event shall the annuitant's interest be commuted. (These were provisions in the gift annuity agreement that PLR 200152018 approved.)

4. The income and remainder interests having merged (again, assuming this has previously been confirmed to be the result under applicable state law), the charitable remainder trust is terminated and all of its assets are transferred to the charity, or, in the case of a pooled income fund, the fund principal associated with the number of units in question is distributed to the charity.

5. In the case of a charitable remainder trust, the trustee files a final tax return for the trust.

6. Substantiation requirements.

   See Appendix.

V. Other Ways of Converting Future Gifts to Present Gifts

A. Suggest to a donor that he/she consider making a current gift of all or a portion of the amount that would otherwise go to the charity via a bequest or dispository language in a living trust.

A donor, who has more than enough other assets for contingencies and surplus income, might be willing to do this to see the gift in action and to realize current income tax savings.

B. **Suggest to a donor that he/she consider contributing for a charitable remainder trust or gift annuity all or a portion of the amount that would otherwise come to the charity via a bequest or dispository language in a living trust.**

While this does not result in the charity's having usable dollars now (unless its practice is to spend up front a fraction of gift annuity contributions), it does convert a revocable gift to an irrevocable one and enables the charity to count it in gift revenue. This will appeal to donors who would like to reduce current income tax and possibly increase cash flow, and who believe they have enough other assets for contingencies.

C. **If a charity is currently named as beneficiary of a donor's IRA, suggest one of the following alternatives:**

1. If the limited IRA rollover provision allowed in the Pension Protection Act of 2006 is reenacted in 2008, and the donor is over age 70½ and does not need all of the required distribution for living expenses, then, as before, suggest a direct gift from the IRA to the charity.

2. If new IRA rollover legislation is enacted that permits a tax-free rollover for life income plans, as well as for outright gifts, suggest that a pooled income fund, gift annuity, or charitable remainder trust funded with IRA assets is a way to preserve all of the assets to generate income rather than have some of them consumed by taxation. Again, this does not generate currently-usable dollars for the charity (unless some portion of gift annuity contributions is spent currently), but it does result in an irrevocable gift that the charity can count now.

3. If no IRA rollover legislation is enacted in 2008; there are ways of making gifts of IRA assets that may achieve comparable results for the donor.

   - The simplest, for itemizers, is a contribution of all or a portion of the required distribution.

   - Possibly more beneficial is to contribute appreciated stock, which the donor would otherwise sell, and use the deduction from that contribution to offset the tax on the distribution.

Example: Mr. W, who has already made a charity a beneficiary of his IRA, is required to take a $40,000 distribution from his IRA, but he does not need it. He contributes outright stock having a fair market value of $40,000 and a cost basis of $10,000, and takes his $40,000 distribution.

No Gift	
IRA distribution	$40,000
Proceeds from stock sale	40,000
	$80,000
Tax on distribution (35% x $40,000)	-14,000
Tax on capital gain in stock (15% x $30,000)	-4,500
	-18,500
Net proceeds	$61,500
Gift	
IRA distribution	$40,000
Tax on distribution	- 0 -*
Tax on capital gain in stock	- 0 -
Net proceeds	$40,000
Net cost of $40,000 gift	$21,500

* Assumes the entire deduction is usable and can offset the taxable distribution.

- Another possibility if the donor needs income is to withdraw the mandatory amount from the IRA, reserve whatever will be required for tax (including the withholding), and contribute the balance for a gift annuity. The deduction resulting from the contribution for a gift annuity will reduce the amount that has to be reserved for the tax.

4. If the charity is owner of a life insurance policy, either surrender the policy for cash or sell it under a life settlement agreement. (Sometimes a policy can be sold for more than the cash value.) These options should normally be exercised only if the donor/insured wants the charity to have cash for current needs.

5. If a person who has a life estate in a personal residence or farm decides to move, suggest that the person make a gift of his or her life estate. An outright gift of the life estate to the charity that owns the remainder interest would enable the charity to sell the property and use the proceeds. An alternative would be to give the life estate for a gift annuity or charitable remainder trust, but that would not result in any present dollars for the charity.

APPENDIX

SUBSTANTIATION

A. When appraisals are required.

If as the result of a gift or a conversion the donor will be entitled to an income tax charitable deduction of more than $5,000, he or she will need to substantiate the deduction with a qualified appraisal. This is because the income or annuity interest being contributed is a non-cash asset, even if, in the case of a charitable remainder trust or a pooled income fund, the trust or fund holds only cash or marketable securities. In addition to obtaining the appraisal (and, if the deduction is greater than $500,000, actually attaching the appraisal to the tax return on which the deduction is claimed initially), the donor will need to file IRS Form 8283 after Section B of the form has been signed by the appraiser and by the charitable donee.

B. Who can do an appraisal.

As revised by the Pension Protection Act of 2006, IRC Sec. 170(f)(11)(E)(ii) defines a qualified appraiser as an individual who "(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary, (II) regularly performs appraisals for which the individual receives compensation, and (III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance." In addition, the individual must demonstrate "verifiable education and experience in valuing the type of property subject to the appraisal." To date, the only regulatory guidance provided by the Secretary has been Section 3 of Notice 2006-96. Nevertheless, actual regulations will be issued at some point, and in the meantime Reg. Sec.1.170A-13(c)(5) continues to be valid.

C. Information that should be contained in the appraisal.

The numerous requirements of a qualified appraisal are set forth in IRC Sec. 170(f)(11)(E)(i) and in Reg. Sec. 1.170A-13(c)(3)(ii). Among other things, the appraisal should describe the gift that resulted in the deduction being claimed by the donor and indicate how the present value of the interest in question was determined. It should also address the qualifications of the appraiser.

D. CMFR to be used in the appraisal.

IRC Sec. 7520(a) indicates that if an income tax charitable deduction is allowable in connection with the transfer of any annuity or any interest for life or a term of years, the deduction may be determined using the CMFR for the month of the transfer or for either of the two months preceding that month. Nevertheless, if calculation of the present value of an annuity interest or an income interest is made other than for the purpose of determining a charitable deduction, then only the CMFR for the month of the transfer may be used.

This means that if the present value of an income or annuity interest is being determined in connection with the sale of that interest, the CMFR used must be the one for the month in which the sale occurs. Similarly, if for example a donor is contributing the income interest in a charitable remainder trust to a charity in order to establish a gift annuity, the present value of that income interest must be determined using the month of the contribution. Yet once that present value has been determined, the charitable deduction associated with establishment of the gift annuity can be determined using the CMFR for the month of establishment or for either of the two months preceding that month.

E. Who pays for the appraisal.

Because the donor is required to have an appraisal in order to substantiate his or her deduction, the donor must bear the cost of obtaining the appraisal. If, however, the donor balks at this, the charity might arrange to obtain the appraisal and then make it available to the donor along with a written indication that the donor's deduction will need to be reduced by the amount the charity paid for the appraisal, on the theory that the appraisal constitutes "goods and services" provided to the donor in exchange for a charitable contribution.

Is There "Security" in Planned Giving?

Presented by:

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28th Conference on Gift Annuities
Thursday, April 3, 2008

I. Introduction.

A. Why explore this subject?

1. Increasing activity by a large number of nonprofits in the area of planned gift development.

2. Many organizations involved have relatively limited experience in the legal ramifications of planned gift development apart from income, gift, and estate tax laws.

a) Securities laws.

U.S. Securities and Exchange Commission

Securities and Exchange Commission

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

b) Insurance laws.

c) State fiduciary laws.

d) State anti-fraud laws.

INDIANA

CHARITABLE GIFT ANNUITIES

Plainly defined, an annuity is a contract for a payment of a specified amount of money payable over a period of time. In these simple terms, the concept of an annuity is not much different than a car loan or a mortgage payment. When considered in terms of investing, annuities are often linked to retired individuals.

Annuities are an attractive investment generally offered through an insurance company. An individual will give the company a specific amount of money that is to be paid back to the investor over a period of time. In addition to the principal amount of money, the investor will be paid interest for allowing the company offering the annuity to use his/her money.

An individual choosing to invest in annuities essentially gives a loan to a company and then collects interest as the money is returned. These investments are generally attractive because they are usually touted with some form of protection, and they pay a fixed amount over the long term. For a retired person, this could be appealing because it promises a steady, "insured" income.

It is important to realize, however, that no investment is truly insured. An insurance company will claim some form of protection when investing in annuities, however, unforeseen circumstances could cause loss of money to the investors (e.g., the company goes out of business).

There are several kinds of annuities, and these are addressed more specifically in annuity-focused literature. When discussing fraud aimed at seniors, the term charitable gift annuity is a familiar buzzword. A charitable gift annuity works much like a regular fixed annuity, except the charity — rather than an insurance company — offers the annuity and benefits from the investment. While most annuities offered by charitable organizations are legitimate investments, investors should be cautious of little-known organizations or those that provide only minimal information.

e) Federal "fiduciary laws" ("self dealing").

f) Unrelated business income tax (UBIT).

B. Increased activity in marketing planned gifts by those outside the fund-raising field, including financial planners, attorneys, accountants, banks, bond underwriters, real estate brokers, stockbrokers, focused widespread attention on securities law implications of planned gifts in the late 1980s and 1990s.

1. Higher capital gains taxes enacted in 1986 contributed to this phenomenon.

2. Elimination of traditional "tax shelters" left some looking for new opportunities.

3. Some referred to planned giving as the "last game in town" for avoidance of what many considered to be punitive rates of taxation on capital gains.

4. In some cases, resulting marketing activities and methods of compensation were unwittingly transforming charitable gifts that were otherwise exempt from securities registration into unregistered securities with no exemption from federal and state registration requirements.

    a) Compensation practices.

    b) Lack of adequate disclosure.

    c) Marketing gifts primarily as vehicles to create wealth or provide investment management.

    d) Co-venturing with those who were "selling" gifts in this manner.

    e) "Wrapping" gift planning vehicles around financial products and services and in so doing inadvertently creating new products which may themselves meet definition of securities which are not exempt from registration.

        (1) Tax-exempt bonds.

        (2) Life insurance and commercial annuities.

        (3) Trust services.

        (4) Investment counsel.

        (5) Others.

II. An Overview of Federal Securities Law As It Relates To Planned Gift Development.

B. Nothing new about federal securities laws applied to planned gift arrangements.

1. Extensive body of law in this area.

2. Much of the law was defined in the years immediately following the 1969 tax reform act.

3. New generation of gift planners sometimes lack familiarity with this area.

4. The implications of certain practices thus reach beyond the possible risk of Congress acting to limit tax benefits, and include risk of violating securities laws and possibly placing tax-exempt status of trusts and tax-exempt status of sponsoring organizations at risk under law as it existed prior to the passage of the Philanthropy Protection Act of 1995.

C. Primary federal securities law statutes.

1. Securities Act of 1933.

2. Securities Exchange Act of 1934.

3. Investment Company Act of 1940.

4. Investment Advisors Act of 1940.

D. Securities Exchange Commission (S.E.C.) charged with enforcement responsibilities.

1. Broad discretion.

2. Oversees laws with "teeth."

3. S.E.C. relies on "examples" to make most impact with limited budget.

E. State regulation.

1. "Blue Sky" laws.

2. Many states incorporate federal law to some extent.

3. Others have adopted unique rules.

F. What is the definition of a "security?"

1. Layperson's perception: Stocks, bonds, mutual funds, and other investments.

2. According to federal law that has been developed over the years, the term security means, "...among other things, any investment contract. The test for an investment contract is 'whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.' SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946)." S.E.C. Release 33-6175 (1980).

G. Who is in the securities business?

1. Securities dealers?

2. Investment advisors?

3. Corporations?

4. Insurance companies?

5. Real estate brokers?

6. Banks?

   a) Where does trust marketing end and a security begin?

   b) "True fiduciary" status is vital.

7. Financial planners?

8. Non-profit organizations and institutions issuing planned gifts or promoting those created by others?

III. The Essential Nature of the Planned Gift - Security or Gift?

B. What makes some planned gifts resemble a security?

1. Transfer of property in return for income.

a) Fixed?

b) Variable?

c) Revocable?

d) Irrevocable?

2. In addition to the workings of a plan, methods of marketing (communication), management, and compensation are key determinants of the status of a particular transaction.

a) Marketing.

(1) Is emphasis on tax and/or other financial benefits?

(2) Is primary emphasis on the plan?

(3) Or on the gift?

(4) Who bears the marketing expenses?

(a) The charity?

(b) A vendor of financial products or services?

(5) What representations are made?

(6) Are alternative projections offered?

b) Who is responsible for the assets?

(1) Who is the trustee?

(2) Who manages the assets?

c) Who receives compensation when a plan is entered into? Were persons paid to "sell" the gift?

(1) Are the employees of the charity paid in relation to the size of individual or aggregate gifts produced.

(2) Are outside parties compensated by the charity, or for the sale of products which are an integral component of the "package?"

(a) Consider case of "buildup unitrust" funded with an insurance policy sold for "wealth replacement" that is marketed as an integral part of the "package."

(b) Comparison to incidental sales of products.

C. What makes a planned gift look like a gift?

1. Transfer of irrevocable nature.

2. Gift where income is fixed.

3. Life income "retained," not purchased.

4. Marketing emphasis on gift element.

IV. A Brief History of S.E.C. Staff Regulation of Planned Gifts.

B. Administration of securities laws is similar to the procedures employed in the area of federal income, gift, and estate taxation.

1. S.E.C. Releases and "no action letters" are somewhat comparable to I.R.S. Revenue Rulings and Private Letter Rulings.

a) "No action letters" may apparently be relied on to a broader extent than private letter rulings from IRS.

b) Unlike IRS pronouncements, however, "no action letters" and SEC "releases" are not official Commission positions, they are simply indications of the recommendations the staff will make to the Commission and thus may not carry the "weight" with practitioners that a private letter ruling or Revenue Ruling might have in the tax area.

(1) This explains to some extent why many attorneys advised their clients that there was an argument that the SEC staff position was their opinion only and did not carry the full force of statutory law.

(2) These same advisors now place much more emphasis on the need for disclosure and adherence to compensation requirements that are now mandated as part of legislation enacted by Congress.

2. Files of non-profits with long history of activity in planned giving indicate that S.E.C. has been interested in regulation of planned gifts since the earliest days of the agency.

3. In 1972, the S.E.C. issued a no action letter that stated that a pooled income fund is a security for purposes of federal securities laws.

The S.E.C. did not agree with argument that pooled income funds were exempt as securities issued by a charitable organization for its sole purposes, and stated that anti-fraud provisions apply. The S.E.C. did not agree that there was no sale for value. The S.E.C. did, however, agree to issue no-action letters in a number of instances.

The S.E.C. no-action position was based on assertions that "the actual establishment and maintenance of the pooled trust would provide no opportunities for personal profits to private promoters or organizers since the Code requires that a pooled trust be established and maintained only by a bona fide public charity for the exclusive purpose of raising funds for its charitable purposes."

"The persons who solicit donations for a college or university, including donations to a pooled trust, would be either volunteers, such as alumni, who would receive no compensation, or persons employed in connection with the college's overall fund-raising activities, only a relatively small part of the which ordinarily involve contributions to a pooled trust. Persons employed in connection with the college's fund-raising activities would receive no commissions or other special compensation based upon the amount of gifts transferred to the pooled trust."

The S.E.C. position was further "based on recognition of the fact that the primary purpose of persons who transfer property to pooled income trusts is to make a gift to the charity of their choice. That, together with applicable Internal Revenue Code and Treasury Department restrictions and regulations, make registration under the federal securities laws appear unnecessary in these circumstances." See American Council for Education CCH Sec. Rep. 79,179 (1973).

4. Subsequent no-action letters insisted on amendments of letters of inquiry to affirmatively state that no private promoters would be allowed to profit and that no one would be paid a commission on the "sale" of interests in the fund. The S.E.C. continually affirmed that the no-action stance was "based on recognition of the fact that the primary purpose of persons who transfer property to pooled income trusts is to make a gift to the charity of their choice. That, together with applicable Internal Revenue Code and Treasury Department restrictions and regulations, make registration under the federal securities laws appear unnecessary in these circumstances." See Jewish Community Federation CCH Sec. Rep. 79,419 (1973).

5. In 1975, the United States Committee for Unicef approached the S.E.C. asking whether charitable remainder trusts were securities. Language in this no action letter indicates that the remainder trusts involved would be created as separately managed trusts managed not by the Committee but by an outside professional fiduciary. The S.E.C. said that it would take a no action position regarding marketing of such charitable remainder trusts so long as there was full and fair disclosure and no private promoters benefitted. The S.E.C. stated it did not "necessarily agree" that charitable remainder trusts were exempt as charitable organizations. It reiterated its position as stated in the 1972 American Council on Education letter that its no-action position was primarily "based on recognition of the fact that the primary purpose of persons who transfer property to pooled income and other charitable remainder trusts is to make a gift to the charity of their choice. That, together with the applicable Internal Revenue Code and Treasury Department restrictions and regulations make registration under the federal securities laws appear unnecessary in these circumstances."

Significantly, however, the S.E.C. in the Unicef no action letter stated that "Our position is conditioned on each prospective donor receiving written disclosures which fully and fairly describe the operation of the Committee's pooled trust and charitable remainder trusts. In this connection, we like to make clear that in our view the anti-fraud provisions of the federal securities laws are applicable to sales of interests in all of these trusts." See UNITED STATES COMMITTEE FOR UNICEF Published June 30, 1975.

6. During the period from 1972 to 1980, pooled income funds were relatively uncommon, as many smaller charities were advised by counsel that they should not proceed with plans for a pooled income fund without an S.E.C. no-action letter. Conventional wisdom in that period was that establishment of pooled income funds would involved expenditures in the range of $20,000 to $25,000.

7. In 1980, when during a period of rising interest rates that drove greater interest in pooled income funds giving rise to numerous requests for no-action letters by those establishing new pooled income funds, the S.E.C. issued a blanket no-action letter in S.E.C. Release 33-6175. In it, the S.E.C. again reiterated a two-part test for exemption from securities status for "investment contracts" issued by charitable organizations:

   a) Organized for charitable purposes.

   b) No part of net earnings may inure to benefit of a private individual.

   The S.E.C. then again stated its basic position that a pooled income fund is a security because "the second part of the test would seem not to be met by a pooled income fund because of the distribution of its income to beneficiaries."

   The release concluded, however, that "the staff under the circumstances set forth below, will not recommend that the Commission take any enforcement action if a public charity establishes and maintains a pooled income fund without registration (1) under the 1940 Act of the fund, the public charity, or any trustee of the fund, including any bank, (2) under the 1933 Act or the 1934 Act of interests in the fund, or (3) under the 1934 Act of persons who solicit gifts by means of the fund. The circumstances in which the staff will take such a position are the following:

      1. The fund qualifies as a recipient of tax deductible contributions under section 642(c)(5) of the Code.

      2. Each prospective donor is furnished written disclosures which fully and fairly describe the operation of the fund. (As a matter of policy, the staff would not review these disclosures in advance. The responsibility for determining compliance with this requirement was with the public charity.)

3. Each person soliciting gifts by means of the fund is either a volunteer, or a person who is employed in the public charity's overall fund-raising activities who receives no commissions or other special compensation based on the amount of gifts transferred to the pooled income fund."

See S.E.C. Release 33-6175, Sec. Rep. 47,374 (1980).

8. The 1980 release did not specifically address gift annuities and remainder trusts.

9. Later that year, University of Minnesota sought and received a no-action letter for its gift annuity program. The S.E.C. acted affirmatively. It stated that its position was based on the fact that the organization was exempt, the payments were made from general assets of the organization, and that the primary purpose of the transaction was to make a gift. Further reasoning is unclear, but it was a matter of debate whether the staff intended that all requirements of Release 33-6175 would apply to gift annuities. See University of Minnesota Foundation CCH Sec. Rep. 76,792 (1980).

10. In 1982, Princeton University sought a no-action letter concerning its charitable remainder trusts. The University stated it would commingle the trust assets with its general endowment, assigning units to the individual trusts, and asked whether this was a security, and if so, would the S.E.C. extend its no-action position in Release 33-6175 to these gift vehicles.

    The S.E.C. granted a no-action letter based on the conditions that the three conditions of Release 33-6175 were met and that the primary purpose of the transaction was charitable. See Princeton University CCH Sec. Rep. 77,246 (1982).

11. In one case involving charitable trusts the S.E.C. refused to issue a no-action letter because the trusts involved were to be revocable and commingled. It reasoned that the ability to recover the funds if desired shifted the transaction away from one which was motivated by the "primacy of charitable purpose." See Society for the Propagation of the Faith CCH Sec. Rep. 77,809 (1984).

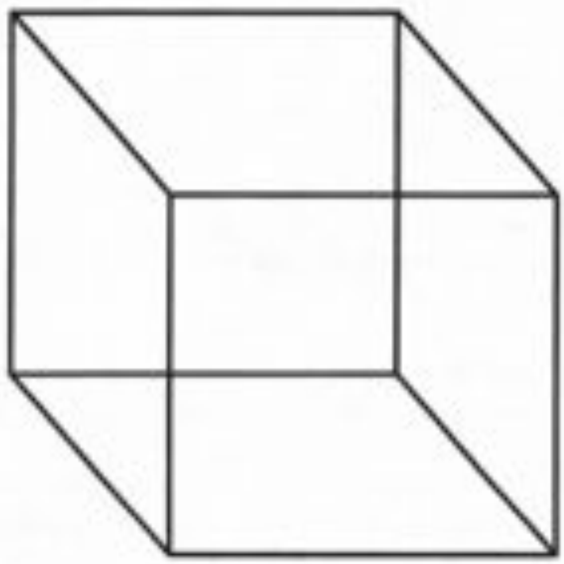
12. In a later pronouncement, the S.E.C. was asked by Middlebury College whether its maintenance of three different types of charitable remainder trusts with a choice of investment objectives changed the balance and created a security. The S.E.C. granted a no-action letter based on similar reasoning as the Princeton letter and stated that it would "no longer respond to no-action requests in this area unless they raise novel or unique questions." See Middlebury College CCH Sec. Rep. 78,347 (1986).

C. Substance over form.

1. The common thread in S.E.C. pronouncements over the years is that it wants to make sure that planned gifts are "packaged and presented" by fundraisers as a vehicle for giving, not as an investment.

2. Does "packaging" count when it comes to determining whether a particular plan or scheme is a "security?"

3. The courts have held that if it "walks like a duck" and "talks like a duck" it's going to be treated as a duck when it comes to federal securities laws. Grainger v. State Security Life Insurance Co. (5th Cir. 1977); S.E.C.v. Joiner Leasing Corp., (U.S. Sup. Ct.1943).



V. Securities Law and Planned Giving Following the "Philanthropy Protection Act of 1995."

A. Background of 1995 congressional legislation that affects charitable gift planning.

1. Two separate bills.

a) Anti-trust law.

b) Securities law.

2. Legislation was in response to litigation in Texas.

a) First known as "Ozee" Case.

b) Later proceeded as the "Ritchie" Case.

3. The Texas lawsuit raised a number of allegations initially related to several charity's dealings with an elderly donor.

a) State fraud.

b) State fiduciary violations.

c) State securities law violations.

d) Federal anti-trust violations.

e) Federal securities law violations.

f) State insurance code violations.

4. Texas legislature acted to remedy certain state claims.

a) Passed legislation to grant trust powers to non-profits.

b) Passed legislation to authorize charitable gift annuities.

c) This effectively negated state law challenges other than those based on fraud, undue influence and overreaching.

C. Charitable community decided it was necessary to seek Congressional relief to neutralize the federal claims.

1. Federal class actions raised specter of multibillion dollar judgments that could reach the assets of charities nationwide that otherwise had no involvement in the underlying Texas case.

    a) Claims of violation of anti-trust laws.

    b) Claims based on federal securities law violations.

    c) Note that the Justice Department and/or the S.E.C. did NOT bring these actions.

    d) Fear of "joint and several liability" for all members of the defendant "class."

        (1) Small charities could be liable for the actions of major organizations.

        (2) Largest endowments in America were theoretically at risk due to actions by other unrelated charitable entities

        (3) Concern that board members could be personally liable for judgments.

2. It was thus necessary to consider all possible avenues to obtain federal relief.

    a) Through the courts.

    b) Through congressional action.

3. Timing was of the essence.

    a) Even though most legal experts questioned the merits of the plaintiff's case, it became evident that charities perhaps could not or should not "afford" justice in the "Ritchie" matter.

        (1) Legal fees were estimated to be astronomical.

        (2) Consensus was that the cost of justice in the courts would be prohibitively expensive for America's nonprofit

community in terms of time and opportunity cost of lost gifts and in terms of funds expended to mount costly and repetitive defense of the suit.

b) Legislative relief was determined to be the most practical alternative.

D. Massive lobbying effort resulted in two pieces of legislation.

1. Antitrust Relief Act of 1995 (H.R. 2525, P.L. 104-63)

2. "Philanthropy Protection Act of 1995" (H.R. 2519, P.L. 104-62)

VI. The Impact of Federal Antitrust Relief Legislation.

B. Claims of plaintiff in Texas lawsuit based on federal antitrust violations were effectively countered by the legislation.

1. In this legislation, Congress provided that the process whereby charities have acted in concert since 1927 through the American Council on Gift Annuities (ACGA) to recommend what are believed to be prudent gift annuity rates does not violate the federal Sherman Anti-trust Act.

2. Relief granted was retroactive.

3. Charities are free to use whatever rates they wish within limits imposed by various state regulatory agencies nationwide.

C. Interested parties may question the constitutionality of the legislation.

1. Issue is whether Congress can grant retroactive relief.

2. Appellate process will ultimately determine this issue.

D. Impact on the future of gift annuity rates?

1. Most organizations will continue to offer gift annuities under ACGA rates.

a) Many states require extensive actuarial analysis of rates other than the committee rates.

b) Those who have attempted to construct their own rate structures have found that resulting rates tend to generally be in line with

ACGA rates in the age ranges where gift annuities have historically been most attractive.

2. Other organizations have continued issuing gift annuities under the alternative rates they developed as a reaction to the Texas litigation.

   a) Upon examination, some organizations found their experience differed from the assumptions utilized in the ACGA rates.

      (1) Lower costs of administration.

      (2) Higher rates of returns.

      (3) Different mortality experience.

   b) Others began constructing rates to be used in some cases as exceptions to ACGA rates based on the amount of the gift and other factors.

      (1) They are utilizing ACGA rates for most annuities.

      (2) They are carefully examining annuities that depart from the norm based on size and other factors.

      (3) State regulations may act as a "brake" as in a number of states that regulate gift annuities (e.g. New York, California) maximum rates with accompanying actuarial analysis must be filed with state authorities prior to issuance of gift annuities.

3. As time goes on, patterns of practice will undoubtedly develop.

   a) There has been more diversity in rate setting practices than the period before the Texas litigation challenged the practice of establishing norms.

   b) Factors that originally resulted in the perceived need for ACGA recommended rates have not, however, materially changed.

VII. The Impact of the "Philanthropy Protection Act of 1995" (PPA).

B. Immediate impact was to counter specific claims put forth in the Texas litigation.

1. Plaintiffs claimed that charities had issued securities in violation of the Investment Company Act of 1940 and the Securities Exchange Act of 1934.

2. The bill provides a "safe harbor" for charities that would otherwise be considered "issuers" of "securities" under the Investment Company Act and whose employees and agents could be considered to be unregistered "broker dealers" under the Securities Exchange Act of 1934."

C. Implications of the PPA of 1995 are numerous.

1. Certain categories of planned gifts now enjoy special treatment under our nation's securities laws.

a) There is now definite guidance where particular types of planned gifts are concerned.

(1) In this act Congress specifically defined certain charitable funds as securities where assets are commingled for the purpose of investment of gifts made in the form of a number of popular planned gifts.

(a) Pooled income funds.

(b) Charitable remainder trusts.

(c) Charitable lead trusts.

(d) Gift annuities.

(e) "Endowments."

(f) Revocable gift arrangements.

(2) To be exempt under this act, the charity must "maintain" the fund.

(a) Serve as trustee or co-trustee or administrator.

(b) Have the power to appoint or remove a trustee or administrator.

(3) Congress granted exemption from full securities law registration process under Investment Company Act of 1940 and the Securities Exchange Act of 1934 with provisos that differ somewhat from prior law.

(a) Planned gifts that qualify for special treatment must be marketed only by volunteers or others "engaged" in the overall fund raising program whose compensation is not based on the amount contributed or the number of gifts that are made.

(b) Full and fair disclosure of the "workings of the fund" must be made to all donors to the fund.

(4) These requirements apply to gifts completed after March 9, 1996.

(a) No guidance on content of disclosure.

(b) Early drafts contained directions for SEC to make rules with 60 days.

(c) SEC declined rulemaking responsibilities and this provision was dropped from final drafts of the legislation.

(5) As in the case of prior SEC staff positions, Congress did not grant exemption from anti-fraud provisions of the securities laws.

Quote from Senator Christopher Dodd, a Senate sponsor of the "Charitable Giving Protection Act of 1995:"

"It [the legislation]also codifies certain exemptions that the Securities Exchange Commission has recognized for charitable organizations that pool and invest donations. However, none of these changes would make it easier for charities to commit fraud. The legislation would not change the anti-fraud provisions in federal securities law or affect federal tax laws related to fraud. People could still bring appropriate lawsuits against cheats or swindlers attempting to disguise themselves as charities, or charities acting fraudulently. [emphasis added]"

2. By granting specific relief only for planned gifts where assets are commingled under the Investment Company Act of 1940 and the Securities Exchange Act of 1934, Congress raised questions regarding other planned gifts that could still be construed to be securities under traditional interpretations of the Securities Act of 1933.

   a) Most planned gifts not covered under the PPA of 1995 will continue to enjoy exemptions previously granted by staff

   b) Even if they are securities they are exempt under conditions that have been repeatedly reaffirmed by SEC staff pronouncements over the past 31 years.

   c) The conditions under pre-PPA law are even more critical, however, as they are prerequisites for exemption from registration whereas the exemption for planned gifts included in the safe harbor is not conditioned on disclosure and non-payment of commissions.

D. Certain other categories of securities issued by a limited number of charities as part of their planned gift development process ARE NOT exempted from securities law registration process by the PPA of 1995.

1. Revocable gift plans where charity "maintains" funds in which these gifts are commingled are specifically excluded from exemption.

2. This was not a change from existing law.

3. Organizations that have engaged in the issuance of affected revocable gifts were granted retroactive relief from securities law on the condition that such revocable gifts were no longer commingled after three years.

4. This category of gifts was not permitted in the future. The relief was retroactive but not prospective.

5. Plans such as a revocable pooled income fund are not permitted under any circumstances under the terms of the PPA.

E. A visual representation of impact of federal securities law regulation after PPA.

VIII. Adapting to the Provisions of the Philanthropy Protection Act of 1995.

B. Disclosure definitely required for certain types of planned gifts.

1. No doubt where commingled funds are involved and the charity "maintains" the fund.

2. Impact on other types of planned gifts not as clear.

C. Congress ended debate regarding methods of compensation of persons marketing gifts affected by PPA.

1. Most organizations not affected by these provisions as they have not paid commissions or finder's fees.

2. Organizations with incentive based compensation in the planned gift area must now reexamine their practices.

IX. Marketing Planned Gifts in Light of Securities Law Regulation.

B. A new look at marketing materials would be prudent in light of anti-fraud provisions of the securities laws.

1. "Puffery" could be seen as misstatement

2. Certain marketing issues also move from realm of ethics to law.

C. Securities law disclosure requirements have a definite impact on planned gift marketing, particularly in the case of gift annuities and pooled income funds.

1. Disclosure statements are required where some gifts are concerned.

a) "Charitable Giving Protection Act of 1995" specifies those gift planning situations where disclosure is a directive but not a condition for exemption.

b) Other planned gifts where funds are not commingled are presumably still in the "grey area" where planned gifts may or may not be a security under the 1933 Act.

2. Regardless of the extent of the content of disclosure statements, it is difficult to separate the process of disclosure from the marketing efforts.

a) When must disclosure take place?

(1) As part of mass marketing phase?

(2) When initial proposal sent?

(3) At time donor is to execute documents?

(4) Will "too much" disclosure "turn off" donors in initial stages.

b) According to the PPA, disclosure must, at the least, be made in writing prior to the completion of the gift.

c) Anti-fraud provisions of securities laws affect pre-disclosure marketing activities.

(1) Planned gifts that are securities and that are exempt from registration are never exempt from anti-fraud provisions of the securities laws.

(2) Recall quote from Senator Christopher Dodd, a Senate sponsor of the "Charitable Giving Protection Act of 1995:"

"It [the legislation]also codifies certain exemptions that the Securities Exchange Commission has recognized for charitable organizations that pool and invest donations. However, none of these changes would make it easier for charities to commit fraud. The legislation would not change the anti-fraud provisions in federal securities law or affect federal tax laws related to fraud. People could still bring appropriate lawsuits against cheats or swindlers attempting to disguise themselves as charities, or charities acting fraudulently. [emphasis added]"

d) Senator Dodd apparently believed that a private right of action exists for those who believe they have been defrauded in the process of making their planned gift.

e) A number of marketing activities designed to interest donors can give rise to about anti-fraud considerations.

(1) Verbal representations.

(2) Advertisements.

(3) Direct mail.

(4) Web-based promotion.

(5) Seminars.

(6) Joint ventures.

3. Securities laws also have an impact on methods of compensating those involved in planned gift marketing.

a) Planned gifts that are securities may only be marketed by persons who are not paid finder's fees or commissions:

(2) "LIMITATION ON COMPENSATION - The exemption provided under paragraph (1) shall not be available to any charitable organization, or any trustee, director, officer, employee, or volunteer of such a charitable organization, unless each person who, on or after 90 days after the date of enactment of this subsection, solicits donations on behalf of such charitable organization from any donor to a fund that is excluded from the definition of an investment company under section 3 (c) (10)(B) of the Investment Company Act of 1940, is either a volunteer or is engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number or the value of donations collected for the fund." [emphasis added] HR 2519 Section 4 (b).

b) This is a point where existing law was not "codified" in the PPA. Prior language under S.E.C. Release 33-6175 (1980) and later interpretations of it as it related to charitable remainder trusts was as follows:

"each person soliciting gifts by means of the fund is either a volunteer, or a person who is employed in the public charity's overall fund-raising activities who receives no commissions or other special compensation based on the amount of gifts transferred to the pooled income fund."

c) Distinction between "employed in" and "engaged in" is broad enough to remove doubt about role of independent contractors. Addition of language cover the number of gifts as well as the amount is presumably intended to cover situations where a flat fee is paid but only if gifts are concluded. Statute seems intended to limit compensation to those who are salaried or who are employed under a contract that does not base compensation on the number or amount of gift arrangements that are concluded.

B. Marketing Case Studies.

1. A donor-instigated planned gift.

Mr. Jeffers, age 57, reads about charitable remainder trusts coupled with wealth replacement insurance in a magazine. He has never made a charitable gift in his life, but he is intrigued by the idea as a way to avoid capital gains tax and increase his income and pass more wealth to his heirs than might otherwise be possible.

He makes an appointment with his attorney and after extensive discussion and analysis, they decide he should set up a charitable remainder annuity trust and fund it with stock in his closely held company prior to a contemplated sale.

Through very careful planning, it is possible to arrange for a $1,000,000 charitable trust which Mr. Jeffers believes will, over the long term, cost very little after-tax to create. As part of the plan, Mr. Jeffers and his attorney contact his regular insurance agent and arrange to purchase an insurance policy with a portion of the income from his trust. If the trust earns the net return expected after payment of fees, the corpus will be exhausted in the 35th year, which is the same length of time as Mr. Jeffers life expectancy.

The possible exhaustion of the corpus does not bother Mr. Jeffers as he feels the charity has done nothing to "deserve" a remainder. He is satisfied with the fact that the charity will receive a gift if the trustee can earn more than expected on average over the term of the trust or if he dies prematurely.

A local bank will serve as trustee of the trust and their fees will be paid from the trust income. Mr. Jeffers pays his attorney based on an hourly rate and the insurance agent makes a normal commission on the policy. After the trust is executed, the charitable remainder recipient is informed by letter from the attorney that Mr. Jeffers has made this provision but that he does not wish to be recognized or thanked in any way.

a) Is this a security which must be registered?

b) Did the charity "cause" Mr. Jeffers to do this?

c) Must there be any disclosure by anyone in this case?

d) What if the bank had conceived of this plan and brought it to Mr. Jeffers attention? Would it make a difference if the bank was part of a group that sold the wealth replacement insurance? What if the charity agreed to serve as trustee or pay the trustee fees of others?

2. The advisor driven gift.

An institution is approached in October, 1986 by a board member who would like to make a $1,000,000 gift to create an endowment in honor of himself and his wife.

An insurance broker/financial planner had learned of these donors' wish to make this gift and suggested that it be structured in the form of an 8% charitable remainder annuity trust funded with highly appreciated publicly traded stock which the donor had accumulated in his capacity as CEO of a major local company.

The donor was to serve as trustee with the aid of a professional administrator, sell the stock and place the proceeds in a $1,000,000 single premium universal life insurance policy projected to earn 8.5%. The policy would be placed on his wife's life, age 66 at the time of the gift. The initial death benefit would have been $2,000,000. The donor was assured that if he and his wife lived normal life expectancies, there would be at least a $1,000,000 death benefit in the policy, even after withdrawing $80,000 per year from the policy in the form of dividends or loans to satisfy the annuity trust payments.

The plan looked very good to the donor, the charity, and to the agent who stood to earn a large commission on the sale of the policy to the trust. The donor was publicly recognized in a campaign for a $1,000,000 gift to the institution and a bust of him and his wife was commissioned.

Today, 22 years later, the donor has been informed as trustee of the trust that the cash value of the policy is down to around $100,000 due to the loans which have been made from the policy, and the current death benefit is minimal. At current earnings projections, the death benefit must be reduced, or loans reduced, or some change made in the current situation, or all cash value and death benefit will be exhausted in less than two years. It is not possible for the donor to make an addition to an annuity trust.

What might the result have been if the trust corpus had been invested in a diversified portfolio including a significant percentage of equities. Would there be a problem today?

The donor, now quite elderly, feels "honor bound" to make good on the $1,000,000 commitment and is now wondering how best to do so. He is also extremely upset with the person who sold him on the idea who has since passed away. He is not upset with the charity, since he realizes that he acted on his own. He has turned the matter over to his attorneys. How might they proceed at this point?

3. Investment-oriented marketing by a charity.

A college with a narrow geographic constituency places an advertisement in a local newspaper which reads as follows:

INVEST IN XYZ COLLEGE!

Guaranteed income for life.

Rates of return higher than CD's.

Tax-free interest income.

Unlock capital gains without tax.

Inquire for more information

Mr. John Doe
Director of Planned Giving
XYZ College
Nowhere, U.S.A.

Mr. Doe is a salaried employee of the college. A number of persons respond, none of whom have ever made a gift to the college. Three persons enter into gift annuities with the college. No outside advisors are involved in any way.

a) Is this a security which must be registered?

b) Would these donors have an action under anti-fraud provisions?

c) Could subsequent disclosure remedy any problems?

d) Does it make any difference where an advertisement is placed?

Compare this advertisement with the following advertisement placed by the American Bible Society in 1921.

4. Aggressive marketing by financial professionals.

A local financial planner learns about the tax planning potential in charitable remainder trusts and places an ad in the local newspaper informing people that he knows how to avoid probate, capital gains, and estate taxes in a way that will result in no fees to the client.

His plan involves placing highly appreciated assets in a charitable remainder annuity trust and creating a higher income flow for life. The donor will serve as trustee. The planner can show persons in the age range of 60 and younger how they and/or their families can come our ahead on such a gift. He then asks charities to pay him a commission of 5% of the amount placed in the trust. He typically approaches several charities and splits the gift to make the commission more affordable. The donor is charged nothing.

a) Is this a security which must be registered?

b) Was there an "offering" by the charity?

c) Was there "co-venturing" by the charity?

d) Can a transaction become a security after the fact?

Suppose the trust is created with no commission paid and the charitable remainder designation is revocable. What if charities are asked to pay a percentage fee if the planner can convince the client to make the charity's share of the trust irrevocable?

5. Payment of other fees.

Same facts as above, except the planner charges the donor an hourly fee for his time and the charity pays the attorney fee for drafting the trust.

6. Traditional planned gift marketing.

Mr. and Mrs. Brown return a card from a mailing describing various life income gift options which was sent only to donors and other parties closely affiliated with a particular organization. They ask for more information about gift annuities. They are 71 and 69 years of age.

A development officer corresponds with them and in addition to furnishing disclosure materials informs them that the minimum contribution is $10,000, according to applicable policies, and they would be eligible for a charitable income tax deduction in the amount of 20% of what they contribute. A development staff member meets with them one time and has a conversation with their accountant and supplies them and the accountant with more details about gift annuities.

The development officer is compensated on a straight salary and may or may not receive a year-end merit bonus along with other employees of the organization. The bonus is not tied directly to the amount and/or number of gifts completed. The Browns send their check to the charity and they are written a letter thanking them for their gift.

a) Is this a security?

b) Is it exempt from registration?

c) Is disclosure required?

7. Marketing by volunteer professionals.

Your organization conducts a seminar and invites a group of volunteers and donors who happen to be engaged in various financial-related professions to make presentations to your invitees. The seminar is billed as a charitable gift planning seminar for those who would like to do a better job of making provisions for your institution. The volunteers agree to answer questions and help people make their gifts with no fees paid by anyone.

A couple comes to one of the seminars and then enters into a gift annuity.

Are there securities law implications to this type of activity?

X. Conclusion.

B. Don't be unduly concerned about securities law ramifications of planned giving programs. But don't ignore this area either.

1. The majority of planned gift marketing activities are unaffected by this area of the law so long as reasonable guidelines are adhered to.

a) Don't venture out of safe harbors without legal advice and possibly a "no-action letter" from the S.E.C.

a) Be careful in "packaging" planned gifts and giving them names other than commonly recognized descriptions which connote investment returns or wealth creation. Expectations which trigger securities concerns may be raised in those circumstances.

2. Bequest development efforts and other efforts to encourage remainders from plans donors have in place for other reasons are generally unaffected.

a) Care should be exercised in encouraging testamentary trusts.

b) Records of disclosure should be kept.

c) Challenges may be brought by heirs who will be less forgiving than the person who originally made the gift.

d) Be very careful in giving advice related to the tax treatment of gifts of retirement plan assets.

3. Carefully review all organizational marketing materials.

a) Carefully scrutinize the use of certain terms.

(1) Investment.

(2) Yield.

(3) Return.

(4) Tax-free.

(5) Capital gains avoidance.

(6) Guaranteed.

(7) Safe.

(8) Income (when dealing with annuities).

(9) Other investment related "buzzwords" and unwarranted comparisons to certificates of deposit, commercial annuities, mutual funds and other true investments.

b) Make sure materials emphasis charitable purpose and there is at least as much discussion of the gift as the plan.

(1) "Donative intent" may not technically be necessary under tax laws.

(2) Can be critical in determining treatment under securities laws.

c) In times of reduced income tax and capital gains tax savings and less of a role for gift and estate tax considerations, be careful not to jump from the "tax frying pan into the securities law fire."

4. Be careful in forming relationships with outside advisors.

a) Be especially careful in marketing any particular financial products and services.

b) Be very careful when paying any fees to those involved in working with the donor.

5. Where a gift has been brought to the institution and there is a request to serve as trustee, consider requiring that the person who structured the gift explain to the charity how the charity's disclosure duty has been met. Then consider holding a "disclosure" meeting with the donor, the person who structured the gift, the charity and any other persons who will be parties to the gift through the sale of investment products or services.

6. At closing, as part of the package of documents, consider having donor sign statement acknowledging that full disclosure has been made and consider asking outside planners to indemnify the charity against any actions resulting under state and/or federal securities laws on account of the manner in which the trust was marketed.

7. Payment of fees to institution's counsel for advice and documentation is acceptable if full disclosure regarding the terms of the professional representation is made to the donor in the event any materials so furnished may be relied on by the donor.

C. Is the risk over when the gift is completed?

1. Liability can sometimes only arise after the actual performance of the plan is compared to the prior representations or lack thereof.

2. Statute of limitations is only protection against future liability.

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Planned Giving and Finance Offices: A Plan for a Productive Partnership

Presented by:

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28th Conference on Gift Annuities
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Effective Communication with the Finance Office: A Plan for a Productive Partnership

Cam Kelly, Smith College

How would you describe the relationship between your planned giving office and your financial office? Friend or Foe? Are there days when you feel like your financial office speaks a different language than you do? If you are like many planned giving officers, these occurrences might be more frequent than you'd like. The responsibilities of the advancement and finance offices are diverse, therefore there will always be differences of opinion on gift crediting, counting, and accounting, as well as differences in terminology.

While many institutions enjoy a positive, professional relationship with a shared goal as their objective, others struggle to see eye-to-eye. Smith College has built and nurtured an excellent partnership for over thirty-seven years with the planned giving and financial offices working closely together for the benefit of the donors, beneficiaries and the college.

This presentation will look at the priorities that are important to "both sides of the street," and share some practical ideas for working in a collaborative manner.

Our Constituency(ies)

As planned giving officers we all know that our main constituency is our donors and prospective donors. We spend much of our work time devoted to building these relationships, finding out what makes them tick, what they wish for, and what information they need. In broadening our constituency a little bit, we can easily include our colleagues in the finance office, our investment committee, and our trustees. They make up a SECOND constituency – an important one – where we also need to work hard to build and cultivate the relationships, provide information, and keep the relationship running smoothly.

One opportunity I had to attend an Investment Committee meeting demonstrated for me that our finance office partners, Investment Committee members, and trustees are definitely another constituency that we need to inform and learn from. I brought information to that meeting focusing on the performance of the planned giving assets. I was surprised that their entire focus was on liability and cash flow: WHEN is the money going to arrive? HOW MUCH are we paying out? What is the average age of our annuitants? What is the average payout on our annuity pool? How much risk are we assuming in our gift annuity pool or with our charitable remainder trusts? I wish I had had a crystal ball at that meeting. Perhaps you've been in this same situation where you felt like the powers that be were questioning the value of your planned giving program. Depending on the size of your institution, there may be a small number of these "partners" or a whole host of them. They can include your CFO, Treasurer or Vice President for Finance, your Investment Director, Controller, or Chief Accountant, your Bequest Coordinator or Investment Accountant or even outside investment managers.

The Relationships at Smith College
Smith has enjoyed a very positive working relationship between the Planned Giving and Financial offices since the inception of the PG program in 1970. For structure, we work collaboratively on everything from gift acceptance to investments to administration of the planned giving assets. For gift annuities, we commingle assets with the endowment (which is overseen by the Treasurer's Office) and administer the program completely out of the Planned Giving office. We provide the tax letters for life income gifts, cut quarterly checks that are signed by the Treasurer, issue 1099-Rs to annuitants, and even run FASB reports for the Controller and our auditors using their guidelines for discount rates. For Pooled Income Funds and Charitable Remainder Trusts, Smith won't act as trustee, so we use BNYMellon as independent trustee, investment manager and administrator. Planned Giving still runs FASB reports for the auditors on all life income gifts because our database is complete. The bequest administration function lies in the Treasurer's Office although the Gift & Bequest Coordinator there works closely with the Planned Giving Coordinator on estate administration.

Collaborative Work
What do we work on collaboratively? Planned Giving shares information on annuity rates including any changes to the schedule that the ACGA suggests. We meet and agree on a schedule to use for CGAs and DPGAs. I send a memo of understanding to our Vice President for Finance for our files. We meet together with BNYMellon annually and decide on an investment strategy and asset allocations. We also review the investment performance quarterly and give guidelines on rebalancing allocations. We work together on preparing reports for auditors and outside groups such as trustees and investment committee. For this function, it is essential that we partner with the finance office because they know exactly what their committees want to have for information.

Wish Lists: If we look at what the finance office would like from us, there are a number of wish lists in different areas:

Financial Officer's Wish List (Gift Planning and Acceptance)
- Work with them before the gift is complete! If someone wants to set up an endowed fund with a strange restriction, call and talk it over. We work directly with our Controller on these issues. He often has suggestions on how to make the gift acceptable for the institution and still palatable for the donor. Then we don't lock ourselves into a situation that requires us to go to court to figure it out years down the road.
- Understand institutional priorities, especially for marketing efforts. We all know current gifts are best for our organization so we try not to compromise those. Example: when IRA contributions were allowed at a new $3,000 limit, we thought we might market DPGAs to that younger set as an alternative to an IRA contribution. I checked in with the VP for Finance who respectfully asked if that might not encourage younger donors to do DPGAs instead of make annual fund gifts. We agreed not to try this effort because we couldn't afford to lose $3,000 annual fund donors.
- Try to stick to the priorities the organization has established. Donors often want to designate gifts for something you don't want or need while you have real priorities that need funding. Make an effort to educate your donors about the current funding priorities and gauge their level of interest. If there's only interest in their pet project, then have one more conversation with finance or development director before accepting the gift. Sometimes you have to turn

down gifts, or more often than not the finance office will understand it's no gift or a gift designated the way the donor wants and they may opt for the gift.

- Remember that these are future gifts so leave the designations as broad as possible with the fewest number of restrictions. Ask yourself "Will the program be viable in the future?" If there is a restriction, try to keep it broad and use language like "with a preference for." Most donors understand the need for flexibility. Also use the "escape clause" that will save the organization from going to court in order to be able to use the funds. Our escape clause reads: *"If in future years circumstances have changed so significantly that it is no longer practical to use this fund as defined, the Trustees of Smith College may use the fund's income for other purposes, which, in their opinion, most closely fit the donor's intent."*
- Also use proper names of programs in parenthesis with a more generic description in case the name of the program changes.
- Document what you set up with donors for the future. Neither you nor the CFO may be there when this gift terminates so put the donor's wishes in writing. Consider using an endowed fund form that will live in the donor's record until her death when the funds are available to your organization.
- Before you finalize that documentation, check with the finance office for sign off. We have a process at Smith where the Controller's sign off is required before finalization of endowed funds. The finance office appreciates being consulted and they can keep us out of hot water or donor relations nightmares when funds can't be administered as the donor wished.
- Good judgment – before you get too far into a troublesome gift, ask for help. Include Finance in setting up gift acceptance policies that can protect you from gifts that are not in your best interest. Example: more and more often donors are calling with the idea that a life insurance policy is a better gift than one through the annual fund or for endowment. Have a policy!
- Be able to evaluate inherent risks with gifts and possible returns. If you embark on an effort to increase gifts of real property, this is a no brainer where you need to involve the finance office and put guidelines in place. <u>Example:</u> in the case of offering an annuity in exchange for real property, we worked closely together on arriving at a rate that made sense for both Smith and the donor.
- Once you've got your policies in place; be ready someday to decline a gift. Although we're always trying to make gift arrangements work for the donor, our first responsibility is to the institution. <u>Example:</u> anyone who knows me knows I worked on a gift of a horse some years back. The horse needed a psychiatrist. We should have looked that gift horse in the mouth!

<u>Financial Officer's Wish List (Administration)</u>

- They CAN be donor oriented! We may call them "bean counters" and they may call us "used car salesmen" but they really can think like a donor! We're thrilled because our Controller, who's been at Smith for 30 years, is very donor centered.
- Finance is happy to have PG be the primary relationship manager. They're also happy to have administration done by PG Office if it's done well. They feel it makes sense for us to remain the front-line contact with donors. We're like the hub with spokes going out to the donors, beneficiaries, financial office and outside manager if there is one. We took over administration of the gift annuity pool in 1998 and it's worked beautifully with software available.
- Excellent service is a primary goal for the financial office. They know that's the bread and butter of a successful PG program, and many financial offices play a large role in administering PG assets.

- Agree on what's out there. Both of our sets of books should reflect the same life income gifts. If we've booked a trust, they also have it accounted for on their books. If they know about a trust, most likely a testamentary trust, they make sure to tell us about it so we can book it on the development side and put it in the database for FASB reporting. You don't want your auditors finding discrepancies in this area. Semi annually we try to look over our lists to make sure they agree.
- Talk about methods of valuing life income gifts for different reasons. Talk about the difference in the IRS calculation compared to what the value of the gift really is to the institution.
- Provide them with data that supports the value of your program. Example: when I came back from the Investment Committee meeting, I needed to produce an analysis on average age of annuitants, average payout rate, termination values as a percentage of original gift and a cash flow projection for when we might actually see some of this money.
- When you make a choice about who will do administration and what product you'll use, shop for them together and make the decision together. Then if something doesn't work out there's no finger pointing. We worked on our RFP for services together back in 1992. Figure out what's in it for both of you. For administration software, we jointly made a choice, and even though we use it exclusively, several people in Finance have access to it and were trained on it.
- Bequest Administration – although it's their function at Smith, we help by setting things up right in the first place.

Financial Officer's Wish List (Investments)

- Whether investing is done in house or by an outside manager, PG offices should be familiar with terminology and investment philosophy for PG assets.
- Finance may not always think of including you on all the information they have so you need to ask for information to be shared so you can do a better job.
- Long-term performance is a priority, along with quality administration.
- Again, bring information to the table that can help educate outside constituencies. Your endowment managers may be crackerjacks at picking stocks, but do they know how a CRT or a PIF needs to be invested given their specific rules?

Planned Giving Officer's Wish List (yes, our wishes matter, too!)

- We are probably more of a partner with Finance than any other unit within development because we understand the financial side of the picture.
- This is often a lifelong financial relationship that is created through planned giving so we know that good collaboration with finance, excellent stewardship and administration are vital.
- We ARE working for the broadest gifts, however, it's our job to look out for both the interests of the donor or beneficiary AS WELL AS the institution. We try very diligently to steer prospective donors to the proper gift type, taking into account their objectives and goals as well as the impact the gift will have on our institution. We will always try to educate donors on why a lower CRT payout rate is preferable to a higher rate. We understand remainder value in the true sense of the word, not the IRS definition, but what a gift is really worth to our institution and we try to maximize that value through education.
- We are the true hub between donors, the financial office, and any outside manager or administrator since we originated the relationship and we are the front-line nurturer of it.
- We're receptive to being coached and appreciate finance-based knowledge. This will only help us do our jobs better. If possible, let us be a part of discussions and decisions regarding

investments, performance, changes in gift annuity rates, etc. This will make us stronger partners in the relationship.

- One of the strongest parts of our relationship at Smith is the collaborative way that we approach the outside management and administration of our CGA, PIF and CRT assets. I feel comfortable talking with any donors about endowment investment and performance facts because information is freely shared with me.
- We are usually the contact with organizations like ACGA. We are constantly provided with information about annuity rates and how they arrive at their suggested schedule, state regulation information, etc. We can and should pass this information back to Finance in order for an informed decision to be made. If we don't pass on this timely information and annuity rates stay high or something happens regarding investment rules or regulations in some states, we are putting our finance office at a disadvantage.
- We often have database information or Excel files that have great information in them for you or another group to review. Let us be a partner in providing and presenting this information. Smith, like other institutions, can be hierarchical about who gets to meet with trustees, etc. It was a great opportunity when I was invited to an Investment Committee meeting in NYC. I was stunned that they didn't focus on performance of the PG assets. They were more worried about payout liabilities, when we might ever realize any of these funds, and how valuable these gifts were to Smith. So I went back and used my database to do some cash flow projections. I also calculated an average age for gift annuitants and an average payout. Then I went to my Excel termination files to show over any number of years how our termination values looked compared to our initial gift values. In short, this information was invaluable to the investment committee members. They were relieved to know that PG at Smith is indeed of great value to the institution. We now are seeing some very large terminations coming at a time when our budget can use them the most. It's a great idea for the PG office to become familiar with this kind of number crunching that you can underscore the value of the program. Finance officers love figures so if you can show an aptitude for presenting figures that support the value of PG, just do it.
- Think with a donor relations hat on. One thing I like best about our Controller, who has been at Smith for 30 years, is his ability to think about how the donor will feel. How can we work together to make this gift happen?

Elements of a Strong Working Relationship

- Appreciate the fact that your two offices have different responsibilities and respect their position when they make an argument.
- Both offices should be able to articulate needs in a way that is inclusive, not merely mandated.
- Have a mutual respect for each other's knowledge and the other person's commitment to his or her primary goals. You're each trying to do the best job you can.
- Do your best to work collaboratively toward a common goal of making your organization as financially healthy as it can be.

The financial office is very concerned with keeping remainder values intact or even increasing them if possible, among other important things. Although planned giving officers understand the dual need to preserve remainder value for the institution as well as secure income for the donors or beneficiaries, we are often thought of as advocates for the donors and beneficiaries only. Working closely with our financial officers, and demonstrating an understanding of the elements that they feel are most important for planned gifts, will go a long way in forging a positive professional relationship between the two offices.

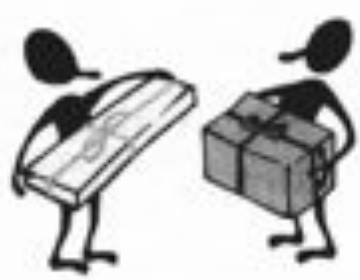
The Planned Giving Office Financial Office Partnership

Cam Kelly, CFA
Director of Campaign & Gift Planning
Smith College
28th Conference on Gift Annuities
April 2008

Players

<u>CFOs, Controllers, Accountants, Investment Directors</u>

<u>Planned Giving Officers, PG Coordinators</u>



Players at Smith
(and their responsibilities)

- FINANCIAL OFFICE
- Oversees endowment management (CGAs)
- Signs quarterly annuity checks
- Reviews endowment strategies and performance with PG
- Reports for auditors

- PLANNED GIVING
- Primary donor contact
- Maintains donor database
- Produces annuity checks
- Produces 1099-Rs
- Produces FASB reports for auditors

Players at Smith
Collaborative Work

- Agree on annuity rate schedules
- Review and decide on investment strategies
- Review and rebalance asset allocations
- Oversee relationship with outside trustee bank
- Prepare reports for auditors and trustees

Financial Officer's Wish List
(Gift Planning & Acceptance)

- Work with us *before* the gift is complete!
- Understand institutional priorities
- Aim for the least restrictive gift
- Use "escape" clauses
- Share new industry information
- Exercise good judgment; know when to ask for help
- Agree on gift acceptance policies and be ready to decline a gift
- Evaluate risks and possible returns
- Document decisions!

Financial Officer's Wish List
(Administration)

- Know that we CAN be donor oriented!
- Primary donor relationship is in PG office
- Maintain excellent service to donors with timely and accurate information
- Agree on life income gifts that exist
- Agree on methods of valuation
- Provide us with data that supports the value of your program
- Evaluate new software collaboratively

Financial Officer's Wish List (Investments)

- Understand investment goals and terminology
- Ask for information to be shared
- Long-term performance and service quality are key goals.
- Bring information to the table that can educate outside constituencies (trustees, investment committee, etc.)

PG Officer's Wish List

- We ARE working for the broadest gifts
- We appreciate our dual responsibilities to donor and institution
- We want to confer on gifts before accepting
- We prefer to be the primary donor contact
- We need to have information on investments in order to talk knowledgeably with donors
- We want to be a part of vendor choices
- We can provide data analysis supporting the value of the program

Elements of a Strong Working Relationship

- Appreciation and respect for differing responsibilities
- Ability to articulate needs
- Respect for each other's knowledge and commitment to primary goals
- Ability to work collaboratively toward a common goal.

Top Ten Estate Settlement Problems & What to Do About Them (a.k.a. Keeping Your Donors From Rolling Over in Their Graves)

Presented by:

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Vice President of Estate Settlement
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St. Petersburg, FL

28th Conference on Gift Annuities
Thursday, April 3, 2008

Top Ten Estate Settlement Problems and What To Do About Them (a.k.a. Keeping Your Donors From Rolling Over in Their Graves)

Some introductory/background comments

Every charity that receives gifts from the various and sundry estate planning methods that their donors use has some "system" for administering such bequests. For smaller charities and churches, usually either the Executive Director (or clergyman) himself or someone responsible for Finance handles these gifts. In my experience, these groups typically don't do much more than sign a receipt and say thank you for the gift. At mid-size organizations, these gifts are usually handled by a planned giving officer or a revenue manager in the Finance department. Procedures here run the gamut from a simple receipt and thank you to full-on monitoring of the probate/trust administration. For large, national charities, there is often a single person or a team solely dedicated to handling bequests. Typically they have the means (a database) to track and monitor these gifts and a standard procedure or set of steps that must be met in order to meet audit requirements.

However, no matter what the size of charity and no matter what the size of the bequest, the receipt of every bequest does not always "go smoothly" and there are several typical problems which seem to occur over and over again. Fortunately they represent a minority of the bequests received by charities – but they can take up a majority of your time in dealing with them.

To give you an idea of how often these problems crop up, the AHA handles approximately $90 million in annual estate settlement revenue, opens about 1,500 new estates every year and maintains files on roughly 300 on-going split-interest trusts and 300 on-going perpetual trusts. Our "litigation rate" is almost always around 4% (although for some reason in Texas it's much, much higher). For about half of those "litigation" files, the AHA hires outside counsel to represent it and the other half are dealt with internally. In total, we estimate that about 10% of the estates we handle have some sort of "problem" – ranging from a full-blown will contest to an executor who's just dragging his feet and is slow in making distribution.

Just as every bequest and decedent is unique, so are the problems that relate to them. There's no magic bullet that will solve every problem, so you have to read the situation carefully each time and be flexible in your response. Most importantly, your job is to maximize the funds distributed to your organization while keeping expenses as low as possible. That means that you matter how strong the principle you are standing on or how right your cause is – you need to evaluate your potential actions in terms of cost-benefit. Or, as a great white-bearded sage once said, "You've got to know when to hold 'em and know when to fold 'em."

So with all of that in mind, here are ten typical problems faced in charitable bequest administration and some helpful (hopefully) tips to deal with them.

<u>The Problem</u>: It's been eons since the estate/trust administration was started and you still don't have the distribution your charity is entitled to receive.

<u>The Cause</u>: Most typically it's just lazy or overworked attorneys, trust officers or others involved in the administration. Maybe the attorney is waiting for the accountant to send her the final tax return (of course, it wouldn't hurt the attorney to call to find out how it's coming along either). Maybe there's a legitimate delay or maybe someone's run off with the money.

<u>What To Do About It</u>:

a. Use a tickler system to stay on top of all of your files

   i. If you don't tickle, you won't know you have a problem.

   ii. General guideline – specific bequest – 6 months.

   iii. General guideline – residual bequest – 12 months.

   iv. General guideline – residual bequest with estate tax – 18 to 24 months.

   v. Request status update regularly (every 3 to 6 months or less depending on how overdue the situation is).

b. The squeaky wheel gets greased.

   i. A phone call works better than a letter or email, but…

   ii. Document you're the call with a follow up letter and cc: other beneficiaries; at least make note in the file that you called to request an update.

   iii. Be pesky, but not annoying.

c. Get others involved.

   i. Have other charitable beneficiaries call/write to ask the same questions.

   ii. Ask to talk to the attorney handling the file if you've been working with the paralegal/assistant or vice versa.

d. Calling the probate court and motion to show cause.

   i. Courts have different rules about setting motions to show cause.

   ii. Send letter to the court detailing your attempts to contact/get action and cc: the other beneficiaries and the problem maker.

   iii. SHOW UP and be heard at Show Cause Hearings.

e. Filing a motion to compel distribution.

   i. Last ditch effort and usually will require you obtaining outside legal counsel unless you are a lawyer.

   ii. Attorney fees can often be recovered.

<u>The Problem</u>: The attorney/executor/trustee has failed to provide you with the information or documents requested.

<u>The Cause</u>: These problems fall into one of two categories – laziness/forgetfulness and willfully withholding information. If it's the first, you've basically got the same problem as a slow moving estate and many of the suggested solutions will apply here as well. If the individual is willfully withholding its usually because 1) they are trying to protect the privacy of the decedent; 2) they don't understand the legal requirements or 3) they are just a jackass. This problem tends to be much more common when you are dealing with a "non-lawyer" who is handling the estate without the assistance of legal counsel.

<u>What To Do About It</u>:

a. Give them options.

   i. If you are asking for a copy of the dispositive instrument and you're just a specific beneficiary – just ask for the section that pertains to your organization; if you're a residual beneficiary, tell the person that they can redact the names of other beneficiaries from the document.

   ii. If you are asking for an accounting, indicate that you don't need a full, formal accounting. Provide a simple form that shows a starting balance, receipts, distributions, general expenses, legal fees and an ending balance.

b. Explain why you need what you are asking for.

i. Will/Trust Document – record of language used to make the gift; confirming unrestricted or restricted; ability to calculate expected distribution.

ii. Accounting – confirm that entity received what it was suppose to and review any fees.

iii. Audit Requirements – sample language we use (especially with non-attorneys)

Before I can provide you with a signed Consent/Receipt, the AHA needs to obtain an accounting for the estate to verify its distribution. We ask for this document, not to be difficult, to pry into the decedent's life or to question the actions of the executor, but rather in order to comply with Generally Accepted Accounting Principles (GAAP) that are required by our external auditors. For the AHA, failure to comply with GAAP could result in the loss of our non-profit status (so I hope you can understand why this is important to us).

c. Site the statute giving you your rights.

i. Almost every state requires executors and trustees to provide beneficiaries with a copy of the instrument upon request (and usually they must provide an inventory and/or accounting as well). You can view almost every state's probate code through its respective Secretary of State or Legislature website for free.

ii. When dealing with attorneys – be sure you are citing the correct statute.

iii. When dealing with non-attorneys – provide a photocopy of the statute with your second request letter.

iv. Don't let them charge you additional fees for providing what is required under the law – especially if they are on a percentage fee.

d. Don't sign receipts/waivers or deposit a final distribution check until you get what you want.

e. But none of the OTHER charities are asking for any of this stuff?

i. "Well, we are."

ii. Here's a list of just a few of the charities that DO always ask for these types of documents: American Cancer Society, American

Heart Association, American Diabetes Association, American Lung Association, The Salvation Army, The Nature Conservancy, Shriners' Hospitals, St. Jude's, Sloan-Kettering, most major universities, etc.

The Problem: The attorney/executor/trustee can't (or doesn't want to go to the hassle) of liquidating certain assets and is asking to distribute them in-kind.

The Cause: Nothing slows down the estate administration process more than difficult-to-liquidate assets. Many times the person handling the estate/trust will not have the expertise to properly deal with such assets. These assets include: oil/gas/mineral interests, tangible personal property (the 2,000 piece Hummel collection), timeshares, cemetery plots (preferably vacant), unmarketable real property, anything that requires to be feed.

What To Do About It:

a. Disclaim, Disclaim, Disclaim

    i. On worthless assets or assets that may create liability (property situated on a Superfund site for example).

    ii. Typically can be done at any time PRIOR to accepting the property.

    iii. Typically must be in writing (and should be recorded).

    iv. Be specific about exactly what you are disclaiming – you still want to get everything else you are entitled to in the estate.

b. Using E-Bay and E-Bay dealers.

    i. Good for tangible personal property, especially collectibles.

    ii. Realize you are going to lose a percentage off the top.

c. EnergyNet.Com and similar services.

    i. Oil/gas/mineral interests are very complicated.

    ii. Gather the basic information and these services, for a fee, will put your property up for auction – let's the market dictate the price – rather than accepting offers from unknown parties.

iii. Try to combine your fractional interest with fractional shares from other charities taking the asset under the will.

d. Courthouse Auction.

i. For real property – depending on the county may only be for tax sales or may include other property.

ii. Problem with valueless property is that it takes a long time for unpaid taxes to accrue enough to the point where the county will force a tax sale.

iii. Keep a catalog or record of all in-kind property your organization holds – know what you own and what you've sold.

e. Pawn it off on someone else.

i. Avoid receiving fractional interests of tough to liquidate property – it will be that much more difficult to get rid of.

ii. See if other parties will take the unwanted asset in-kind as part of their share (discount if necessary).

<u>The Problem</u>: The attorney/executor/trustee appears to be charging an excessive fee for his or her services.

<u>The Cause</u>: Good, old-fashioned greed. "They can't possibly bill that much on this matter," asked the young associate. "They can and they will," answered the wily old partner. While most attorneys and other professionals will not attempt to take advantage of an estate where there are only charitable beneficiaries, I've met plenty that will.

Sometimes the fee is just plain high. Other times they hit you in sneakier ways. Watch for pre-death attorney service fees ("I never charged old Barney for any of the services I provided to him while he was alive"). Watch for charges at attorney rates for non-attorney services ("You mean I can't charge $300/hour to mow the deceased's lawn?"). Watch for requests for compensation for actions taken during the lifetime of the deceased ("I should get paid for all those trips when I went to check on Grandpa – no one else was looking out for him"). Watch for duplicate billing for the same service ("Hmm, the accountant charged the estate for six hours to do the tax return and the attorney also charged us seven hours to do the tax return").

<u>What To Do About It:</u>

a. Know the statutory and customary rates for your state/region.

i. Some fees are limited by statute; sometimes the statutes only set a ceiling on what is presumed to be reasonable.

ii. Attorney fees typically range from 3% to 5% (NY goes higher).

iii. Executor/Personal Representative fees typically range from 3% to 5%.

iv. Trustee fees typically range from 1% to 3%.

v. Most states permit an attorney who is serving as either trustee or executor to "double-dip" and take both fees.

vi. Understand what services a party can charge "extraordinary fees" for doing – selling real estate, managing decedent's business, liquidating hard to sell assets, tax preparation, dealing with litigation (not answering your basic questions or providing you with an accounting).

b. Ask for documentation of hourly billing in detail.

i. Most attorneys on hourly fees won't have this for percentage based fees and then they don't have much to hang their hats on.

ii. Have a "friendly" attorney (perhaps a board member) look over it to see if it generally seems reasonable.

c. Complain.

i. For fees above the reasonable rate, ask what was unusual about this probate/trust administration – especially if you know all the assets were pretty run-of-the-mill.

ii. Gather the troops and get the other charities to question the fees as well.

iii. Even if you don't win this battle; the individual will think twice about charging such fees the next time your organization is involved.

iv. Call the state Attorney General and see if it will help.

d. Do a Cost-Benefit Analysis.

i. The fees may be excessive by $100,000, but if your entity is only a 1% beneficiary, you're only looking at a gain of $1,000 at a max;

and that doesn't include your costs in fighting the fees (and potential bad will you're generating).

ii. You can always ask for a donation – ha!

<u>The Problem</u>: Your charity is named in the decedent's final will, but someone is claiming that will is invalid due to lack of testamentary capacity or because of undue influence. Alternatively, the charity was named in the decedent's prior will, but a "deathbed" will was procured that leaves all the deceased's assets to a previously unnamed individual who magically appeared near the end of the deceased's life.

<u>The Cause</u>: There are generally two sources of the problem here: disgruntled relatives (who can't seem to understand why Cousin Earl would choose to leave money to charities when he had us as kin, even though we haven't spoken in 40 years) or the dubious caretaker (shouldn't they get something for cleaning that old man up every other day and staying out of the nightclubs for nearly three straight weeks?). These cases are often very tragic, but can produce some great anecdotes for cocktail parties.

Testamentary capacity is the mental ability to execute a will. It is a very low standard. Basically the person has to know generally what her assets are, who her intended beneficiaries are, who her natural "kin" are, and who's getting what when she dies. Episodes of poor memory or even some types of dementia or delusions aren't necessarily enough to prevent someone from having testamentary capacity.

Undue influence tends to be where most of these fights take place. In order to unduly influence a testator, one must be in a confidential relationship with the testator who is susceptible to influence and have gotten the testator to alter his/her post-death plans to the influencer's benefit. I've never seen a charity be found to have unduly influenced a person, but its plead all the time – so don't panic (unless of course your planned giving officer was driving the deceased to the lawyer's office and moved the pen for him as her signed his will). I have seen plenty of other individuals – usually family members, next-door neighbors or caregivers – be found to have unduly influenced a testator.

<u>What To Do About It:</u>

a. Get an attorney – but settle.

   i. Even in nuisance suits, this is one time being represented by legal counsel is crucial.

   ii. Your attorney can use the tools of discovery to determine the validity of the claims – medical records, history of prior wills, taking depositions, etc.

iii. It really stinks/hurts to settle when you are clearly in the right, but again it is often a cost-benefit analysis you have to undergo. You may be likely to win if you go to trial, but your legal fees might be $100,000. So if the contestant is asking for $25,000 to go away – it's probably worth agreeing to.

iv. If your interests are aligned, share attorney fees with other charities involved. Make it clear up front how fees are to be divided. Be aware that different sized charities might have different priorities as well.

b. Know the parties, the stakes and how everyone is going to get paid.

i. Be sure you understand the total financial picture of the estate and trust and exactly what's at stake; compare your "take" under different versions of the document in question (as well as the other parties).

ii. Most of the time, individuals contesting the will are represented by an attorney on a contingent fee recovery; that can work in your favor or against it.

iii. Get a feel for the relationships between the deceased and the contestants and between the contestants themselves if there are multiple ones.

iv. Settlements can be creative. One potential party hasn't bothered to participate – let them get the short end of the stick.

c. Keep in mind – you're almost always the "good guy" as the charity.

i. Don't feel bad for the "poor family" members; if they were such loyal relatives, why didn't Uncle Sid leave any of his money to them? Plus, you know funds your charity receives will be put to good use.

ii. You have fiduciary duty to make sure that the deceased's wishes are upheld and your charity might be the only person fighting for those wishes (but don't be blinded by this fact either; remember cost-benefit).

d. The longer the money is tied up, the itchier non-charities will get to settle.

i. Patience is a virtue and the majority of the time your charity doesn't absolutely need these funds to stay in existence; nor is it usually the case that these funds will make a dramatic difference in the way your organization is run. Hence, time is on your side.

ii. Attorneys on contingent fees don't get paid unless they win or settle. The longer a case goes, the more aggressive they will get with their clients to settle (but you'll also be racking up your own attorney fees in the interim – did I mention cost-benefit?).

iii. Contestants can get as frustrated with the process as you and may have "made plans" for the money they expect to receive. They might take less now if they see you are determined to fight and drag this matter out for years.

The Problem: The testator hasn't exactly named your organization correctly or your organization name has changed since the will was written. Now the attorney/trustee is questioning whether your entity is the proper beneficiary or is arguing that the bequest has lapsed.

The Cause: Not every attorney calls or otherwise confirms the legal name of the charity before drafting a will. The testator may be confused about what entity she means to support. Your organization was originally made up of separately incorporated local chapters, but over time they've merged into a single entity to effect economies of scale. Your entity is better known by the name of a fundraising campaign it conducts than its legal name or the mission has changed somewhat prompting a name change.

What To Do About It:

a. Keep a history of documents accepted under other alternate entity names; especially if a court has entered a ruling on the validity of the gift

   i. Create an affidavit for a senior official to sign explaining how the organization is often referred to as "X" and how in cases "Y" and "Z" the probate court held that your entity was the same as the one named in the document.

   ii. Avoid the problem my making sure your PG officers and others are distributing correct "suggested wording for bequests" forms that identify your organization by tax-identification number and explicitly include the phrase "or its successor".

b. Keep merger paperwork handy and organized.

   i. Create a "family tree" of your organizations history when there are multiple mergers or name changes or both.

ii. Check to see that prior entities are properly listed as "merged" (assuming they properly were merged) on the website of the state Secretary of State/Department of Corporations.

c. Know the prior addresses of your organization and the addresses of any field offices.

d. Know your competition.

i. "Sound-alike" organizations – know their legal names, status, locations, etc.

ii. Sometimes "splitting the baby" is cheaper than fighting to the death over a bequest (Example – The bequest is made to the American Heart and Lung Association. No such organization exists, but the AHA and ALA agreed to split the bequest equally).

<u>The Problem</u>: Your organization has been given a wonderful gift (maybe a swanky residence or a huge trust portfolio of assets)– but alas, you can't get access to the funds until some contingency occurs (i.e. a friend is permitted to live in the house until she dies or a nephew gets income from the trust until he turns 50).

<u>The Cause</u>: Testators want to ultimately benefit charity, but there are certain individuals they want to be sure are taken care of while those individuals are still alive. Setting up a trust that distributes net income to a beneficiary for life might enable him to maintain his lifestyle, while still preserving the corpus for charitable (albeit delayed) purposes.

The problems here are three-fold. First you may be required to recognize (and annually revalue) the asset on your accounting records even though you won't "get" it for many years to come. Second, the asset could be substantially deteriorated/degraded in the hands of the intervening beneficiary. Third, there's the question of responsibility for maintaining the asset in the interim.

<u>What To Do About It:</u>

a. Get the life holder to buy you out if possible (or vice versa).

i. Especially in cases of life estates in real property – you don't want the hassle for the next forty years and at this point the present value of your remainder interest isn't typically huge.

ii. For life income trusts, the present value of the individual beneficiary's lifetime income flow can often be calculated based on a variety of factors. The beneficiary might be more interested in a getting a single lump sum rather than a sting of otherwise smaller payments.

b. Monitor, monitor, monitor.

   i. For real property, make sure that the annual property taxes are being paid, that homeowner's insurance is obtained (and that you are one of the beneficiaries) and that the property is being properly maintained.

   ii. If the decedent didn't set up a mechanism for supporting the costs (taxes, maintenance, etc.) of the real property, get a written agreement with the life beneficiary detailing each parties rights and responsibilities.

   iii. On trusts, monitor any discretionary principal distributions and make sure they conform with the dispositive instrument – especially if the life beneficiary and the trustee are one and the same person.

c. Confirm annually that the contingency hasn't occurred (i.e. is that guy still alive?)

   i. Plenty of trusts keep paying out to dead people (i.e. the people that have access to their bank accounts) long after they are dead and buried.

   ii. Obtain the age and/or birth date of the life beneficiary; check with the trustee and review the social security death index to make sure he/she is still alive.

   iii. The pets for which pet trusts are set up are notorious for living extraordinarily long lives when the trustee gets an annual fee for handling the trust and the pet. Make sure that Fluffy hasn't been replace with a younger look-alike.

   iv. Use your tickler system to schedule reminders to review these trusts; especially when they may have staggered multi-year principal payments or partial terminations due to multiple life beneficiaries.

<u>The Problem</u>: The estate has been closed for four years. You thought you had seen the last of the file when you sent it off to storage. Then, like manna from heaven, someone tells you there are additional assets belonging to the deceased that have just been discovered.

The Cause: Someone at a bank discovered an account hasn't been touched in ten years as part of an annual review or more likely an asset recovery service has been searching your state's unclaimed property website or database.

What To Do About It:

a. Routinely check unclaimed property websites for states you operate in.

    i. Beat the asset recovery services at their own game.

    ii. You'd be surprised the goodies you'll find there for your charity.

b. Negotiate fee rates with asset recovery services. Play the charity card.

    i. Asset Recovery Services usually charge anywhere from 10% to 40% for their services. They are easy to use since they usually do most of the work and they only recover if you do. They can often be negotiated down on the fee.

    ii.

The Problem:

The Cause:

What To Do About It:

a. Have a clear and well-documented policy on gift restrictions.

b. Compare to the other charitable bequests in the document.

c. Compare to lifetime giving of decedent, if any.

d. Require additional documentation of donor's intent – such as a letter from the trustee/executor.

The Problem:

The Cause:

What To Do About It:

a. Private inurement – hang your hat on it.

b. Create a united front with the other charitable beneficiaries.

c. Find a way to recognize within your organization that doesn't affect the bottom line.

d. Do a cost-benefit analysis.

Conclusion

- Just because your organization is a charitable beneficiary doesn't mean you don't have the same rights (and responsibilities) as any other type of beneficiary.
- Making sure the deceased donor's wishes are properly followed (which includes making sure your entity has received its full share) doesn't ever make your charity ungrateful for the gift they have bestowed upon your organization.

TOP TEN ESTATE SETTLEMENT PROBLEMS AND WHAT TO DO ABOUT THEM

(Keeping Your Donors From Rolling Over in Their Graves)

Presented By: Andrew M. Fussner
Vice President – Estate Settlement
American Heart Association

American Heart Association

Learn and Live

THE SLOW MOVING ESTATE/TRUST ADMINISTRATION

THE SLOW MOVING ESTATE/TRUST ADMINISTRATION

- Use a tickler system.
- The squeaky wheel gets greased.
- Get others involved.
- Calling the probate court & getting a motion to show cause.
- Filing a motion to compel distribution.

FAILURE TO PROVIDE REQUESTED INFORMATION

FAILURE TO PROVIDE REQUESTED INFORMATION

- Give them options.
- Explain why you need what you are asking for (audit requirements, etc.).
- Site the statute giving you your rights.
- Don't sign receipts or waivers or deposit a final distribution check until you get what you want.
- But none of the OTHER charities are asking for this.

UNWANTED ASSETS

UNWANTED ASSETS

- Disclaim, Disclaim, Disclaim.
- E-Bay and E-Bay dealers.
- EnergyNet.Com and similar services.
- Courthouse Auctions.
- Pawn it off on someone else.

TOP FIVE ASSETS DEVISED TO THE AHA

5. The goat.

4. Our very own crack house.

3. The 1972 Buick with shag carpet in back.

2. The rights to the name and image of baseball's "Shoeless" Joe Jackson.

1. The royalty rights to the song "I'll Be Home For Christmas".

4

EXCESSIVE OR HIGH FEES

EXCESSIVE OR HIGH FEES

- Know the statutory & customary rates for your state/region.
- Ask for documentation of hourly billing.
- Complain.
- Do a cost-benefit analysis.

WILL CONTESTS

WILL CONTESTS

- Get an attorney – but settle.
- Know the parties, the stakes and how everyone is going to get paid.
- Keep in mind – you're almost always the "good guy" as the charity.
- The longer money is tied up, the itchier non-charities will get to settle.

DETERMINATION OF BENEFICIARY ISSUES

DETERMINATION OF BENEFICIARY ISSUES

- Keep a history of documents accepted under other names; especially if a court has entered a ruling on validity; create an affidavit in support.
- Keep merger paperwork handy and organized.
- Know your prior addresses.
- Know your competition.

VII

THE INTERVENING CONTINGENCY YOU MUST MONITOR FOR YEARS

THE INTERVENING CONTINGENCY YOU MUST MONITOR FOR YEARS

- Get the life holder to buy you out if possible.
- Monitor, Monitor, Monitor.
- Confirm annually that the contingency hasn't occurred (i.e. is that guy still alive?).

AFTER-DISCOVERED ASSETS

AFTER DISCOVERED ASSETS

- Routinely check unclaimed property websites for states you operate in.
- Negotiate fee rates with asset recovery services. Play the charity card.

THE "RESTRICTED"
UNRESTRICTED GIFT

THE "RESTRICTED" UNRESTRICTED GIFT

- Have a clear and well-documented policy on gift restrictions.
- Compare to the other charitable bequests in the document.
- Compare to lifetime giving, if any.
- Require additional documentation of donor's intent – such as a letter from the trustee/executor.

THE SPECIAL REQUEST – COMPLETE WITH SOB STORY

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- Private inurement – hang you hat on it.
- Create a united front with the other charitable beneficiaries.
- Find a way to recognize within your organization that doesn't affect the bottom line.
- Do a cost-benefit analysis.

LAST POINTS WORTH REMEMBERING

- Just because you're a charitable beneficiary doesn't mean you don't have the same rights (and responsibilities) as any other type of beneficiary.
- Making sure the deceased donor's wishes are properly honored doesn't ever make you ungrateful for the gift they have bestowed upon your organization.

Optimizing CRT, CGA and Endowment Investments

Presented by:

Donald P. Kent
Principal
Bernstein Global Wealth Management
New York, NY

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Bernstein Global Wealth Management
New York, NY

28th Conference on Gift Annuities
Thursday, April 3, 2008

Setting Objectives: A Historical Perspective

1965–2006

- A 60/40 mix maintained its real value even after giving 5% of assets annually...

	60% Stocks/ 40% Bonds
Annualized Return	9.6%
Inflation[1]	(4.6)
Giving Level	(5.0)
Return After Inflation and Giving	**0.0%**

- ...without significant volatility in annual giving

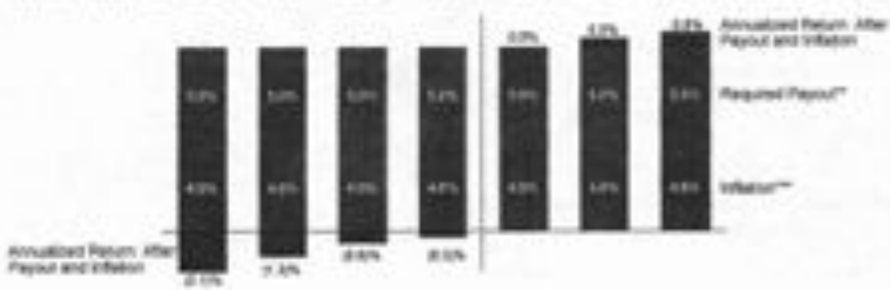
60% Stocks/40% Bonds	
# Years with >10% Decline	1 out of 42
# Years with >20% Decline	0 out of 42

Outpacing Inflation Required More Stocks

1965–2006

Annualized Return: After Payout and Inflation

Asset Allocation							
Stocks	0%	20%	40%	50%	60%	80%	100%
Bonds	100	80	60	50	40	20	0
Annualized Return*	**7.8%**	**8.2%**	**9.0%**	**9.1%**	**9.6%**	**10.1%**	**10.4%**



Endowments and Foundations Are Equity Oriented

Average Asset Allocation

■ Endowments average 73%

Endowments*

Equities	57.7%
Hedge Funds	9.8
Real Estate	3.5
Venture Capital	0.8
Private Equity	1.8
Bonds and Cash	23.6
Other	2.8
Total	100.0%

Commitment to risky assets 73.6%

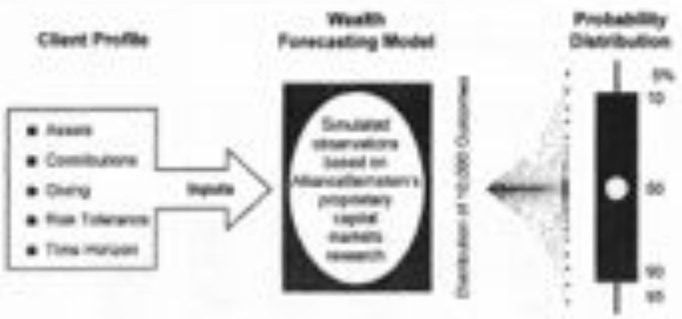
■ Foundations average 67%

Foundations**

Equities	60.0%
Hedge Funds	4.6
Real Estate	2.6
Venture Capital	—
Private Equity	—
Bonds and Cash	28.0
Other	4.8
Total	100.0%

Commitment to risky assets 67.2%

Analytical Approach Is Essential



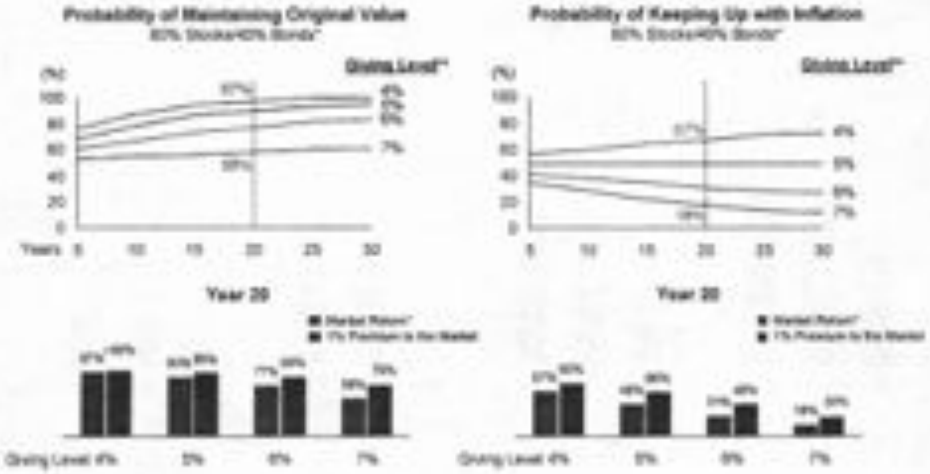
■ Assumes uncertainty in the future to determine a realistic range of outcomes

■ Incorporates complex interrelationships among asset classes

■ Takes into account current market conditions

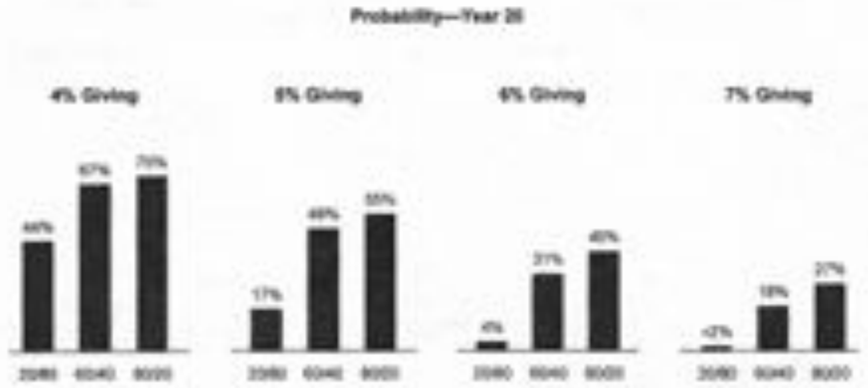
■ Considers historical patterns of returns—without relying on averages

What Level of Giving Is Sustainable?



Maintaining Original Value: Alternative Asset Allocation

Keeping Up with Inflation: Alternative Asset Allocation



Performance During Down Stock Market Years

1951–2006

	30% Stocks/ 70% Bonds	40/60	50/50	60/40	70/30	100% Stocks
1953	2.3%	1.9%	1.4%	0.9%	0.5%	(1.0)%
1957	1.9	2.1	(1.8)	(3.6)	(5.4)	(10.8)
1962	2.4	0.8	(0.7)	(2.3)	(3.9)	(8.7)
1966	(0.6)	(1.9)	(3.3)	(4.7)	(6.0)	(10.1)
1969	(6.0)	(6.4)	(6.7)	(7.1)	(7.5)	(8.5)
1973	(2.2)	(4.0)	(5.8)	(7.6)	(9.4)	(14.7)
1974	(3.7)	(7.2)	(10.6)	(13.8)	(17.5)	(26.5)
1977	(0.1)	(1.5)	(2.1)	(3.1)	(4.2)	(7.2)
1981	5.9	4.3	2.8	1.2	(0.4)	(4.9)
1990	5.9	4.8	3.4	2.1	0.8	(3.1)
2000	4.5	2.5	0.6	(1.4)	(3.3)	(9.1)
2001	2.4	0.4	(1.7)	(3.7)	(5.7)	(11.9)
2002	(0.4)	(3.6)	(6.9)	(10.0)	(13.1)	(22.1)
1951–2006*	7.6	8.2	8.8	9.4	10.0	11.6
Growth of $100,000	$4.9 Mil.	$6.2 Mil.	$11.6 Mil.	$15.7 Mil.	$21.1 Mil.	$48.3 Mil.

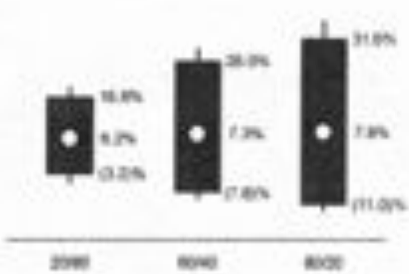
The Severity of Deep Bear Markets

Peak-to-Trough

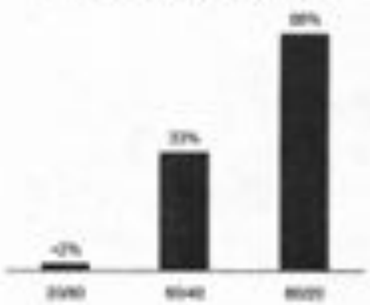
	100% Bonds	30/70	40/60	50/50	60/40	70/30	100% Stocks
Dec 1968–Jun 1970	(8.0)%	(14.8)%	(16.7)%	(18.8)%	(21.0)%	(23.1)%	(29.3)%
Jan 1973–Sep 1974	5.8	(11.8)	(16.7)	(21.8)	(26.2)	(30.7)	(42.7)
Sep 1987–Nov 1987	2.3	(7.8)	(11.0)	(14.2)	(17.4)	(20.5)	(29.6)
Apr 2000–Mar 2003	30.4	4.2	(3.3)	(10.8)	(17.6)	(24.0)	(40.9)

What Are the Chances of Future Loss?

Range of Annual Returns

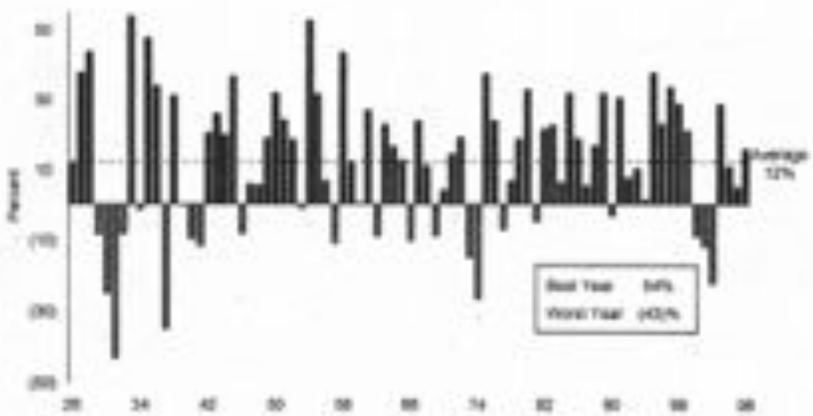


Probability of 20% Peak-to-Trough Loss at Any Time over 20 Years



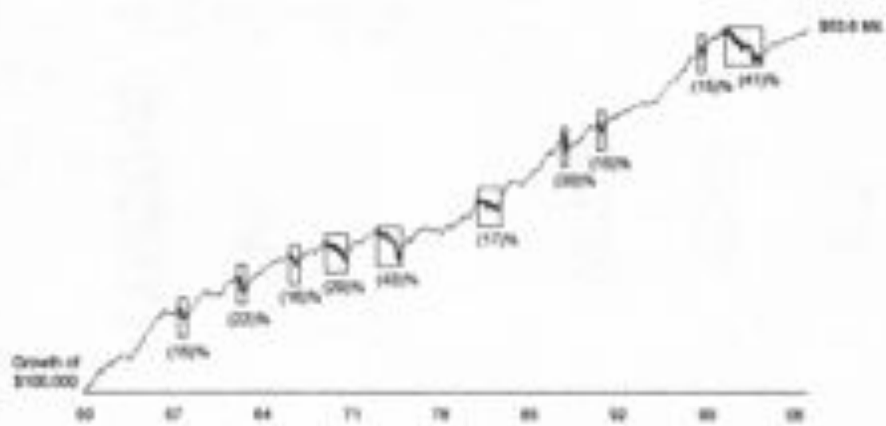
Stock Returns Have Been Volatile over the Short Term

S&P 500: Annual Returns



Major Declines in the Stock Market

S&P 500

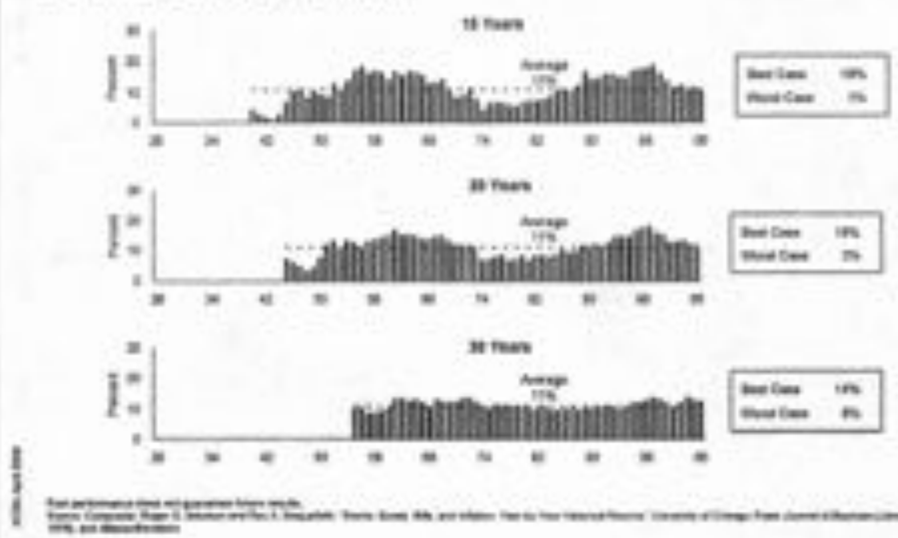


Five-Year Losses Have Been Rare

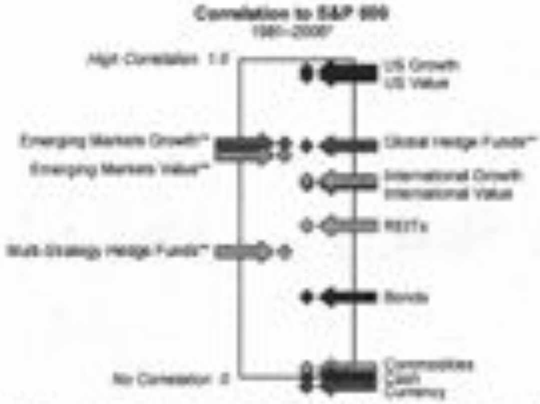
S&P 500: Rolling Five-Year Periods (Annualized)

Stocks Have Not Lost Money over the Long Term

S&P 500: Rolling Periods (Annualized)



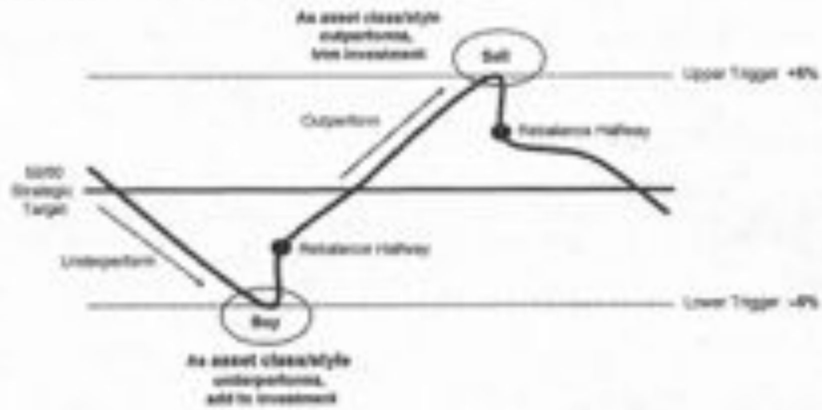
Key to Diversification: Combining Low-Correlated Assets



Investors Have Chased the Past

Rebalance to Control Risk

- Rebalancing must be dynamic, not static
  - As an asset class/style outperforms, trim investment
  - As an asset class/style underperforms, add to investment



Rebalancing Increases Alpha, Reduces Extreme Outcomes

Rules for Success in Combining Investment Styles

- Establish risk tolerance
- Allocate assets strategically
- Rebalance to control risk and add value
- Demand style discipline from managers
- Avoid psychological traps

Implementation is Difficult

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Do CRTs Still Make Sense?

Answer

Yes

Benefits of CRTs

- Diversify concentrated stock or real estate
- Defer capital gains tax
- Increase income stream
- Receive income tax deduction
- Give to charity

Late 90s

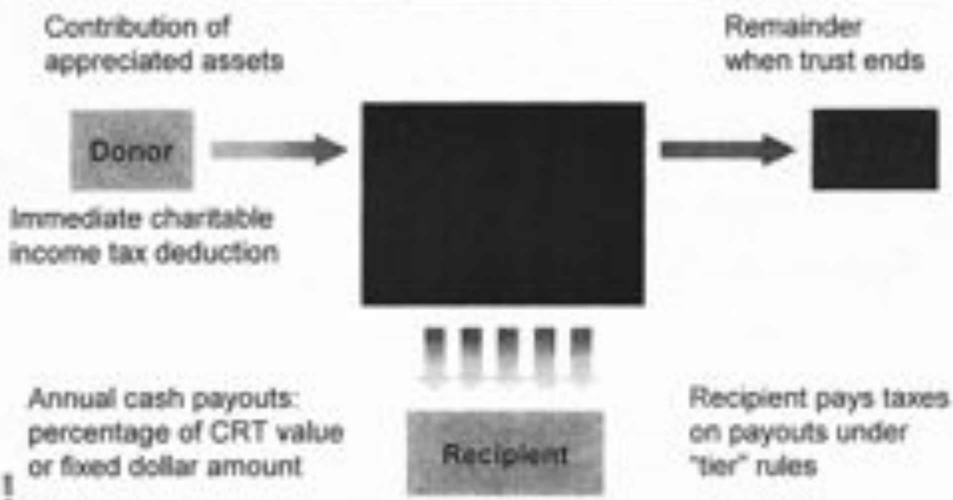
<u>Environment</u>

- Lots of highly appreciated, low-basis stocks
- Relatively "high" tax rates

<u>Common Understandings – CRTs</u>

- **CRTs make sense even if I have no charitable intent**
- The highest payout is the best (the stock market goes up 20% per year)
- Invest 100% in US stocks (the stock market goes up 20% per year)

Typical View of Charitable Remainder Trusts



Taxation of Payouts: The Tier Rules

- The CRT is tax-exempt **but** the payouts are taxed

Taxed as:	"Tier Rules" of Accounting Order:
1 Ordinary Income	Comes out first
2 Capital Gains	Second
3 Tax-Exempt Income	Third
4 Tax-Free Principal	Fourth

"Worst In, First Out"

Bear Market 2000–2002

Top 10 on the *Fortune* "Most Admired" List of 2000

Company	Bear Market Return Mar 31, 2000–Sep 30, 2002
Lucent	(98)%
Cisco	(86)
Intel	(79)
Home Depot	(59)
Microsoft	(59)
Dell	(56)
General Electric	(50)
S&P 500	**(44)**
Wal-Mart	(12)
Southwest Airlines	(6)
Berkshire Hathaway	29

Source: FactSet, Fortune, Standard & Poor's and AllianceBernstein

Volatile Combo–High Payouts and 100% Stocks

- High equity allocation coupled with a high unitrust percentage (13.3%) will intensify the losses to a CRUT in a bear market

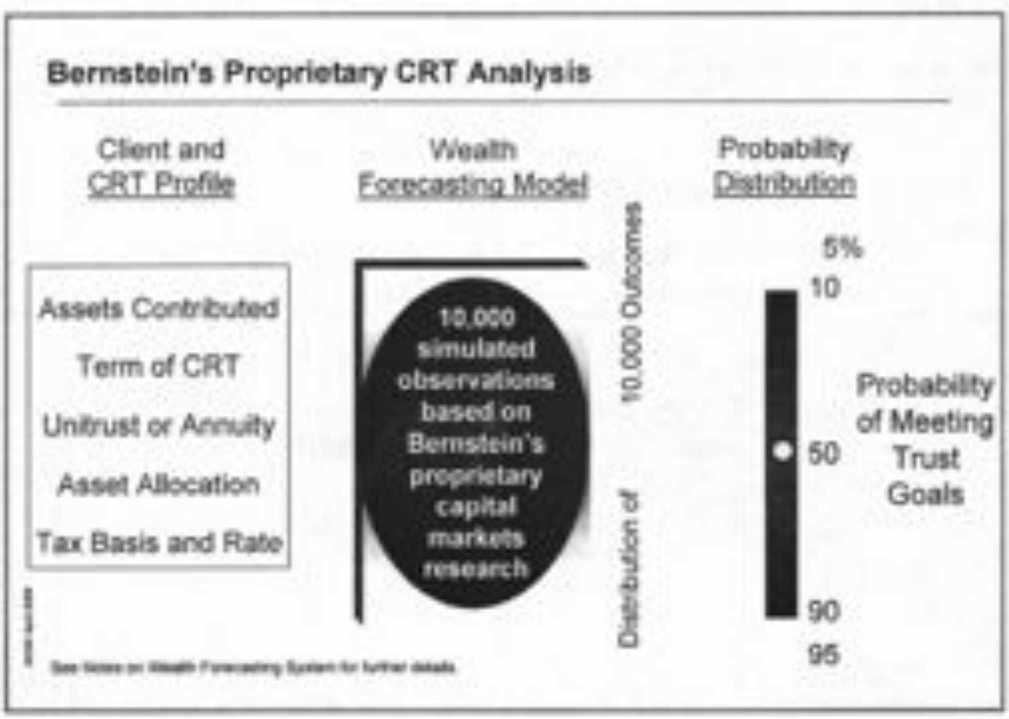
	2000	2001	2002
Beginning CRUT Value	**$10,000,000**	**$7,752,100**	**$5,792,447**
Performance (100% S&P 500)	(910,000)	(922,500)	(1,280,131)
Payout (13.3%)	(1,337,900)	(1,037,153)	(774,971)
Ending CRUT Value	**$7,752,100**	**$5,792,447**	**$3,737,345**

Bonds Will Mitigate the Losses

- If the same CRUT is allocated 50% to stocks and 50% to bonds, the reduction of the assets is minimized

	2000	2001	2002
Beginning CRUT Value	**$10,000,000**	**$7,762,200**	**$5,807,833**
Performance (100% S&P 500)	125,000	(153,774)	(440,004)
Payout (13.3%)	(1,337,900)	(1,175,626)	(997,766)
Ending CRUT Value	**$8,787,100**	**$7,457,700**	**$6,019,930**


Will I Ever Be Financially Better Off by Creating a CRT?
Asset Growth After Taxes–15% Capital Gains Rate
(Cumulative Results)
Accumulated Wealth ($ Millions)
50
40
30
20
10
0
0
5
10
15
20
25
30
Years
Crossover
Additional wealth from creating CRT


Bernstein's Proprietary CRT Analysis
Client and CRT Profile
Wealth Forecasting Model
Probability Distribution
Assets Contributed
Term of CRT
Unitrust or Annuity
Asset Allocation
Tax Basis and Rate
10,000 simulated observations based on Bernstein's proprietary capital markets research
Distribution of 10,000 Outcomes
5%
10
50
90
95
Probability of Meeting Trust Goals
See Notes on Wealth Forecasting System for further details

More Realistic Outlook

What Unitrust Percentage Should I Choose?

Client Scenario
55-year-old
$10 million assets/$2.5 million tax basis
(60%/40% personal allocation)

Range of Allowable Unitrust Percentages:
5% to 13.3%

- *Common Advice: Highest unitrust percentage allowable by law (and 100% stocks)*

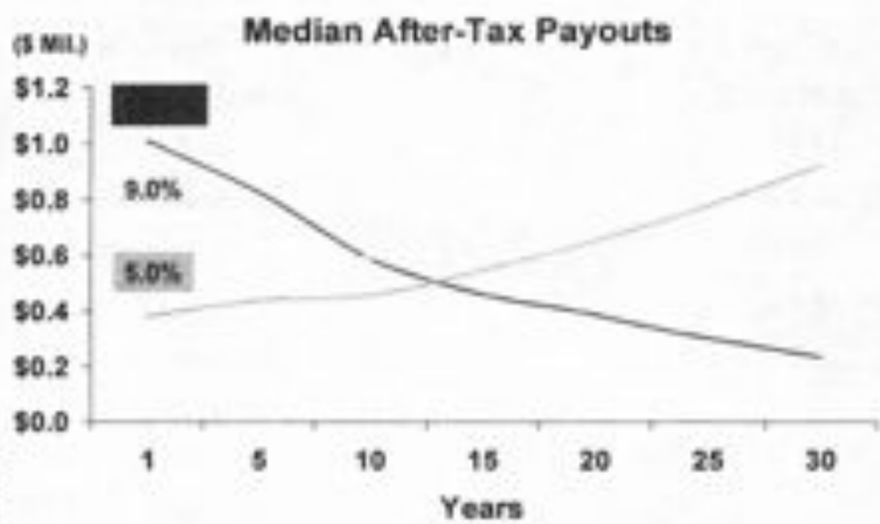
13.3%

The Benefits of a Higher Percentage

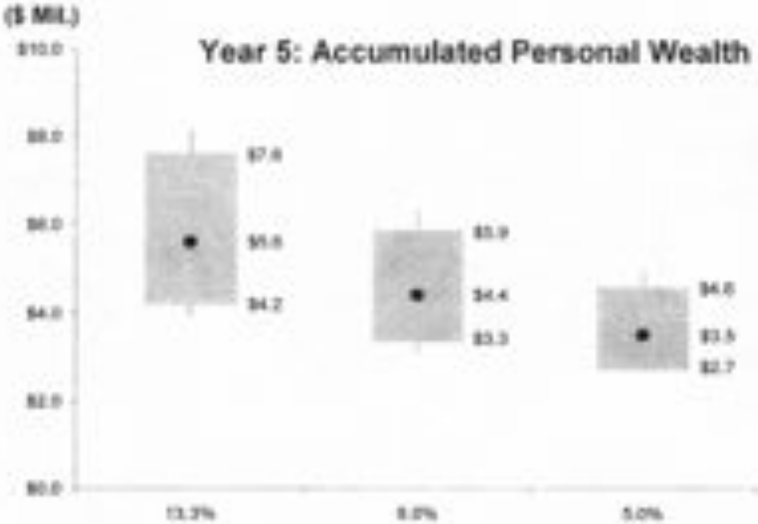
Unitrust Percentages
13.3%
10.0%
9.0%
6.0%
5.0%

Faster Return on Contribution
Lower Mortality Risk

Higher Percentage: Faster Return, Falling Payouts



Higher Percentage: Lower Mortality Risk



The Benefits of a Lower Percentage

Unitrust Percentages
13.3%
10.0%
9.0%
6.0%
5.0%

Larger Tax Deduction
More Tax Deferral

Tax Deductions
$1,000,100
$1,514,600
$1,750,900
$2,864,100
$3,441,900

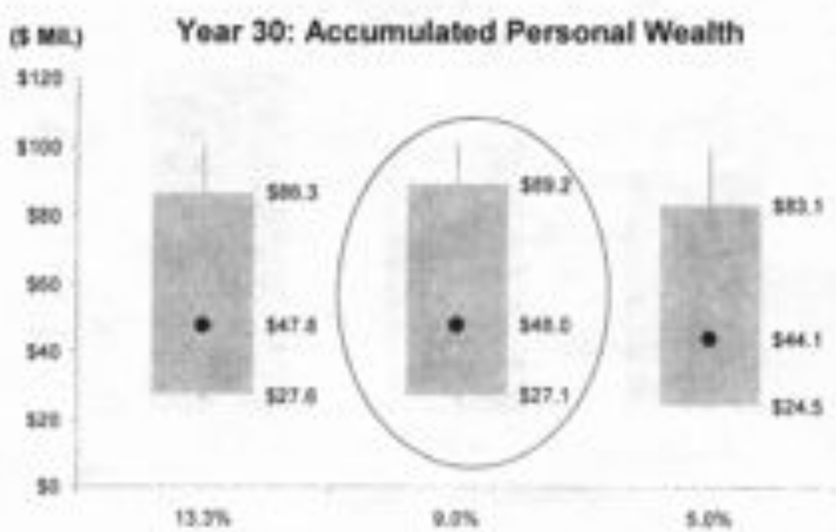
Trade-Offs

Unitrust Percentages	Tax Deductions
13.3%	$1,000,100
10.0%	$1,514,600
9.0%	$1,750,900
6.0%	$2,864,100
5.0%	$3,441,900

Faster Return on Contribution
Lower Mortality Risk

Larger Tax Deduction
More Tax Deferral

Lower Payout Can Be More Efficient



Every Client Situation Is Different

CRT $ amount, payout % and asset allocation depend on client's primary goal

Goal A		Goal B		Goal C
Maximize Personal Wealth	+	Maximize Ultimate Gift to Charity	=	Maximize Total Wealth

Lower Payouts: More "Total Wealth"

Bernstein's Best Thinking on CRTs

- CRTs are still a great tool <u>if</u> you have:
  - **Charitable intent (and)**
  - Concentrated low-basis stock or real estate

- A moderate payout may work better than the highest payout allowable
- A balanced, but still aggressive, allocation may work better than 100% stocks

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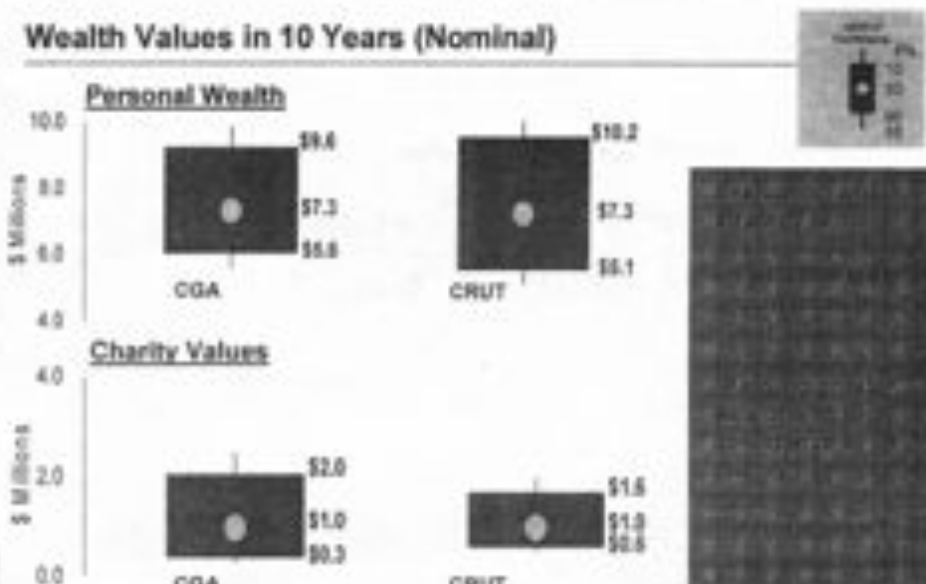
Comparison of Charitable Gift Annuity vs. CRUT

Client Situation

- Client is 83 years old with liquid assets of $4.68 million (not including charitable gift):
  - $4.12 million taxable
  - $490,000 IRA
- Client currently receives annual Social Security benefits of $20,000 and spends $120,000 per year. Benefits and expenses are assumed to increase annually with inflation.
- Considering a contribution of $1 million highly appreciated securities to either a CRUT or $1 million cash to a CGA. Corresponding deductions have been modeled.
- CGA and CRUT are assumed to be invested 80% equities 20% bonds. Personal assets are assumed to be invested 40% equities, 60% bonds.
- Analysis will compare the following two options:
  - Lifetime CGA with annual payments of $160,000 (8%)
    - 40% of distribution taxed as ordinary income
  - Lifetime CRUT with annual distribution of 8%

Wealth Values in 10 Years (Nominal)



[redacted]

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Charitable Gift Annuity Analysis

Key Questions Addressed

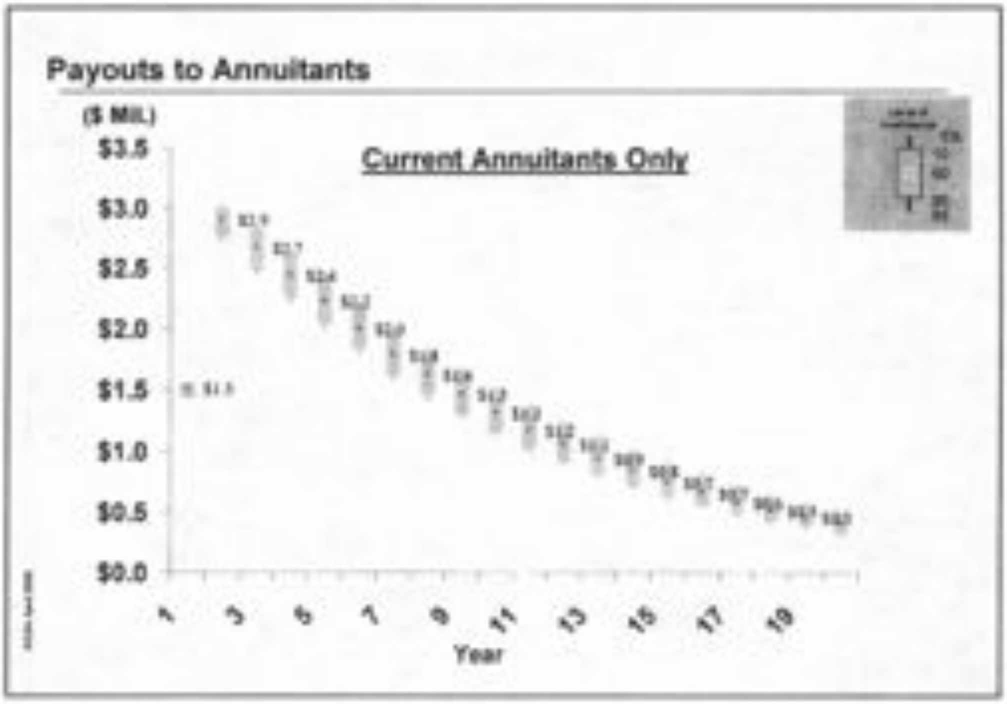
- What is the likelihood that the Fund will meet its obligations?
- What will the impact of increasing exposure to equities in the Reserve account have on the wealth of the Fund?
- How will leaving 5% of the Annuitant's remainder gift in the Fund effect the overall wealth and likelihood that the Fund will meet its obligations?

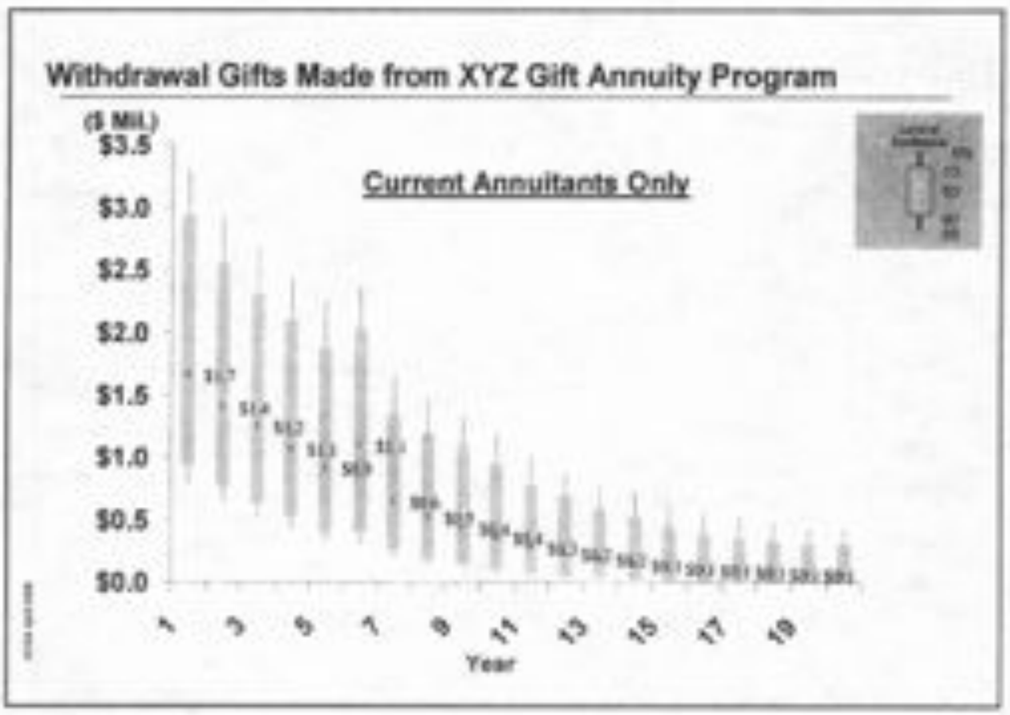
Assumptions for Analysis

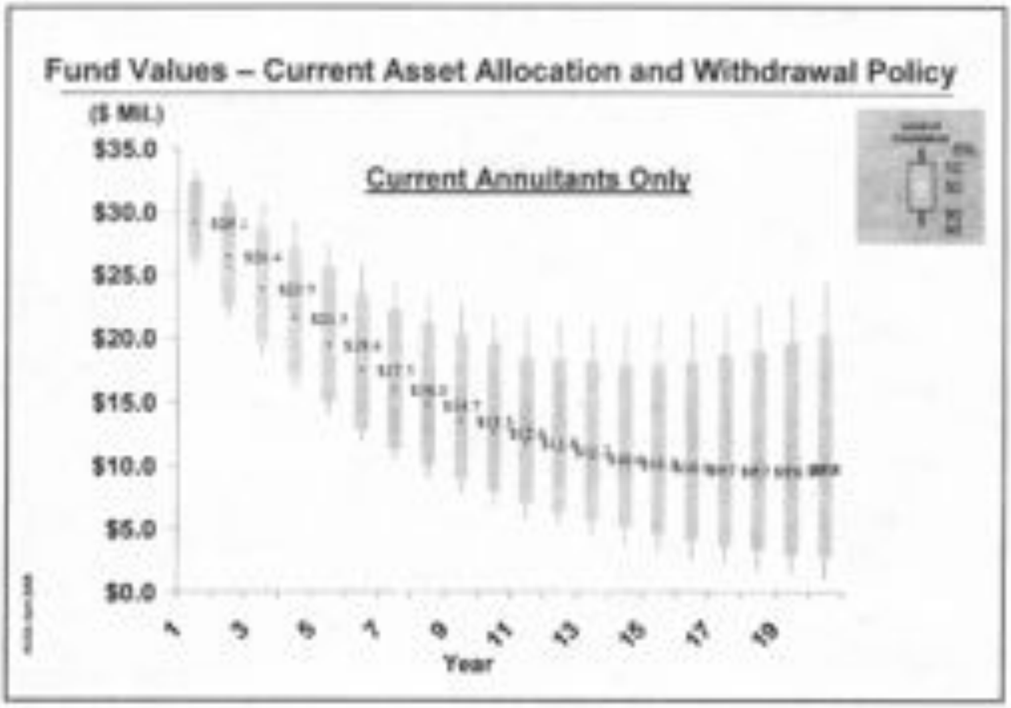
- Mortality assumptions are based on the Society of Actuaries "Annuity 2000" tables
- Upon the death of an annuitant, the Fund will gift the "remainder," defined as the:
  - The pro rata portion of the annuity that is attributable to the annuitant based on the value of the individual policy. This amount is grown by the investment performance experienced by the Fund for the duration of the annuity.

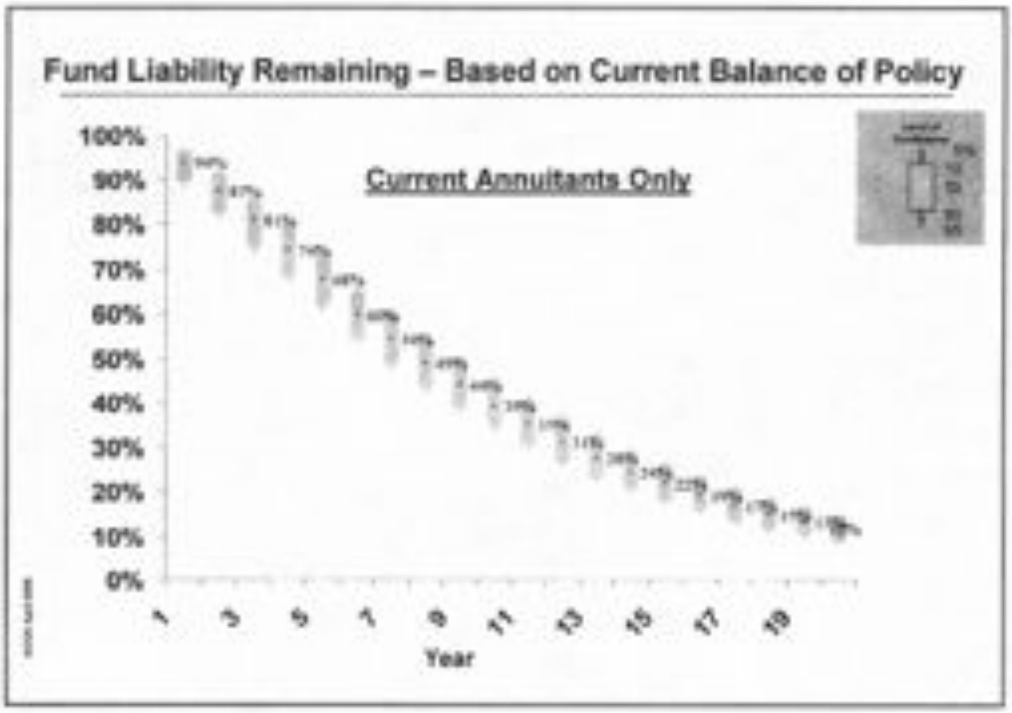
Key Assumptions

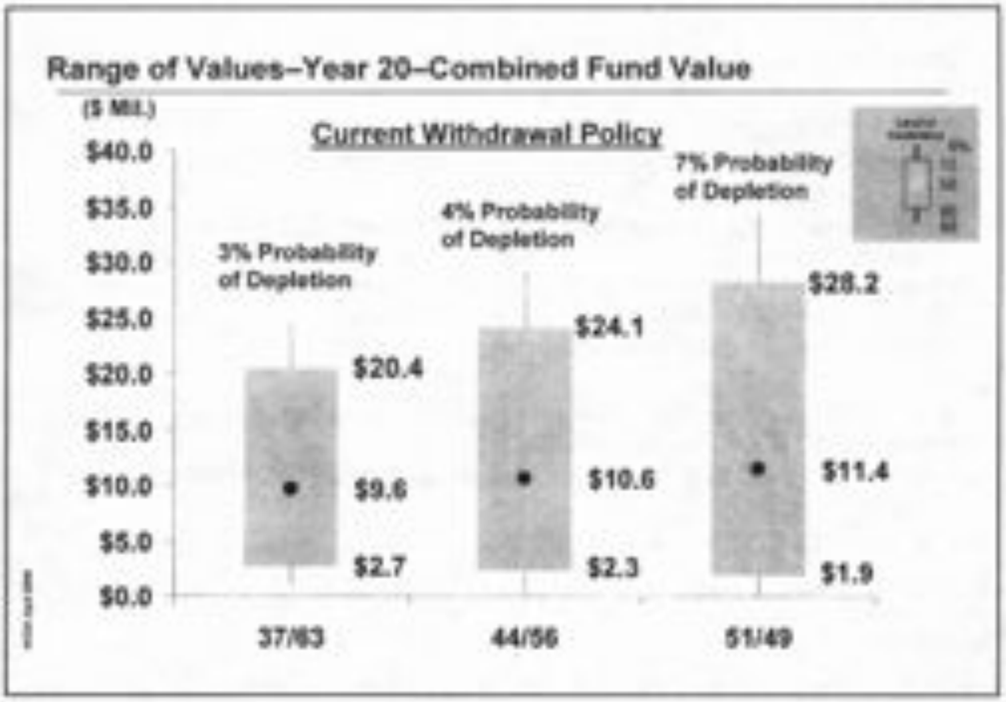
- Initial assets of $30.7 million
  - Reserve Account–$23.5 million (we assume that the Reserve will have at least 70% of the assets in the overall fund at the end of each year)
  - Non-Reserve Account–$7.2 million
- 514 Active Annuity Policies–Face Value of $35.8 million; average age of 85
  - Single-Life Annuities–184 policies; face value of $26.4 million; average age of 86
  - Joint-Life Annuities–130 policies; face value of $9.4 million; average age of 82
  - Payouts are assumed to take place in the middle of the calendar year
- Asset allocation for Non-Reserve is 100% equities
- Asset allocations studied–Reserve Account Only:
- Current Allocation
  - (10% U.S. Value, 90% intermediate-term bonds)–overall allocation of 37/63
  - 20% Equities, 80% Bonds–overall allocation of 44/56
  - 30% Equities, 70% Bonds–overall allocation of 51/49
- All bonds are intermediate-term taxable

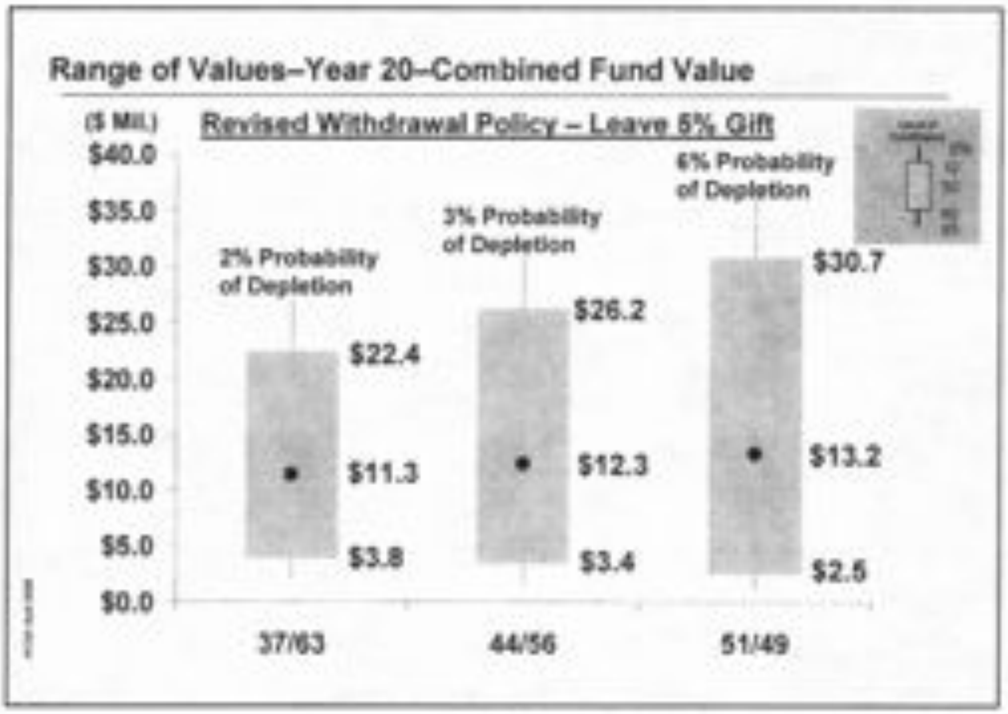

Payouts to Annuitants
($ Mil.)
Current Annuitants Only
$3.5
$3.0
$2.5
$2.0
$1.5
$1.0
$0.5
$0.0
1
3
5
7
9
11
13
15
17
19
Year


Withdrawal Gifts Made from XYZ Gift Annuity Program
($ Mil.)
Current Annuitants Only
$3.5
$3.0
$2.5
$2.0
$1.5
$1.0
$0.5
$0.0
1
3
5
7
9
11
13
15
17
19
Year


Fund Values – Current Asset Allocation and Withdrawal Policy
($ Mil.)
$35.0
$30.0
$25.0
$20.0
$15.0
$10.0
$5.0
$0.0
Current Annuitants Only
1
3
5
7
9
11
13
15
17
19
Year


Fund Liability Remaining – Based on Current Balance of Policy
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Current Annuitants Only
1
3
5
7
9
11
13
15
17
19
Year


Range of Values–Year 20–Combined Fund Value
($ Mil.)
Current Withdrawal Policy
$40.0
$35.0
$30.0
$25.0
$20.0
$15.0
$10.0
$5.0
$0.0
3% Probability of Depletion
4% Probability of Depletion
7% Probability of Depletion
$20.4
$9.6
$2.7
$24.1
$10.6
$2.3
$28.2
$11.4
$1.9
37/63
44/56
51/49


Range of Values–Year 20–Combined Fund Value
($ Mil.)
Revised Withdrawal Policy – Leave 5% Gift
$40.0
$35.0
$30.0
$25.0
$20.0
$15.0
$10.0
$5.0
$0.0
2% Probability of Depletion
3% Probability of Depletion
6% Probability of Depletion
$22.4
$11.3
$3.8
$26.2
$12.3
$3.4
$30.7
$13.2
$2.5
37/63
44/56
51/49

Conclusions

- There is a high degree of confidence (97% probability under the current asset allocation) that the Fund will be able to meet its obligations.
- By increasing the exposure to equities in the Reserve Account to 20%, the Fund can expect to add a modest amount of wealth over the 20 year period, while taking on minimal additional risk. However, increasing exposure to equities to 30% will add additional risk and provide only a modest increase in expected wealth.
- By keeping a modest 5% of the remainder gift in the Non-Reserve Account, the Fund can expect to add $1.6 million of wealth in the median case (20/80), and slightly increase the probability of the Fund meeting its obligations.

Appendix

Probability of Maintaining Original Value

100% Equities

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

Probability of Keeping Pace with Inflation

[illegible]

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[illegible]

Growth of $1: Nominal

Median Case: 50% Confidence

100% Equities

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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40% Equities/60% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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80% Equities/20% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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20% Equities/80% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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60% Equities/40% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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100% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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[illegible]

Growth of $1: Inflation Adjusted

Median Case: 50% Confidence

100% Equities

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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40% Equities/60% Bonds

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80% Equities/20% Bonds

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20% Equities/80% Bonds

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60% Equities/40% Bonds

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100% Bonds

[illegible]	5 years	10 years	15 years	20 years	25 years	30 years
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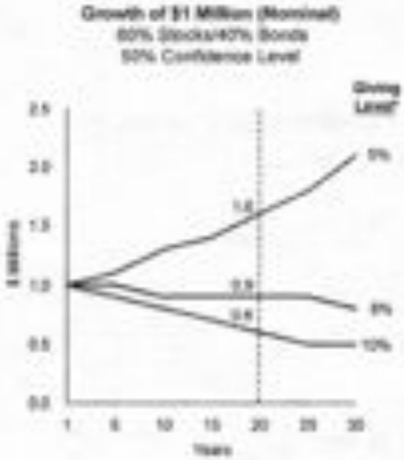
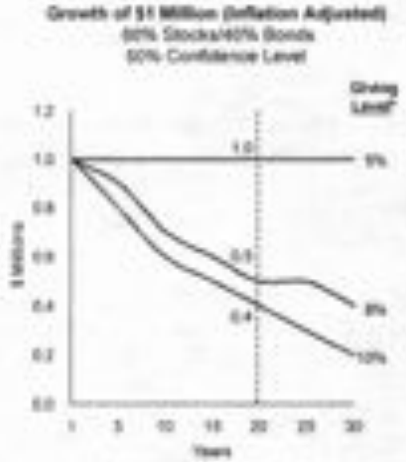
What If We Want to Raise Our Giving?





Notes on Wealth Forecasting System

1. Purpose and Description of Wealth Forecasting Analysis

2. Rebalancing

Notes on Wealth Forecasting System

3. Expenses and Spending Plans (Withdrawals)

4. Modeled Asset Classes

Asset Class	Modeled As...	Annual Turnover Rate
Cash Equivalents	3-month Treasury bills	[illegible]
Intermediate-Term In-State Municipals	AA-rated in-state municipal bonds of a 7-year maturity	[illegible]
Intermediate-Term Taxables	Taxable bonds with maturity of 7 years	[illegible]
U.S. Value	S & P / Barra Value Index	[illegible]
U.S. Growth	S & P / Barra Growth Index	[illegible]
Developed International	MSCI EAFE Unhedged	[illegible]
Emerging Markets	MSCI Emerging Markets Index	[illegible]

5. Volatility

6. Technical Assumptions

Notes on Wealth Forecasting System

7. Private Foundations

8. Endowments

Notes on Wealth Forecasting System

5. Assumptions: Capital Market Projections

	Median 30-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	30-Year Annual Equivalent Volatility
Cash Equivalents	3.4%	3.5%	3.5%	0.8%	0.4%
Int.-Term In-State Municipal	4.3	4.6	4.3	4.4	4.7
Int.-Term Taxables	5.3	5.6	5.2	5.9	5.9
US Value	8.0	9.5	3.3	16.2	12.9
US Growth	7.9	10.2	1.6	18.7	14.7
Developed International	7.7	10.7	3.0	21.8	15.6
Emerging Markets	6.5	11.4	3.1	27.4	20.6
Inflation	2.4	2.5	n/a	1.5	0.8

[illegible]
[illegible]
[illegible]

Charitable Remainder Trusts – Better Living Through Charitable Giving!

Presented by:

Marc Carmichael
President
R & R Newkirk Company
Willow Springs, IL

28th Conference on Gift Annuities
Friday, April 4, 2008

Introduction to Charitable Remainder Trusts

People who have included, or plan to include, bequests to charities in their wills or living trusts often are better advised to "accelerate their bequests" through a charitable remainder trust that provides a gift at death, but additionally offers income tax deductions, capital gains tax benefits, the assistance of a skilled trustee, the satisfaction (and recognition) of making a lifetime gift, plus a variety of other potential benefits. Establishing lifetime CRTs can, in many cases, be a solution to personal and family challenges. Indeed, donors may find that they truly can enjoy "better living through charitable giving" through creative application of charitable remainder unitrusts or annuity trusts. In recent years, CRTs have been employed to supplement retirement savings, educate grandchildren, pay alimony, liquidate art collections, "rule from the grave," sell businesses and support disabled family members – all in the context of invaluable assistance to worthwhile causes and institutions and tax-saving charitable deductions.

A Case Study in the Benefits of Charitable Remainder Trusts

Consider the case of Mary Smith, a 62-year-old widow. Her two children, Tom and Jane, are professionals earning good incomes. They and their children were well provided for through a trust set up under the will of Mary's husband, Robert. Mary's sister, Amy, age 64, is not so well off. Amy's husband has suffered a series of financial setbacks, and Amy has little income of her own. Mary would like to do something for Amy – and for her alma mater and the hospital that cared for her husband during his final illness. Mary owns various properties, including some highly appreciated, low-yield stock worth about $190,000 and some highly appreciated, undeveloped real estate worth about $120,000. She has contemplated leaving these assets to charity at death. A number personal and financial goals might be inferred from the foregoing description, many of which Mary can achieve through a charitable remainder unitrust.

1. Mary can fund a charitable remainder unitrust with the stocks and real estate and retain lifetime payments of 5%, 6% or higher – a significant increase in family income – which can be paid to someone in a low tax bracket, such as her sister Amy, and then to a survivor beneficiary (Mary, herself, for example), if desired. A trustee will provide skilled investment and management services, which can be important for many families.

2. The trustee can invest so that trust payments are taxed at low dividend or capital gains tax rates. Through 2010, Mary's sister might pay little or no

tax on her trust income if she is in a 15% tax bracket. Payments consisting of trust principal or tax exempt interest escape taxation, irrespective of the beneficiary's tax bracket.

3. No erosion from capital gains taxes occurs when the trustee sells Mary's stocks and real estate, which leaves the full $310,000 available for reinvestment.

4. Mary can deduct roughly $100,000 on her next tax return if the trust is to pay Amy 6% for life. Gift taxes can be minimized, with proper planning.

5. Mary will name this arrangement "The Robert and Mary Smith Trust to Save Humanity" and become eligible for membership in the "Heritage Societies" of the organizations she selects as remainder beneficiaries.

To summarize, charitable remainder trusts have the ability to:

- Increase a donor's income (or that of a family member) by reinvesting low-yield or no-yield properties for a fixed or variable income (generally 5% to 7%);

- Provide favorably-taxed income if careful attention is given to how the trust is funded and invested;

- Avoid capital gains taxes when the trust is funded and when the trust assets are sold and reinvested by the trustee;

- Supply income tax and transfer tax charitable deductions (generally 20% to 50% of the amount transferred, depending on beneficiaries' ages or the length of the trust term);

- Afford significant personal satisfaction and recognition, including memorializing the life of the donor, a friend or family member.

Fundamentals of Charitable Remainder Trusts

Charitable remainder trusts are irrevocable trusts that donors establish for the benefit of designated income beneficiaries and one or more charitable remaindermen (IRC §664). The trusts last for the lifetimes of the income beneficiaries or for a term of years (20-year maximum) [IRC §664(d)] or sometimes a combination of lifetimes and a term of years. Income tax and estate tax charitable deductions (10% minimum) reduce the cost of benefitting charity and improve the donor's tax situation. Deductions depend on the ages and number of the income beneficiaries (or the term of years the trust is to last), the amount of income retained for the beneficiaries and the applicable federal (midterm) rates (§7520 rates) in effect at the time the trust is established. Donors can choose the current monthly interest rate or either of the rates from the previous two months, whichever is most favorable for deduction purposes.

Charitable remainder trusts come in two varieties: annuity trusts and unitrusts. According to IRS statistics for 2005, 116,446 CRTs filed trust tax returns, of which 81% were unitrusts and 19% annuity trusts, and the trend in recent years has been for donors to establish unitrusts. CRTs are commonly set up in amounts from $100,000 to $1 million, although $10 million trusts and larger have been established.

Annuity trusts pay an unchanging dollar amount (a minimum of 5% of the initial value of the trust assets, maximum of 50%) to beneficiaries. The payout is unaffected by fluctuations in trust income or changes in the value of trust assets [IRC §664(d)(1)]. Annuity trusts, except for term-of-years trusts, must pass a "5% probability test" – that is, no deduction is allowed if there is more than one chance in 20 that the trust assets will be exhausted when the trust ends (Rev. Rul. 77-374). A private letter ruling states that, in addition to loss of deductions, annuity trusts that fail the 5% probability test will be disqualified as charitable remainder trusts (PLR 9532006). Donors may not make additional contributions to annuity trusts [Reg. §1.664-2(b)]. Annuity trusts are less common than unitrusts, in part because they are at risk in times of inflation, but primarily because they lack the flexibility and planning options of unitrusts. Falling interest rates (AFRs) also heighten the chances that annuity trusts will fail the 5% probability test or the 10% minimum charitable deduction requirement.

Unitrusts (so called because trust principal and trust income generally are treated as a "unit" in calculating payouts) pay beneficiaries a percentage (minimum 5%, maximum 50%) of the value of the trust as revalued at least once a year [IRC §664(d)(2)(A).] Payments will rise or decline according to the investment results experienced by the trustee. This arrangement is commonly called the "standard" unitrust (STANCRUT). Additional contributions may be made to unitrusts [Reg. §1.664-3(b)], if the trust instrument so provides.

Payouts can be limited to the *lesser* of the trust's net income or the unitrust percentage – a "net income" or "income exception" unitrust (NICRUT) – and provision also can be made for "make-up" or "catch-up" of deficiencies from years in which payouts were less than the payout percentage stated in the unitrust agreement (NIMCRUT) [Reg. §1.664-3(a)(1)(i)(b)]. The trustee may make up prior years' deficiencies in payouts to the extent current income of the trust exceeds the specified unitrust amount. Note: IRS has approved several trusts that defined realized capital gains as "income" for purposes of making payments and "makeups" from net income unitrusts (post-contribution gains only.)

"Flip" unitrusts are the most recent variation in CRT design [Reg. §1.664-3(a)(1)(i)(c)]. Donors who fund trusts with real estate, closely-held stock and other nonliquid assets historically have used a net-income or net-income with make up unitrust, which permitted the trustee to avoid or postpone income payments prior to the sale of the trust assets. Once property is sold, however, most donors prefer the fixed percentage payments offered by a standard unitrust. Unitrusts created after December 9, 1998, may contain provisions allowing them to "flip" from a net-income trust to a standard unitrust upon the occurrence of a specific date or triggering event, which must be outside the control of the trustees or any other persons. Examples of permissible triggering events include a beneficiary achieving a particular age, marriage, divorce, death, birth of a child and sale of unmarketable assets, such as real estate. Impermissible events include sale of marketable assets or a request from a beneficiary to convert to fixed percentage payouts.

Conversion must occur at the start of the taxable year immediately following the year in which the triggering date or event occurs, and any make-up amounts are forfeited. Unmarketable assets are defined as anything other than cash, cash equivalents or assets that can be readily converted to cash or cash equivalents. Originally, the flipCRUT merely seemed to be a "fix-up" measure that would ease the pain of donors who funded NIMCRUTs with vacant lots and later were saddled with low payouts. On closer examination, new or refined gift plans began to emerge. Examples (detailed later in this presentation) include:

- Donor wants to make a gift today, obtain a tax deduction and receive lifetime income – but postpone most or all of the income until some future date (the year he or she retires, for example);

- Donor wants to help worthwhile causes and at the same time arrange for young grandchildren (or children) to receive payments when they start college – five, ten or 15 years in the future.

Taxation of CRTs and Beneficiaries

CRTs are tax exempt; however, any unrelated business taxable income (UBTI) will be taxed at a 100% tax rate (that is, UBTI will be confiscated). Rents and dividends from corporations generally are not considered unrelated business taxable income. UBTI also includes "debt-financed income," which may occur if the trustee borrows funds to produce investment income or incurs debt to fix up real estate in the trust prior to selling. A portion of the eventual sale proceeds could be taxed at a 100% rate.

While CRTs are tax exempt, income beneficiaries are taxable on their payments, depending on the character of the income earned by the trust. Under this "four-tier" system: (1) the trust's current and accumulated "ordinary income" (usually taxed at the beneficiary's highest rates) is considered first, then (2) current and accumulated capital gains (generally taxed at lower rates than ordinary income), (3) "other" (tax-exempt) income, and (4) corpus (also tax free). It's sometimes called the "worst-in-first-out" system, or "WIFO."

Tier One. The annuity or unitrust amount is deemed first to consist of ordinary income, to the extent the trust has any current or accumulated ordinary income, including interest, rents, royalties and dividends. Qualified dividends, which currently receive favored tax treatment, are considered to be distributed last.

Tier Two. If the annuity or unitrust amount exceeds the current and accumulated ordinary income of the trust, it is deemed to consist of capital gain, to the extent the trust has any net capital gain for the current year or carried over from a prior year. Note that short-term gain is distributed before long-term gain. After short-term gain comes long-term gain taxed at a maximum of 28% (collectibles), then 25% gain (from real estate as to which the donor claimed depreciation deductions), and finally gain taxed at a maximum rate of 15%.

Tier Three. The "third tier" consists of tax-exempt income – for example, municipal bond interest.

Tier Four. The "fourth tier" consists of trust corpus. The trustee takes the donor's adjusted basis in gift assets, and any distribution of that basis or cash is always tax free.

Recent tax rate changes may have increased the appeal of charitable remainder trusts. Lower capital gains rates (generally capped at 15%) are helpful to recipients of capital gain income from charitable remainder trusts. It is easier to invest charitable remainder trusts for favorably-taxed income, at least while dividend relief remains in place (15% top rate through 2010). Trustees could sell capital gain property, reinvest in dividend stocks and beneficiaries would enjoy income taxed either at low capital gains rates or low dividend tax rates. Capital gains tax avoidance remains a good incentive, especially for funding trusts with tangible personal property (28% capital gains tax rate) and commercial real estate on which donors have taken depreciation deductions (25% capital gains tax rate). Commercial properties, such as apartments and office buildings, should be good candidates, so long as they are debt-free.

What Are the Payout Options and Alternatives?

Trusts generally make payments for the lifetimes of one or more individuals, but all of them must be alive at the time the trust is established. The income beneficiaries can be a class of persons, i.e., "all my children," but the class must be limited to living and ascertainable members. Charities can be named to receive some of the payout, but the trust must have at least one non-charitable beneficiary. Payments can be made for a fixed term of years to individuals, corporations or noncharitable trusts, or to non-charitable trusts for the lifetimes of "financially disabled" or incompetent persons. Term-of-years trusts can last no more than 20 years; trusts for the lives of beneficiaries may last much longer.

Payments can be made jointly to multiple income beneficiaries, then continue for the survivor(s), or be made to one person alone, then continue for a survivor: "Pay the unitrust amount to John for his life and then to Mary for her life." The trust document can provide that an *independent trustee* may "sprinkle" the yearly payment among a group of beneficiaries (Rev. Rul. 77-285). This power allows the trustee to vary the amount of payout to each beneficiary from year to year as situations change.

Payments can be made to one or more persons for life (a husband and wife, for example), then to others (e.g., children), for a fixed term of years. Technically, the trust must pay children for their lifetimes or a term of years, whichever is *shorter*. Payouts must be made at least annually, but quarterly payments are the norm. In the case of a testamentary CRT, the payout may be deferred until a reasonable time after the close of the year in which the trust is fully funded.

Who Can Be Remainder Beneficiaries?

Both public charities and private foundations can be named as remainder beneficiaries of CRTs, but including private foundations may produce unfavorable deduction results. The trust document must provide that if the designated charitable remainderman is not a qualified charitable organization at the time any amount is to be paid to the remainderman, the payments will be made to either (1) stated alternative qualified organizations or (2) made to a qualified charitable organization chosen by the trustee. Donors may retain the right to revoke a charity as remainderman and name others.

Who Can Serve as Trustee?

The following can serve as trustee of a charitable remainder trust: (1) a commercial trustee, such as a bank trust department, but minimum required funding amounts are often $500,000 or more; (2) the charitable remainderman, if permitted by the organization's charter and bylaws; (3) an unrelated third person; (4) the donor – however this may be risky if the donor retains an inappropriate interest or power in the trust that would cause the trust to be disqualified as a grantor trust (a sprinkling power, for example).

What Can't You Do with a Unitrust?

A charitable remainder trust is subject to special penalty taxes (private foundation excise taxes) if the trust engages in certain prohibited activities. The trust instrument must specifically prohibit the trustee from engaging in these activities or the trust will be treated as a taxable trust. The most important prohibition is *self-dealing*, [IRC §4944(d)] which is generally defined as the use of trust assets to benefit the trust grantor or close family members ("disqualified persons). Self-dealing includes a sale or lease of property between the grantor and the trust, or the transfer of mortgaged property to the trust. If a charity receives any part of the trust income, the trust is liable under rules prohibiting excess business holdings [IRC §4943(c)], jeopardizing investments (IRC §4944) and taxable expenditures (IRC §4945).

Gift and Estate Tax Results of CRTs

Donors who establish charitable remainder trusts and name another person as income beneficiary (or as a joint or survivor beneficiary) are actually making two gifts: one to charity and one to the other person. Charity's gift is nontaxable because of the gift tax charitable deduction. The gift to the income beneficiary is taxed based on the value of that person's income interest. The gift is eligible for the $12,000 annual exclusion if payments start immediately. If the donor keeps the right to revoke a *survivor beneficiary's* income interest by will, the gift will be incomplete and nontaxable for gift tax purposes. It is not clear how the power of revocation would work if the donee is the sole income beneficiary or is a joint beneficiary. Donors are required to file Form 709 (gift tax return) for all CRTs, even where the donor is the only income beneficiary. A spouse who establishes a charitable remainder trust for the other spouse (or as a joint and survivor arrangement for both spouses) escapes gift tax because of the unlimited gift tax marital and charitable deductions. Gift tax returns are required, nonetheless, and the marital deduction will not be available if the trust has another beneficiary who is not a spouse.

Charitable remainder trusts that make payments only to the donor pass free of estate tax, thanks to the estate tax charitable deduction. CRTs that include spouses as beneficiaries qualify for the unlimited estate tax marital deduction, but only where the surviving spouse is the sole noncharitable beneficiary [IRC §2056(b)]. A CRT established during life for a nonspouse gives rise to an adjusted taxable gift in the donor's estate. If the donor and a nonspouse are both beneficiaries, the entire trust value is included in the donor's estate, which is entitled to an estate tax charitable deduction measured by the surviving beneficiary's current age and the value of the trust assets. If a donor sets up a testamentary CRT for a nonspouse, the estate gets a deduction based on the beneficiary's age at the donor's death, the payout amount and the value of the trust assets.

Selecting Assets to Fund Charitable Remainder Unitrusts

A donor desiring to create a charitable remainder trust should give careful thought to what kind of property to place in the trust. Generally speaking, donors should not use property that (1) will cause the trust to have unrelated business taxable income, or (2) could result in a private foundation excise tax to be imposed. Transfers of debt-encumbered real estate will disqualify a charitable remainder trust, and donors should be aware that deductions for gifts of tangible personal property will be reduced and postponed until the item is sold from the trust. Transfer of S corporation stock to a charitable remainder trust will terminate the company's S status.

Real estate that is not subject to a mortgage can be excellent for funding a unitrust or annuity trust. Office buildings and apartments that have been depreciated can be sold and reinvested within the trust without loss to capital gains taxes as high as 25% on the depreciation recapture portion.

A personal residence is suitable for transfer to a charitable remainder trust, but not if the grantor wishes to continue living in the house. The prohibition against self-dealing would be violated if the donor continued using the house rent free, and probably would be violated even if a reasonable rent were charged, because the regulations forbid a lease of property by a charitable remainder trust to a disqualified person [Reg. §53.4941(d)-2(b)].

Publicly-traded securities that have appreciated in value are ideal for funding a charitable remainder trust. Unlike closely-held stock, these shares are freely transferable and generally pose no problems under the private foundation rules. Donors do not realize capital gain upon the transfer to the trust because the transfer is not considered a "sale or exchange." The trustee may sell the stock without causing the donor or the trust to incur current capital gains tax, enabling the trustee to construct a diversified portfolio, invest for higher yield or tax-favored income, such as qualified dividends. Income beneficiaries eventually may report capital gain income from the sale appreciated assets by the trust, under the four-tier system of trust taxation. But such gains typically are taxed at low rates.

Closely-held stock may be transferred to a charitable remainder trust, but practical problems may arise: Is there a ready buyer for the shares? Is redemption of the stock from the corporation a possibility? Note that if charity is named to receive any portion of the trust income, the excess business holdings prohibition may apply.

Case Studies in Better Living Through Charitable Giving

Estate Planning Lessons from Leona Helmsley? When billionaire Leona Helmsley died last summer, newspaper accounts dwelled upon her controversial personality, tax problems, career as a hotel tycoon, and an unusual estate plan that included a $12 million trust for her pet dog. What didn't come out in the media was that almost all of her billions were left to charity, and that she gave millions of dollars away to worthwhile causes during her lifetime. Mrs. Helmsley's will also established three charitable remainder trusts, one for her brother and one for each of her two grandchildren. Most interesting was a clause in the grandchildren's trusts that they would receive income for life – but only if they visited the grave of their father at least once a year for the rest of their lives. The clause was framed as a "qualified contingency" under IRC §664(f)(2), which permits CRTs to terminate early upon the happening of specified contingencies. Here, if a grandchild ever failed to make an annual cemetery visit, the trust would come to an end, with all assets passing immediately to charity.

Ruling from the Grave, Part II. Can a donor control a beneficiary's behavior with a CRT provision that is less extreme than ending the trust early (see above)? A planned giving officer asked recently whether a mother could establish a CRT that would withhold payments from her drug-abusing son at any time when he was not "clean and sober." "I don't want trust payments going to his drug dealer," the mother explained. Suppose the trust had an additional income beneficiary – which could be a charitable organization. Suppose further that an independent trustee has been given the power to sprinkle (apportion) trust income among the beneficiaries. Such a clause would not disqualify the trust [IRC §674(c), Rev. Rul. 77-73, PLR 9052038], although naming charity as an income beneficiary would not increase the donor's income tax charitable deduction [Reg. §1.664-3(d)]. A private letter ruling approved a payout arrangement in which the donor and the charitable remainderman were co-income beneficiaries of a CRAT, with an independent trustee holding the power to sprinkle the trust's annuity amount. At least 20% was required to be paid to the donor (PLR 9052038). The IRS might approve a similar income beneficiary arrangement in which the donor's son receives only 5% or 10% of the payout – more, at the trustee's discretion, if he can pass an annual drug test. If the son continues to use drugs, he would receive only minimum annuity or unitrust amounts from the trust, with the other beneficiary receiving the rest.

Tax-favored retirement savings. Many high-income professionals and executives are looking for tax relief during their years of high income and for a supplementary retirement savings vehicle that permits tax-free growth of their nest egg. The "Retirement Unitrust," sometimes referred to as a "Charitable IRA," can be a useful planning tool for such individuals – assuming they also have a motivation to provide substantial benefit to a charitable organization. The tax laws do not recognize a creature called a deferred payment charitable remainder trust. But it is possible to set up such an arrangement (or a reasonable facsimile thereof) through a "flip" unitrust. Such a trust could provide:

- An income tax deduction for part of the funds or property transferred to the trust, based on the age of the grantor at the time of contribution and the amount of income retained (minimum 5%).

- Deferral of much – perhaps all – of the trust income until the grantor retires. Principal would grow quickly because the trust is tax-exempt.

- Payment of substantial income after retirement, reflecting rapid growth of principal within a tax-exempt trust – and perhaps make-up of payment deficiencies during years grantor was receiving little or no trust income.

- An important gift to the grantor's charity when the trust ends.

The trustee would invest initially in growth stocks, growth mutual funds or other investments (some have suggested zero-coupon bonds – See PLR 8604027) that will swell the trust principal but pay very little income until the grantor retires.

> Example: Dr. King, 45, transfers assets worth $100,000 to a net income unitrust that will pay him the lesser of the trust's net income or 6% annually. The trust contains a "flip" provision that will cause the trust to change to a standard unitrust in the year following his 69th birthday. In the year he sets up the trust, Dr. King can deduct a charitable contribution of $18,278 (6.0% AFR). The trustee invests entirely in growth stock that is expected to appreciate in value by 9% a year. Dr. King's trust will have grown to $862,300 by the time he retires at age 70 (returns based on historical standards). By then he will enjoy 6% annual payments of nearly $52,000 that will be part tax free, part capital gain, assuming the trustee sells just enough growth stock each year to make the 6% payout.

Note: If Dr. King wishes, he can add even more each year to his "retirement unitrust" – $25,000, for example – and receive additional deductions and even more income.

Supplemental College Funds for Grandchildren. CRTs can be established to pay income to children or grandchildren who are in college – subject to the "kiddie tax." The "kiddie tax" threshold increased to $1,800 for 2008 (investment income over that amount is taxed at the kids' parents' tax rates. This comes on the heels of the 2007 Small Business and Work Opportunity Act, which extended the kiddie tax to children age 18 and below (formerly 17 or younger) and to full-time college students under age 24, effective in 2008, unless a student's earned income exceeds half of his or her support (H.R. 2206).

How would an education unitrust work? Donors with young grandchildren could establish term-of-years charitable remainder unitrusts equipped with sprinkling provisions that allow the trustee to bestow income only on those grandchildren who are attending college. (The donor cannot serve as trustee if there is a sprinkling power, or have the ability to change the trustee). Donors receive income tax charitable deductions and avoid capital gains taxes if the trust is funded with appreciated assets. The trust could be structured as a "flip" unitrust, with the trigger event being a particular event or date preceeding the year the oldest child was expected to matriculate. So the trust might be established as a 20-year net income unitrust when grandchildren were ages two, five, eight and nine and invested primarily for growth until the oldest grandchild enters the 12th grade (a "triggering event"). The following year the trust would "flip" to become a standard payment unitrust, and start making unitrust payments to the oldest grandchild, then to other grandchildren, at the trustee's discretion.

Under prior law, the "college unitrust" arrangement produced trust income that would be taxed at the beneficiaries' relatively low rates, assuming they were past the age of 17 and therefore not subject to the kiddie tax rules. As noted earlier, however, in 2008, the parents' rates will apply to trust income (above $1,800) of full-time college students under age 24. Can the college unitrust still work? The answer should be yes, if the trust is invested to provide favorably taxed income.

A college unitrust, invested to generate primarily long-term capital gains and qualified dividends, can be extremely tax efficient even where the beneficiaries' parents are in a 33% or 35% federal tax bracket. Such a plan would enable beneficiaries to enjoy income taxed at a 15% rate, under current law. In some cases, part of the beneficiaries' payout may be tax-free return of corpus, reducing tax rates on the unitrust amount to under 15%

Suppose a grandfather transfers a $200,000 stock portfolio with an aggregate basis of $100,000 to an 8%, 20-year college unitrust, with a "flip" provision. The stocks earn 1% dividends and grow at an annual rate of 8%, so that after nine years the trust grows to $400,000 (dividends are paid out annually but capital gains are not). The trust flips to become a standard payout unitrust in Year 10, when the oldest grandchild, now age 18, starts receiving 8% of $400,000. The stocks pay 1% dividends ($4,000) annually so the trustee must sell $28,000 of stock the first year to pay the grandchild the remaining $28,000 due him (a $32,000 total unitrust amount). The sale results in $21,000 of long-term gain and $7,000 tax-free return of corpus (basis). Under 2008 law, $1,800 of capital gains/dividends would be tax free, assuming the grandchild is in a 15% tax bracket; $7,000 would be tax-free return of corpus and the remaining $23,200 of payout would be taxed at the 15% rate applicable to capital gains and dividends . . . an average 10.9% tax rate. It should be mentioned that the donor also receives a charitable deduction of about $40,000 in the year the trust is created.

Note: This discussion presupposes that the grandparent who funds a "college unitrust" has the twin goals of helping charitable organizations and supplementing grandchildren's college education. There are many other plans for funding college educations that provide more funds for college but do not benefit worthwhile causes.

Providing for "Financially Disabled" Beneficiaries A charitable remainder trust may pay income to a noncharitable trust for the life of an individual who is "financially disabled" (Rev. Ruls. 2002-20, 2002-17). The IRS has indicated that such arrangements are appropriate where the income beneficiary, by reason of a medically determinable physical or mental impairment, is unable to manage his or her own financial affairs. The trustee of the noncharitable trust could have broad discretion as to how much income or principal would be paid to the beneficiary, and could take into account government benefits to which the beneficiary may be entitled. The noncharitable trust could pass at the beneficiary's death either to charitable or noncharitable remaindermen.

CRT Planning in a Shaky Marriage. Richard is happily married to Elizabeth (his fourth wife) and he wants to set up a charitable remainder unitrust for the two of them with his separate property. He expects to die married to Elizabeth, but he's also a realist and asks you privately what tax planning steps should be taken, "just in case" this marriage doesn't last. Richard understands taxes and knows that, in case of divorce, his estate would owe federal estate tax on Elizabeth's survivor income interest (the marital deduction will have been lost).

Richard should establish a two-life unitrust that pays income first to himself and then to Elizabeth as survivor beneficiary, with Richard retaining in the trust instrument the right to revoke Elizabeth's survivorship interest in his will (See Rev. Rul. 72-395, §7.07). The transfer will be incomplete for gift tax purposes [Reg. §25.2511-2(c)]. If they should divorce, he changes his will and follows through with revocation at death. The trust assets will be included in his gross estate but will qualify for the100% estate tax charitable deduction. If he dies married to Elizabeth, a 100% estate tax marital deduction should be available under IRC §2056(b)(8).

Stock in Family Business Fits in CRT. A recent private ruling illustrates how closely held stock (often the most valuable asset owned by a donor) can be used to fund a charitable remainder trust. Morton funded a charitable remainder unitrust with stock in his company, and now the unitrust owns 62% of the shares, Morton has 5% and his company's employee stock ownership plan owns the remaining 33%. His company plans to redeem for cash a certain number of shares held by the shareholders (the company has only one class of stock). The stock will be redeemed at fair market value as determined by an independent appraiser. Will self-dealing occur when the unitrust trustee has its shares redeemed by Morton's company? The IRS said no, because all shareholders are subject to the same redemption offer and the trust will receive fair market value (PLR 200720021).

Flexibility: Hallmark of the Charitable Remainder Trust

Donors who establish charitable remainder trusts have a broad array of choices as to the objectives, management and operation of their gift plan. They can:

1. Choose fixed or variable payments (CRAT or CRUT), decide the payout amount or percentage, and how frequently payments will be made;

2. Name themselves and/or a spouse, or any other person as income beneficiaries;

3. Decide whether the trust will continue for one or more lives or a specific length of time (up to 20 years), or perhaps "life plus a term of years";

4. Select the trustee (or serve as trustee themselves), fix the trustee's powers and give instructions (within certain limits) as to investments;

5. Choose the charitable beneficiary or beneficiaries, reserving the right to change charities, if desired, and describe the purposes of their gifts;

6. Choose a NIMCRUT or flipCRUT arrangement that has the potential to defer payment of some or all trust income until some future time;

7. Designate "qualified contingencies" that will terminate the trust "early" on the happening of specified events, with trust assets passing immediately to charity;

8. Provide that the trust will be continued (or established) upon their deaths, to provide financial security and money management for spouses, friends or family members;

9. Arrange for "wealth replacement" of assets transferred during life to a CRT, through the purchase of life insurance (an irrevocable life insurance trust should be considered where the donor has a taxable estate);

10. Select the assets to fund the trust, especially tax-burdened investments

such as long-term capital gain property. For testamentary CRTs, income in respect of a decedent such as retirement accounts, U.S. savings bonds, stock options and accounts receivable can have favorable tax results.

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Charitable Remainder Trusts

Charities

Donor, others

CRTs Can Achieve Personal Goals

1. ____________
2. ____________
3. ____________
4. ____________
5. ____________

Charitable Remainder Trusts Can

- Pay fixed or variable income for life or term of years (1-20)
- Reinvest assets for higher income without capital gains taxes
- Provide income that is minimally taxed
- Yield large deductions

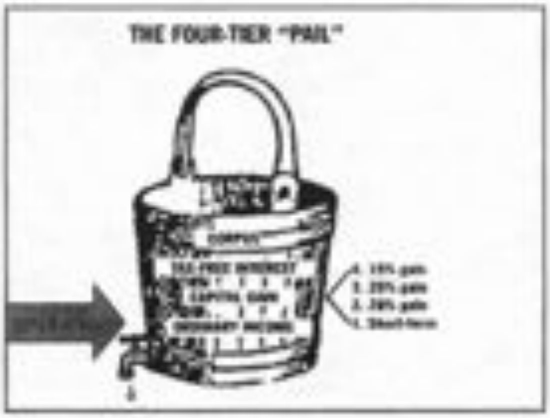
Annuity Trust vs. Unitrust

- Flat dollar amount
- 5% probability test
- No additional contributions
- Deductions sometimes larger

- Payout varies
- Additional contributions O.K.
- "Net Income" provisions allowed
- Revaluation of assets required

Charitable Remainder Unitrust Options

- Standard (STANCRUT)
- Net Income (NICRUT)
- Net Income with Makeup (NIMCRUT)
- Flip (FLIPCRUT)

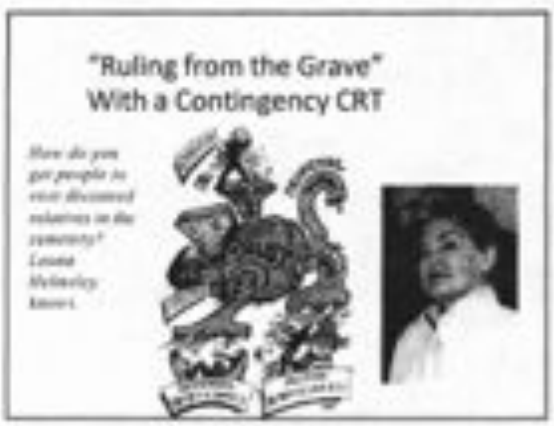

THE FOUR-TIER "PAIL"
CORPUS
TAX-FREE INTEREST
CAPITAL GAIN
ORDINARY INCOME
1. Short-term


TRUST


No Self-Dealing Between Trust and Donor or Donor's Family


Donor
Charity
Donee
Donor who arranges "life income gift" for another makes a taxable gift, unless...
• Donor and donee are married to each other
• Donor keeps right to revoke income interest


Collectibles in Unitrust


"Ruling from the Grave"
With a Contingency CRT

Independent trustee could sprinkle income among good/ not-so-good beneficiaries & discourage bad behavior

College Education Unitrusts

What to do about the "kiddie tax"?

CRT Pays to Special Needs Trust

Special
Needs
Family Member

Right To Revoke and Matrimony

Charitable Remainder Trusts Can

- Pay fixed or variable income for life or term of years (1-20)
- Reinvest assets for higher income without capital gains taxes
- Provide income that is minimally taxed
- Yield large deductions

Take the "Blues" out of your Planned Giving Marketing Program

Presented by:

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28th Conference on Gift Annuities
Friday, April 4, 2008

Taking the Blues Out Of Marketing

By: Kimberly Soltis
Ellen Shugart

Most people think that Marketing is a tool...

Marketing is a mindset…

…It's a way of thinking!

Always ask yourself
2 questions:

1. Am I communicating with my key audiences?

2. How can I use every contact as a marketing opportunity?

Design Your marketing strategies to get more face to face visits

- You can't get the gift without the visit
- Your purpose for marketing is to get a visit.
- Find ways to get MORE meetings, face time is priceless!

Why Market?

- Marketing
  - Educates your broader audience about your mission and why it deserves their attention – what sets you apart from the competition?
  - Invites your audience to get involved and make a difference.
  - Opens the door for long-term planning and promise of a positive and productive relationship with the prospect/donor.
  - Reminds long term donors why you are still relevant and why their continued support is still important.

QuickTime™ and a
TIFF (Uncompressed) decompressor
are needed to see this picture.

Designing your program: First steps

Segmentation

** Recognize the market clusters that exist in your target prospects.

** Geographic, age, past interest (response to past marketing)

* relationship with your organization

* What differentiates each prospect?

* What makes them unique?

Targeting

* Choose the prospects that will be the focus of your campaign

Positioning

* What message do you want
  to convey?
* How do you want your prospects to see you?
* What do you want the prospect to do?

Building your Marketing plan

√Market Identified
√ Reaching your prospects
    Letters, ads, seminars
√ Budget
√ Evaluation of the plan

QuickTime™ and a
TIFF (Uncompressed) decompressor
are needed to see this picture.

Tips

More than selling...
- Understand your prospect/donor's needs.
- Develop plans that reflect those needs.

Support the Marketing function...
- Develop a specialized plan of attack,
- Find ways to get MORE meetings, face time is priceless!

The 5 Most Important Questions?

1. What is your Mission?
2. Who is your prospect?
3. What does the prospect consider value?
4. What is the plan?
5. What is your evaluation criteria?

Planned Giving Marketing Secre
Revealed…

Good Planned Giving Marketing
has 1 RESULT…

The FACE-TO-FACE
visit

Marketing only opens the door
to a relationship…

…it does NOT create one!

While gifts may come in because of
marketing, they are RARELY as large
as those you get by …
Working directly with the donor and advisor.

Who are my best planned giving prospects?

?

Everyone is a PR0SPECT

Seniors...
Wealthy...
&/or High-income earners.

Who is the perfect prospect?

Those who are your LOYAL givers.

Focus on Institutional Loyalty

When data-mining for your best prospects… focus on institutional loyalty.

- ✓NOT ON…
  - ✓ Age
  - ✓ Wealth

✓But RATHER…

✓loyalty to your organization demonstrated by consistent annual giving.

Your best NEW prospects are your existing customers!

Your present customers already know you & LIKE you;
You've established rapport, confidence, & trust; your know they have good credit because they have paid you in the past, & you know they will return your call.

Existing Customers…

They will donate more, & since th
relationship is there, they will ref
you to others!

Looking for new Prospects? Some places to look:

Annual giving
Direct mail
Special events
Memorial gifts
Boards
Volunteers
Alums
Staff

Tip

✓ Find a champion within your organization that can help you rally support among all of the various functions and departments

QuickTime™ and a
TIFF (Uncompressed) decompressor
are needed to see this picture.

*Tip: go to your annual giving data base and carefully select donors who have given consecutively for 10 years or more.

? ? ? ? ? ? ? ? ? ? ? ? ?

What about marketing to younger donors?

Planned Giving applies ONLY to older people…

While many giving opportunities are best suited for older individuals, there are significant opportunities for younger individuals too.

√

FACTS:

- ✓15% of all planned gifts are set up by donors 45 and younger
- ✓The typical planned giving prospect is someone who has earned between $50,000 - $150,000 per year his or her entire life.

The Truth about youth

National Committee on Planned Giving Survey

•Average at at time of first will	44
•Average at at time of first bequest	49
•Percentage of remainder trust donors under 55	34%

How to keep LOYAL clients

- ✓ Follow Up & Follow through
  - ✓ Following up with clients or potential prospects should be second nature

- ✓ When someone new inquires about your service, follow up with a call or email.

FACT

✓ Most companies base 80% of their hiring on technical skills.

✓ DON'T get hung up on fulfilling technical requirements & forget the key to retaining prospects/donors is building relationships with PEOPLE, not paper.

So…

✓ You've designed your plan
✓ You've identified your prospects
✓ You've marketed
✓ You've gotten a good response

Now what…

The one and ONLY Guaranteed Strategy…

ONLY ONLY ONLY
ONLY ONLY ONLY
ONLY ONLY ONLY
ONLY ONLY ONLY
ONLY ONLY ONLY

Donor / Prospect Visits!

Donor/ Prospect Visits are a MUST

- ✓ The most important marketing is visits.
- ✓ Your campaign should be targeted to get MORE visits.

MORE

FACT

- ✓ You can have the BEST marketing material but if you aren't visiting your prospects, the material is meaningless.

Getting the visit

The First Steps

Create a Cultivation Plan for EVERY lead

- ✓Phone call
- ✓Follow-up Packet of information
- ✓Second Mailing (opt)
- ✓Second Phone call
- ✓Appointment
- ✓Stewardship

Set the stage to call

QuickTime™ and a TIFF (Uncompressed) decompressor are needed to see this picture.

- ✓Research – as much information as possibl
  - ✓History/affiliation with organization
  - ✓Giving history /activity
- ✓Prioritize leads
  - ✓ "considering"
  - ✓ Information on life income gifts
  - ✓ age
  - ✓ Frequency of requests

Initial Phone call

- ✓ Thank you (for considering or included)
- ✓ Put them at ease – this call is not a request for money
- ✓ Establish yourself as a person from XYZ organization not a telemarketer
- ✓Get them to tell you what they want to receive from yo
- ✓If they are a new donor – how they want to be steward

Best Case Scenario

- ✓ Prospect is talkative
- ✓ Prospect gives you an idea of what to send for follow-up
- ✓ Set a time to call back after material is sent – call Friday after 3 p.m.

Worst Case Scenario

- ✓ Donor: Blown off –
  - ✓I'm Too Busy
  - ✓Running out the door
- ✓ Send the packet anyway and move on with the follow-up

Tips for successful calling

- ✓Set Blocks of time in your calendar and just call.
- ✓Take notes during the call but do all follow-up later
- ✓Stop the calls if you are getting rejections.
- ✓Do something else or call a cherished donor who v
  get you re-energized to call again.

Now let's get the Appointment!

- ✓Appointments are harder to get with a call out of the blue. More contact – better odds
- ✓30-day follow-up, surveys, mailings gives you more to discuss with a prospect
- ✓Enthusiasm for your organization ca help you move past many objections

Some days are better then others…

- ✓ Snow days and very poor weather keeps older folks inside. *Weather is always an ice breaker*
- ✓ Lunch and afternoons for older folks are best
- ✓ Birthdays and Birthday weeks work well
- ✓ For working prospects and allied professionals 5 – 6pm & 8 – 9am
- ✓ Friday afternoons work well for all

Let's look at Creative Ways to Market

Prospect Acquisition Marketing

Prospect Marketing

✓SHOW your personality

✓GET creative

✓THINK outside the box!


Putting Your
House In Order

Used in magazines such as Garden State Women (NJ), Palm Beach (FL) and newspapers such as Women's Times in Berkshires (MA) and local affiliate newsletters.

Newsletter, Is it Worth it?

QuickTime™ and a
TIFF (Uncompressed) decompressor
are needed to see this picture.

The Battle

- ✓ Everyday the average prospect/donor is bombarded with over 2,500 marketing messages.
- ✓ It's a battle being fought for the eyes and ears of the world, and in most cases it's an overstuffed mailbox.

Face IT…

Americans read their mail standing over a waste basket!

- ✓ Do you really believe your prospects/donors are *dying* to come home to read your newsletter describing how to part with their wealth & estates after death?

A cleverly designed newsletter ad to get you in the door….

Alternatives to Newsletters

✓ Your prospects will pay more attention to an advertising medium that delivers a quick, simple, straight-forward & focused message.

✓ One that is creatively designed, cleverly delivered, & most importantly one that is benefits-based.

FACT:

Postcards have over a 95% readership rate.

✓ This does not mean your prospect will donate dearly & forever because you sent a post card.

BONUS:

✓A postcard does not have to be opened-it makes an impression at a GLANCE.

An American Heart CGA postcard

And from the Arthritis Foundation

Go ahead…Cast the net…

✓ IF your message is creative, & you are using frequent mailings (frequent is the KEY), most likely your message will be retained.

Q: If Americans read standing over the trash, then why mail?

A: One day, the right card will arrive at
the right time with
the right message-when the prospect is in
the right mood.

Your mailings should be just 1 part of your overall marketing campaign.

6

✓ e recommend sending 6 postcards per year to a *highly select*
g prospect groups, in addition to the other targeting
hniques cussed.

For effective responsiveness...
you should reach out and touch your prospects/donors
least 10-20 times a year

A touch can be:

- ✓ Calling a prospect/donor
- ✓ The prospect/donor visiting your website
- ✓ Mailing out a postcard
- ✓ Mailing a personalized letter
- ✓ Mailing a thank you note or greeting card
- ✓ The prospect seeing your ad in a publication
- ✓ Or other advertisements you've purchased, etc.

Does your website prompt planned giving?

- ✓ Is it user friendly?
- ✓ Easy to navigate?
- ✓ Is your contact info there and easy to find?
- ✓ Do you have bequest wording available for advisors & donors?

www.americanheart.org

Support research, education, and community programs leading the fight against America's No. 1 killer, cardiovascular disease. learn more...

Get credible information on your heart condition in just 20 minutes. Discuss treatment options with your healthcare provider. It only takes 20 minutes. Log on today for yourself or a loved one. learn more...

Ways To Give
Making Contributions

Wills, Trusts, Annuities

Estate Settlement After Death

Heart Walk

Hoops For Heart

Jump Rope For Heart

Train To End Stroke

Workplace Giving

Dear Neighbor Campaign

Heart to Heart E-Cards

To Email..or NOT to Email?

The Pros of Emailing

- ✓ Cost effective; for reaching large groups of people.
- ✓ Enables you to target audience
- ✓ Effortless way to communicate for both parties
- ✓ Some donors prefer this mode of contact
- ✓ Easy/quick way to market and communicate

The Cons of emailing

- ✓ Organization restrictions to our blast emails
- ✓ Emails are lost because of the spam filters
- ✓ Limited Audience, not all prospects have computer knowledge
- ✓ Not personal, prospects need the and deserve a face to face

If you're thinking...

Think again...

A Clear Message to the right audience = success

- ✓ Clear, relevant & timely emails
  - ✓ not only help but boost short-term returns today.
- ✓ They also enhance
  - ✓ the lifetime giving potential of current & future prospects/donors

For the younger prospects

Deferred CGA ad

Marketing to the Allied Professional

Allied Professional Marketing Tools

Getting In Front of the Allied Professional

- ✓ There are experts who can aid you.
- ✓ Have the names of a few trusted advisors who you can recommend work out the details on your behalf.
  - ✓ Form Advisory Councils
- ✓ Find out what allied professionals in your area need, and try to facilitate:
  - ✓ Continuing Education credits
  - ✓ Tax Updates
  - ✓ Giftlaw email

Designed to be hand-delivered

More ways to get in front of the AP

- ✓ Attorney referral letter
- ✓ Attorney sheet
- ✓ Trust and Estate Seminar

Integration

- ✓ Look for opportunities to integrate Planned Giving into your organization's other activities that will put you face-to-face
  - ✓ Walks
  - ✓ Galas, Balls
  - ✓ Special events designed to target an audience – women, older adults.

- Go Red for Women Luncheons
  - Special *Go Red for Women* packet
  - Special gift for filling out form
  - Run gift annuity illustrations on-site

- Heart Walks –
  - Red Cap Raffle Table
    - Meet the Heart Survivors
    - Offer a free heart-healthy gift basket
    - Donors and prospect self –identify on the form
    - Follow-up with face-to-face visit after the walk

Go Red Luncheon

- ✓ Raffle prize – identify new donors Westchester, New York:
  - ✓ 150 people,
  - ✓ 1 gift several prospects
  - ✓ several volunteers

- ✓ Offer Planning for Women brochure
- ✓ Offer deferred gift annuity illustration at event
- ✓ Estate Planning Questionnaire

Stewardship Marketing

- ✓ What happens after the gift?
  - ✓ Implement a marketing plan to continue the relationship

Valentine Project

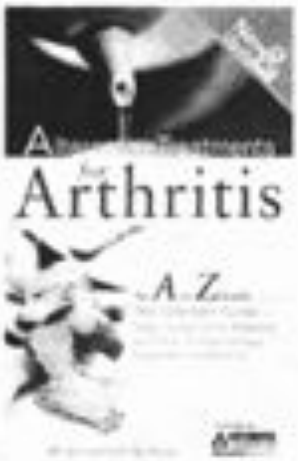
✓ Send chocolate hearts to all donors and some prospects for Valentines Day with special

you card

Additional Cultivation for donors

Literature that helps donors define and meet their overall planning goals.

Make your donor events different!



- ✓ Talk by author sponsored by Planned Giving Department and used as a special event for prospects and donors. Attendees received book, and planned giving information

Why do prospects/donors give?

?

✓Because they are

asked to.

Ask your prospects what they want they will tell you & when they tell you, do it...they will be loyal for life.

FACT

✓Most people would give more if they were simply asked!

ALWAYS REMEMBER:

✓ "People give to PEOPLE, not institutions!"

Planned Giving Success in a Nutshell

✓ The more you believe, the more you will succeed
✓ The more value you provide to others, the more people will come to know & respect you
✓ The more you prepare, the more you will know how to react to any situation.


SEI New ways. New answers.*
SUCCESS IS
MANY GOOD IDEAS
COMING TOGETHER

Philanthropy: Going the Magnificent Mile
28th Conference on Gift Annuities • April 2-4, 2008

Working with Elderly Donors

Presented by:

Laura Hansen Dean
Executive Director of Gift Planning
The University of Texas at Austin
Austin, TX

28th Conference on Gift Annuities
Friday, April 4, 2008

Psychological Needs and Emotional Well-Being

An individual's later years can be a time of declining health and social losses. But, in 1997, Diener and Suh (E. Diener and E. M. Suh, Subjective well-being and age: An international analysis. In: K.W. Schaie and M.P. Lawton, Editors, *Annual review of gerontology and geriatrics* **Vol. 8,** Springer, New York (1997), pp.304-324) found that emotional well-being in old age remains intact.

In a 1989 study, both middle-aged and older adults reported that being a caring person and having a good relationship with others is the key feature of a well-adjusted and mature person. Older adults reported "accepting changes" as the second most important quality of positive functioning (C.D. Ryff, In the eye of the beholder: Views on psychological well-being among middle-aged and older adults, *Psychology and Aging* **4** (1989), pp. 195-210).

Sheldon, Elliott, Kim, and Kasser (2001) list ten psychological needs:

- Autonomy
- Competence
- Relatedness
- Physical thriving
- Security
- Self-esteem
- Self-actualization
- Pleasure-stimulation
- Money-luxury
- Popularity-influence

Among Americans, satisfaction of the self-esteem need was the strongest predictor of well-being. (Sheldon et. al., What is satisfying about satisfying events? Testing 10 candidate psychological needs, *Journal of Personality and Social Psychology* **80** (2001), pp. 325-339).

Financial Needs of Older Adults

- Sufficient resources to be independent
- Sufficient resources to pay for health care and assisted living if needed
- Sufficient resources to deal with emergencies
- Stable income with the ability to keep up with inflation
- Conversion of appreciation to income
- Assistance in management of assets
- Assistance in bill paying
- Knowledgeable, independent financial advice
- Protection from scams and schemers who prey on older adults
- Assistance in will planning and review

(Originally complied by Dr. Alice Kethley, Benjamin Rose Institute, Cleveland, Ohio)

Challenges in Charitable Gift Planning with Older Adults

Increasing costs of long term care, including in-home services, assisted living and skilled nursing, when coupled with the changes in Medicaid eligibility included in the *Deficit Reduction Act of 2005*, may lead to fewer irrevocable charitable gifts during lifetime from other than the truly wealthy.

Increasing life expectancies means much longer time period individuals can expect to be "retired." The need for retirement income to keep up with inflation is increasingly important. Charitable gift annuities may be less attractive due to offering only fixed income.

Opportunities in Charitable Gift Planning with Older Adults

Loans to charitable organizations that can be forgiven at death provide the donor/lender with the comfort of knowing they can access all or part of the "loan" if needed for emergencies or if their financial circumstances change.

Flexible deferred charitable gift annuities offer opportunity for higher payout rate option.

Charitable remainder trusts and charitable gift annuities continue to provide opportunities to convert appreciation to income with total or partial avoidance of capital gains tax on the appreciation.

In 2008, 2009, and 2010 charitable gift annuities can provide increased tax-free income when established by individuals in the 10% and 15% federal income tax brackets and funded with appreciated property due to 0% long-term capital gains tax rate for these individuals.

Issues Which Prevent Individuals From Making Planned Gifts

- Concerns About Privacy
- Irrevocability
- Emotional/psychological Aspects of Aging and Widowhood
- Health Care Concerns
- Entrepreneur Mentality -- I can make more money for you if I use it/invest it during my lifetime and make a testamentary gift.
- Lack of Charitable Intent
- Skepticism About Stewardship/Long Term Management Capabilities of Organization
- Perceived/Real Complexity of Arrangement
- Perceived/Real Cost to Create the Gift Arrangement
- Distrust of Professional Advisors -- attorneys, bankers, insurance agents, investment counsel, etc. -- Involved in the Process
- Accountability of the Charitable Organization
- Viability/Long term Prognosis of Charitable Organization
- Skepticism That the Charitable Organization will use the Gift as Restricted/Designated by the Donor

Charitable Gifts of Retirement Plan Assets

Presented by:

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28th Conference on Gift Annuities
Friday, April 4, 2008

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I. Introduction

A. Many individuals have a significant amount of their net worth in individual retirement accounts (IRA) or qualified retirement plans (QRP).

B. An IRA may be subject to estate tax, income tax and possibly generation skipping tax.

1. IRAs may be subject to both income tax and estate tax. If an IRA passes at death to a noncharitable beneficiary (other than a spouse), it is fully subject to federal estate tax and the recipient will pay income tax on the IRA funds as distributions are made. Distributions from the IRA will represent income in respect of a decedent. §691.

a. If charity is named as the beneficiary of an IRA, the portion of the IRA left to charity will be deductible for federal (and, possibly, state) estate tax purposes.

2. Income tax - at some point in time distributions must be taken from the IRA at which point the withdrawals are subject to income tax (unless it qualifies as an IRA rollover).

a. If an IRA is distributed to charity (a tax-exempt organization), the IRA will not be subject to federal (and, possibly, state) income taxation.

(1) Exception: A charity which has unrelated business taxable income (UBTI) will be taxable on the UBTI.

3. Generation skipping tax – If an IRA is left to a "skip person," the generation-skipping tax may also apply.

4. Prior to December 31, 1996, IRAs and QRPs were also subject to a 15% excise tax on "excess accumulations." The 15% excise tax on excess accumulations tax was repealed by the Taxpayer Relief Act of 1997 effective for deaths occurring after December 31, 1996.

C. Income, estate and generation skipping taxes may consume as much as (or more than) 75% of an IRA.

D. Example. John, a widower, dies in 2008 at age 65 a resident of Massachusetts. He has a $2 million IRA. He names his estate as the beneficiary of his IRA. John is in the highest income tax and estate tax bracket and has exhausted his estate tax and generation skipping tax exemptions. Shortly after John's death his executor liquidates his IRA. As a result of his death, the IRA is included in his gross estate for federal estate tax purposes. Since John's spouse predeceased him and he did not leave his IRA to charity, the IRA will be subject to estate tax. In addition, the withdrawal of all of the money in the IRA by John's executor results in a taxable distribution for income tax purposes. Here is a summary of the taxes imposed on John's IRA at his death:

Value of IRA	$2,000,000
Federal Estate Tax	(773,820)
Massachusetts Estate Tax	(180,800)
Federal Income Tax (35% x $1,120,180)	(392,063)
Massachusetts Income Tax (5.3% x $2,000,000)	(106,000)
Balance of IRA	$ 547,317

The amount received by the estate and its heirs is $547,317, less than 28 cents on the dollar. Almost 73% of the IRA is consumed by taxes!!!

The application of the generation skipping tax makes the tax impact even more dramatic. Assuming the same facts as above except that the IRA is left to a grandchild. This results in a direct skip and the imposition of the generation-skipping tax. Here's a summary of the taxes imposed on John's IRA at his death:

Value of IRA	$2,000,000
Federal Estate Tax	(773,820)
Massachusetts Estate Tax	(180,800)
Generation-skipping tax	(324,348)
Federal Income Tax (35% x $795,832)	(278,541)
Massachusetts Income Tax (5.3% x. $2,000,000)	(106,000)
Balance of IRA	$ 336,491

The amount received by the estate and its heirs is $336.491, less than 17 cents on the dollar. Almost 83% of the IRA is consumed by taxes!!!

II. Tax consequences of leaving IRA to charity

A. Naming a charity as the beneficiary of an IRA qualifies for a federal estate tax charitable deduction. §2055(a)(2).

B. The income tax consequences of leaving an IRA to charity were uncertain until the Service started issuing rulings in this area in 1992.

C. Nine private letter rulings set forth the Service's position in this area:

9237020 - IRA to CRT (June 12, 1992)
9253038 - Qualified Plan to CRUT (Oct. 5, 1992)
9341008 - IRA to Private Foundation (July 14, 1993)
9633006 - Keogh to Private Foundation (May 9, 1996)
9634019 - Qualified Plan to CRUT (May 24, 1996)
9723038 - IRA to Charity (March 11, 1997)
9818009 – IRA and 401(k) to Private Foundation (January 8, 1998)
199901023 – Qualified Plan to CRUT (October 8, 1998)
199939039 – IRA and Qualified Plan to Private Foundation (June 30, 1999)

D. Summary of the tax consequences of leaving an IRA to charity according to the private letter rulings listed above:

1. Distribution of IRA proceeds to charity will not result in income tax to charity, the donor or the donor's estate.

   a. The IRA/qualified plan constitutes income in respect of a decedent (IRD). IRD is taxable to the recipient. A charitable organization is exempt from income tax unless it had unrelated business taxable income (UBTI). IRD is not deemed to be unrelated business taxable income. PLR 9237020, PLR 9253038, PLR 9634019 and PLR 9901023. Hence, the distribution of retirement plan benefits to a charitable organization is exempt from income tax.

2. The value of the IRA left to charity qualifies for federal estate tax charitable deduction.

3. IRA left to private foundation - PLR 9633006 says receipt of Keogh proceeds by a private foundation is subject to the 2% excise tax on net investment income. This is a reversal of the Service's position in PLR 9341008 where the Service held that the receipt of an IRA by a private foundation was not subject to the 2% excise tax on net investment income. In PLR 9818009 and PLR 199939039 (involving IRAs and qualified plans payable to a private foundation) the Service refused to rule on the applicability of the 2% excise tax to an IRA and 401(k) left to a private foundation. The Service stated that the issue is under "further study." Recently, in PLR 9838028 (involving a qualified plan and IRA) and PLR 200003055 (involving an IRA) the Service ruled that the 2% excise tax on net investment income does not apply to retirement plan assets. The Service based its decision in PLR 9838028 and PLR 200003055 on the fact that retirement accounts are deferred

compensation and deferred compensation is not cited in either §4940(c)(2) or Reg. 1.512(b)-1(a) as an item that is included in the gross investment income of a foundation.

a. Query - What is the basis of assets distributed from an IRA to a private foundation – fair market value at the date of distribution or carryover basis? The answer is not clear. Solution: Sell assets in the IRA before distribution to the private foundation. Distribute cash to private foundation and let foundation reinvest. Then you'll be sure what the basis is i.e. the purchase price paid by the foundation paid for the assets.

III. Tax reasons to leave IRA to charity – no estate tax, no income tax.

A. IRA is deductible for federal estate tax purposes if charity is named as beneficiary.

B. Distribution of IRA to charity will allow the IRA to escape federal income taxation.

1. Reason: charity, as the recipient of the distributions from the IRA, is a tax-exempt organization.

2. Exception: charity is taxable to the extent of UBTI it receives. As stated above, retirement plan benefits which constitute IRD are not deemed to be unrelated business taxable income. PLR 9634019, PLR 9901023.

C. IRA proceeds are income in respect of a decedent (IRD). §691; Rev. Rul. 92-47, 1992-1 C.B. 198.

1. A beneficiary of a IRA treats the receipt of the IRA proceeds from a deceased IRA owner as the IRA owner would have treated it had he lived to receive the proceeds i.e. as ordinary income.

2. A taxpayer who receives IRD which is subject to income tax is entitled to an income tax deduction equal to the federal estate tax attributable to the IRD. §691(c).

a. The §691(c) deduction is claimed as a miscellaneous itemized deduction which is not subject to the 2% floor. §67(b)(7); Rev. Rul. 78-203. 1978-1 C.B. 199. Note that no benefit is derived from the §691(c) deduction unless the recipient of the IRD itemizes his deductions. The §691(c) deduction is deductible for purposes of the alternative minimum tax. §56(b)(1)(A)(i) excludes the §691(c) deduction from treatment as a miscellaneous itemized deduction for purposes of the alternative minimum tax.

b. The §691(c) deduction is, however, subject to the 3% phase-out of itemized deductions. §68.

3. IRD does not get a stepped-up basis at death. §1014(c).

D. The cost of making a charitable bequest to the IRA owner's family is less than the face amount of the bequest because the federal estate tax and federal income tax plus any applicable state taxes will reduce the amount otherwise received by the family. As stated in the example above, John's estate or his grandchild will not receive the entire amount of the IRA. Instead, the estate, in the first section of the example, will only receive $547,317 of the $2 million IRA and his grandchild, in the second section of the example, will receive only $336,491 of the $2 million IRA. On the other hand, if John left his IRA to charity, the charity would receive the entire $2 million IRA. Thus, at a cost to the estate of $547,317 or to the grandchild of $336,491, the entire $2 million of the IRA can serve a charitable purpose. Thus, leaving an IRA to charity is a tax-efficient way to fund a charitable gift.

E. In determining which assets to leave to an individual beneficiary and which one to leave to a charity, the tax consequences must be considered. If a client has a charitable intent, it is generally more tax efficient to transfer an IRA to a charity and to leave assets that don't constitute income in respect of a decedent (IRD) to non-charitable beneficiaries. For example, if a parent named a child as the beneficiary of the parent's IRA and left an equal amount of stock to a charity, the child would net less than the charity after paying income tax on the IRA. If instead, the parent left the stock to the child and named the charity as the beneficiary of the IRA, the child would net more after tax.

Example: Father has a $500,000 IRA and $500,000 in appreciated securities. He wants to leave $500,000 to his son and $500,000 to charity. His son is in the 35% income tax bracket. Both the son and the charity intend to liquidate their bequest as soon as possible. If the Father leaves the IRA to his son and the stock to charity, the son will pay a Federal income tax of $175,000 on the distribution of the IRA. Thus, the son will net $325,000 after tax whereas the charity will receive the full $500,000 in stock. (Note: the son may be entitled to a §691(c) deduction for the federal estate tax attributable to the IRA which will lower the actual income tax). If the Father gave the stock to the son and the IRA to charity, both the son and the charity would receive $500,000. The stock would receive a step-up in basis on the Father's death, giving the son a $500,000 basis in stock worth $500,000. If the son sold the stock immediately after his father's death, there would be little or no gain. Since the charity is not subject to income tax on the receipt of the IRA proceeds, it will receive the full $500,000 unreduced by any taxes. Thus, a tax efficient selection of assets will prevent the son from unnecessarily incurring an income tax.

IV. When to leave an IRA to charity – at death and during life.

A. Generally, a IRA owner can give an IRA to charity either at death or during life. Under current federal tax law, leaving an IRA to charity at the death of the IRA owner is the most tax efficient way to transfer an IRA to charity because the IRA will not be subject to either income tax or estate tax. Giving an IRA to charity during life, while possible, generally results in unfavorable income tax consequences. There are some ways to lessen the tax pain of making a lifetime gift of an IRA to charity but these opportunities, discussed below, are fairly limited.

B. While leaving an IRA to charity at death is the most tax efficient, there are four ways in which an IRA owner can give an IRA to charity during life. They are: (1) take a distribution from the IRA, pay the income tax and contribute the balance to charity, (2) utilize the $100,000 charitable exclusion provided by the Pension Protection Act of 2006 (for 2006 and 2007 only), (3) take a lump sum distribution from a qualified plan and, if eligible, elect to pay the income tax using the 10 year averaging method and (4) take a lump sum distribution from a qualified plan, pay tax on the cost basis of employer stock, give the employer stock to charity and roll over the balance of the distribution to an IRA.

1. Take a distribution from the IRA, pay the income tax (and the 10% penalty on early distribution, if applicable) and contribute the balance to charity.

a. A lifetime distribution from an IRA is subject to income tax at ordinary income tax rates and, if the IRA owner is under age 59 ½ at the time of the distribution, a 10% penalty tax on the early withdrawal, unless an exception to the 10% penalty applies. There is no charitable deduction to offset the 10% penalty.

b. The IRA owner who itemizes his deductions will be entitled to an income tax charitable deduction for the amount of the gift to charity. The tax savings from the income tax charitable deduction reduces the cost of taking a distribution from the IRA. However, the income tax charitable deduction will not necessarily be a wash against the amount of the IRA distribution included in the IRA owner's income. The amount of the income tax charitable deduction may not fully offset the amount of the IRA distribution included in income because of the fact that the individual income tax charitable deduction is limited to 50% of the IRA owner's adjusted gross income (AGI) for the year of the contribution with a five year carryover of the excess amount of the contribution that is not deductible due to the charitable contribution limits. For example, if an IRA owner had an AGI of $100,000 and withdrew $200,000 to give to charity, his AGI for the year would be $300,000 ($100,000 normal AGI plus the $200,000 taxable distribution from the IRA). The income tax charitable deduction would be limited to 50% of the IRA owner's AGI or $150,000 (50% of $300,000 AGI) with the excess $50,000 carried over as an income tax charitable deduction for up to five subsequent years until used. Thus, the IRA owner would include $200,000 in his income but would only get a $150,000 charitable deduction for the year of the withdrawal. If the IRA were given to a charitable remainder trust, pooled income fund or in the form of a charitable gift annuity, a full charitable deduction is not allowed – only the actuarial value of the remainder interest qualifies for the charitable deduction which is not enough to offset the amount of the IRA distribution required to be included in the IRA owner's income. In addition, an income tax charitable deduction may not be allowable for state income tax purposes. In other words, even if the amount of the IRA distribution included in income is fully offset by the income tax charitable deduction for federal income tax purposes, the state (e.g. Massachusetts) may not allow an income tax charitable deduction so that even if there was no federal income tax liability on the withdrawal, there may be a state income tax liability. Finally, the amount of the IRA distribution included in income may not be fully offset by the income tax charitable deduction because of the overall limit on the amount of itemized deductions. Under §68(b) a taxpayer loses the portion of his itemized deduction that is equal to 3% of the amount of his AGI in excess of (for 2008) $159,950 (married filing joint) or $79,975 (married filing separate). Thus, for 2008 a married taxpayer filing joint with an AGI of $300,000 would lose $4,202 ([$300,000 less $159,950] times 3%) of his itemized deductions. This limit on the allowable itemized deductions is another reason why the amount of the IRA distribution included in taxable income may not be fully offset by an income tax charitable deduction for the contribution of the IRA distribution to charity.

c. Scenario: Can a participant, upon retirement, transfer ("assign") the proceeds of his retirement plan to a CRT, reserving income to himself and his spouse for life, never pay income tax on the "principal" and even get an income tax charitable deduction for the value of his remainder gift. This is unlikely to work.

(1) Qualified plan benefits are completely non-assignable (with limited exception for divorce and tax liens). §401(a)(13).

(2) Will above scenario work for IRAs?

(a) There are no rules prohibiting the assignment of an IRA. There are rules discouraging pledging an IRA for a loan - if an IRA is pledged as security for a loan, it ceases to be an IRA and is treated as being distributed to the participant. §408(e)(4). In addition, any lifetime assignment or transfer of an IRA will be included in the transferor's income. §408(d)(1).

(b) If IRA owner assigns his IRA to a CRT or other charity and takes back an annuity or other income interest, the IRS might say there is a "prohibited transaction" under §4975. The "prohibited transaction" would be the use of plan assets for the benefit of a disqualified person (the IRA owner). §4975(c)(1)(D). The prohibited transaction rule doesn't apply if the distribution in accordance with the terms of the IRA. §4975(d)(12) exempts distributions made under the IRA plan from the prohibited transaction rule. The IRS could argue that it is a prohibited transaction if there is "receipt of consideration" by a prohibited person (the IRA owner) in connection with plan assets. In other words, the IRA owner is getting a lifetime benefit from the CRT by transferring his IRA to the CRT during life.

(c) A prohibited transaction causes loss of IRA status and the IRA is treated as if it were entirely distributed to the participant on the first day of the taxable year. §408(e)(2).

(d) What if the IRA owner assigns the IRA to a CRT or other charity and does not take back an annuity or income interest? All he wants is a charitable deduction for the value of the IRA without having to pay income tax on that value. IRS may still say that getting an income tax charitable deduction is a "use of plan assets for personal benefit" and therefore is a prohibited transaction.

(e) Alternatively, the IRS might treat it as an "assignment of income," not effective to shift the tax burden away from the IRA owner.

(f) Final Regs. under §2056A (QDOT regs.), the IRS says that an IRA is assignable but that the assignment of an IRA to any assignee other than a 100% "grantor trust" under 671 et. seq. would cause the assignor to be taxed immediately on the full value of the IRA. Reg. 20.2056A, Preamble, §E. Likewise, the Roth IRA regulations say that the assignment of a Roth IRA by gift would be treated as a distribution of the account to the participant and the account would cease to be any type of IRA after the assignment. Reg. 1.408A-6, Q&A 19.

(g) Since the proceeds of an IRA are ordinary income, if an IRA were assigned to a charity the income tax charitable deduction would be limited to the IRA's basis, which in most cases is zero. (The income tax charitable deduction for a contribution of ordinary income property is limited to the property's basis.) This is the case when the IRA is assigned to charity – this is not the case if a distribution is taken from the IRA and the proceeds are contributed to charity.

2. Utilize the $100,000 charitable exclusion provided by the Pension Protection Act of 2006 (for 2006 and 2007 only).

   a. The Pension Protection Act of 2006 allows for (1) an exclusion from gross income (2) of up to $100,000 per IRA owner per year (3) from a traditional IRA or Roth

IRA (4) for a "qualified charitable distribution" (5) made during 2006 and 2007 (6) by an IRA owner who has attained age 70 ½ on the date of distribution. Thus, an IRA owner who has attained age 70 ½ is allowed to make a tax-free distribution from a traditional IRA or a Roth IRA in 2006 and 2007 to organizations that qualify under §170(b)(1)(A) i.e. a public charity.

b. President Bush's 2009 budget proposal as well as proposed legislation (H.R. 3596, Charitable Tax Relief Act of 2007, H.R. 4086, Healthy Families and Dedicated Teachers Tax Relief Act of 2007 and S. 819/S.1419 (identical bills) Public Good IRA Rollover Act of 2007 would make the provision permanent while H.R. 3970, the Tax Reduction and Reform Act of 2007 proposed a one-year extension to December 31, 2008 while S. 2264 would extend the provision until December 31, 2009) seeks to extend the benefit of this expired provision of the Pension Protection Act of 2006. Even though this provision has expired as of the date this outline was written, there is a good chance this provision will be revived and therefore its provisions are discussed in this outline.

c. "Qualified Charitable Distributions" (QCD) can only be made from a traditional IRA or a Roth IRA. A QCD cannot be made from a 401(k) plan, a 403(b) plan, a defined benefit plan, a defined contribution/profit sharing plan, a Keogh plan, a simplified employee pension (SEP) or a SIMPLE plan. However, Notice 2007-7 makes an exception for SEPs and SIMPLEs. A QCD may be made from a SEP or a SIMPLE as long as the SEP or SIMPLE is not an "ongoing" SEP or SIMPLE- an "ongoing" SEP or SIMPLE means one where an employer contribution is made for the plan year ending with or within the IRA owner's tax year in which the charitable contribution would be made. Thus, a QCD can be made from an inactive SEP or SIMPLE.

d. The QCD must be made on or after the IRA owner has attained the age of 70 ½.

e. The QCD must be made <u>directly</u> by the IRA administrator to the charity i.e. the IRA owner cannot take a distribution from the IRA and then contribute the distribution to the charity. However, a check that is payable to a charity and that is sent to the IRA owner for delivery to the charity will be treated as a direct payment. Notice 2007-7.

f. The QCD must be made to an organization described in §170(b)(1)(A). Thus, a QCD may not be made to a donor advised fund (as defined in §4966(d)(2)) or a supporting organization (as defined in §509(a)(3)).

g. The QCD must otherwise fully qualify for a income tax charitable deduction. As a result of this requirement, a charitable gift annuity, pooled income fund and a charitable remainder trust are ineligible to receive a QCD. No split interest gifts of any type will qualify as a QCD. To quote the Joint Committee on Taxation Technical Explanation, "The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution."

h. The distribution must have been taxable if distributed to the plan participant.

i. Administration issues.

   (1) The charity must furnish a "contemporaneous written acknowledgement" to the donor. See Treasury regulation 1.170A-13(f). The IRA administrator should note the donor's name on the transmittal of the check or wire transfer to the charity so that the charity can identify the donor and furnish the donor with a "contemporaneous written acknowledgement."

   (2) The charity cannot furnish any "quid pro quo" for the contribution. Thus, the charity should make sure that nothing of value is exchanged in

connection with the gift of the IRA as that would make the exclusion inapplicable with respect to any part of the IRA distribution.

(3) The QCD counts as part of the IRA owner's minimum required distribution. The IRA distribution is not includible in income.

(4) A income tax charitable deduction cannot be taken for the QCD.

(5) If more than $100,000 is transferred by an IRA owner to a charity, there is no carryover to a future year. The amount of the contribution in excess of $100,000 is taxable income and a charitable deduction can be claimed if the IRA owner itemizes his deductions.

(6) There is a special rule for IRAs that include nondeductible contributions. If an IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income if the aggregate balance of all IRAs having the same owner were distributed during the same year. In other words, taxable distributions are considered distributed first before any nontaxable distributions. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

(7) IRA owners should consult with the IRA administrator to determine how late in December the IRA administrator will allow an IRA owner to make a QCD to a charity.

(8) IRA beneficiaries are allowed to make QCD as well as IRA owners. Notice 2007-7. The charitable distribution will only be qualified if the distribution is made on or after the date the IRA owner or beneficiary attains age 70 ½. Thus, a beneficiary of an IRA can make a QCD if the beneficiary is over age 70 ½ in 2006 or 2007.

(9) For married couples, if each spouse has their own IRA, each spouse can transfer up to $100,000 from their own IRA to charity as long as each spouse meets all of the QCD requirements. Notice 2007-7. However, gift-splitting is not allowed for charitable distributions. An IRA owner cannot make a distribution of $200,00 from his IRA and treat half of the distribution as being made by him and half being made by his spouse. Notice 2007-7.

(10) A distribution from a checkbook IRA to a qualified charity will qualify as a QCD. Notice 2007-7 says that a check from an IRA payable to a charity and delivered by the IRA owner to the charity will be considered a direct distribution from the IRA custodian.

(11) A charitable distribution to a charity where the IRA owner has an outstanding pledge will be treated as a QCD and not as a prohibited transaction. Notice 2007-7. The Department of Labor (which has interpretive authority over the self-dealing rules) has advised the IRS that a QCD made by an IRA trustee directly to a qualifying charity will be treated as received by the IRA owner i.e. it will not constitute self-dealing, a prohibited transaction.

(12) A QCD is not subject to income tax withholding. The IRA owner that requests the QCD is deemed to have elected out of withholding under §3405(a)(2).

(13) Income tax reporting. The instructions to Form 1040, page 21 (for 2007 returns) tells how to report a QCD. The IRA custodian will report all distributions from the IRA on a Form 1099-R as taxable distributions to both the IRA owner and the IRS. The IRA owner will report all of the IRA distributions on line 15a of the Form 1040 but only the taxable distributions on line 15b. This is similar to the tax reporting for IRA rollovers i.e. only the taxable portion of the distribution is shown on line 15b. The QCD will not be disclosed on Schedule A, the schedule where itemized deductions, including charitable gifts, are reported. This method of tax reporting relieves the IRA custodian from determining whether a distribution qualifies as a QCD. The IRA custodian simply reports the entire distribution as taxable. The burden is on the IRA owner to determine whether the distribution qualifies as a QCD and to report it accordingly. For example, if the IRA owner, over age 70 ½ took a $5,000 distribution from his IRA in 2007 and had the IRA custodian send a qualifying charity a check for $2,000 of the $5,000 as a QCD, the IRA custodian would report a taxable distribution from the IRA on Form 1099-R of $5,000 and the IRA owner would report the total $5,000 distribution on line 15a of his 1040 and $3,000 on line 15b as a taxable distribution. The $2,000 QCD would not appear on Schedule A, Itemized Deductions.

3. Take a lump sum distribution from a qualified plan and, if eligible, elect to pay the income tax using the 10 year averaging method.

   a. Taxpayers born before 1936 (and their beneficiaries) have the option of taking a lump sum distribution from a qualified plan (IRAs don't qualify) and having the income taxed under a special 10 year averaging method. In general, the 10 year averaging method calculates the tax on 1/10 of the distribution using tax rates in effect in 1986 and then multiplies the resulting tax by 10. For some distributions the tax computed using the 10 year averaging method results in less income tax than if the distribution were taxed as ordinary income. Thus, a taxpayer, if eligible, could take a lump sum distribution from a qualified plan, possibly pay a lower amount of tax than would be due if the distribution were taxed as ordinary income and contribute the balance of the distribution to charity. The 10 year averaging method is one way to get money out of a qualified plan at a low income tax cost and donate the balance to charity during life. This availability of this method is limited due to the requirement that the taxpayer be born before 1936.

b. A lump-sum distribution made after 12/31/99 is defined in §402(e)(4)(D). Generally, a lump-sum distribution is defined as follows:

1) Only distributions from a "qualified plan" are eligible for lump-sum distribution treatment. IRAs do not qualify.

2) Distribution of the entire balance to the credit of the employee must be made within one taxable year of the recipient. All similar plans must be aggregated for purposes of applying this rule. §402(e)(4)(D)(ii). All trusts which are part of a single plan are treated as a single trust, all pension plans maintained by the employer are treated as a single plan, all profit-sharing plans maintained by the employer are treated as a single plan, and all stock bonus plans maintained by the employer are treated as a single plan

i) The balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of §72(o)(5)). §402(e)(4)(D)(i).

(ii) The balance to the credit of an employee also does not include any amount payable to an alternative payee under a Qualified Domestic Relations Order (QDRO). §402(e)(4)(D)(v).

3) The distribution must be made (1) on account of the employee's death, (2) after the employee attains age 59 1/2, (3) on account of the employee's (not including self-employed individuals) separation from service, or (4) after a person who is self-employed becomes disabled.

4) Other complicated rules apply in determining if a taxpayer is eligible for 10 year averaging and should be researched to determine if 10 year averaging is applicable.

4. Take a lump sum distribution from a qualified plan, pay tax on the *cost basis* of employer stock, give the employer stock to charity and roll over the balance of the distribution to an IRA.

a. §402(e) provides another, although limited, way to get appreciated employer stock out of a qualified plan (not an IRA) at a lower income tax cost so that the employer stock may be contributed to charity. §402(e) requires that the donor take a lump sum distribution from a qualified plan in which he participates and that the distribution from the plan includes "employer stock" (stock in the company he works for) that has a significant amount of "net unrealized appreciation" (NUA).

b. How it works. The plan participant takes a lump sum distribution from a qualified plan. The donor retains the employer stock and rolls the balance of the distribution into an IRA to defer income taxation on the non-employer stock portion of the distribution. The retention of the employer stock is a taxable distribution to the employer but the value of the stock for income tax purposes under §402(e) is the *cost basis* of the stock to the plan, not the fair market value of the employer stock on the date of distribution. The difference between the fair market value of the stock on the date of distribution and the stock's cost basis to the plan is know as "net unrealized appreciation" (NUA). The NUA is taxed only when the employer stock is subsequently sold and at that point it is taxed as capital gain, even if the stock is held by the donor only for a day. Any gain in excess of the fair market value of the stock on the date of the distribution is taxed as either long-term or short-term capital gain depending on the holding period of the stock.

c. Result: The cost basis of the employer stock that the donor withdrew (and retained) from the plan as part of the lump sum distribution is taxed as ordinary income. If the donor had taken a distribution from the plan or rolled the entire lump sum distribution into an IRA and subsequently taken a distribution from the IRA, the distribution would have been taxed as ordinary income. Thus, the NUA technique allows the employee to convert potential ordinary income into capital gain. If the donor was under age 59 ½ at the time he took the lump sum distribution, the 10% penalty on early withdrawal would be applied to the cost basis of the employer stock, not its fair market value.

d. Example: Ed gets a lump sum distribution from his qualified plan. The distribution includes 1,000 shares of stock in his employer. The fair market value of the stock as of the date of distribution was $50/share while the cost basis of the stock to the plan was $10/share – thus, the NUA is $40 ($50 fair market value less $10 basis). Ed retains the employer stock and pays income tax on the $10/share. Ed rolls the balance of the distribution (everything except the employer stock) into an IRA. The NUA of $40/share is long-term capital gain when Ed ultimately sells the stock. Any appreciation of the stock over $50/share is short-term or long-term gain depending on how long Ed holds onto the stock after he receives the distribution.

e. The charitable solution. A donor who takes advantage of §402(e) by taking a lump sum distribution from a qualified plan and holding onto the employer stock now has appreciated stock with a potential large capital gain. For example, Ed in the above example has employer stock with a $50/share value with a $10 basis. To ease his income tax burden, Ed could contribute the employer stock directly to charity or to a charitable remainder trust. If he contributes the shares of stock to a public charity, Ed will get a individual income tax charitable deduction for the full fair market value of the employer stock ($50 in Ed's example). If he contributes the employer stock to a charitable remainder trust, he will get an individual income tax charitable deduction for the fair market value of the employer stock less the value of the interest payable to the noncharitable beneficiary of the charitable remainder trust. The charity can sell the appreciated stock without paying any income tax on the gain. The charitable remainder trust will not recognize any capital gain when it sells the employer stock but the amount of the gain on the sale of the stock will be gain (either long-term or short-term) under the charitable remainder trust tier system of taxation.

f. The charitable result: The donor takes a lump sum distribution from his qualified plan during life, contributes the employer stock that he retains to a public charity or to a charitable remainder trust. The cost to the donor is the ordinary income tax he paid on the *cost basis* (not the fair market value) of the employer securities. Thus, the donor is able to get appreciated employer stock out of his qualified plan at a low income tax cost and give the stock to charity during his life.

g. Will this work? The IRS has issued the private letter rulings that confirm the validity of this planned giving technique. PLRs 199919039, 200038050,200202078, 200215032, 200302048 and 200335017.

V. Ways to Give an IRA to Charity

A. There are a number of ways to give an IRA to charity. The methods most frequently encountered are (1) directly i.e. name the charity as the beneficiary of the IRA on the beneficiary designation form, (2) name an individual as the primary beneficiary on the beneficiary designation form, name a charity as the contingent beneficiary and rely on the individual to disclaim his right in the IRA so that the contingent charitable beneficiary takes the IRA, (3) name an estate or trust as the beneficiary of the IRA with provisions in the will or trust to distribute some of all of the estate or trust to a charity or (4) structure the IRA so that an individual gets the lifetime benefit of an IRA with charity enjoying the remainder interest i.e. naming a qualified terminable interest property trust or a charitable remainder trust as the beneficiary of an IRA. All of these alternatives are discussed below.

B. Leaving an IRA directly to charity e.g. charity is named as the beneficiary of an IRA.

1. The easiest and recommended way to leave an IRA to charity is to name the charity as the primary beneficiary of the IRA on the beneficiary designation form. When the IRA owner dies, the charity is the beneficiary of the IRA and can take a distribution of the IRA without estate or income tax consequences.

2. Who takes the IRA. The person or entity named as the beneficiary on an IRA beneficiary designation form is the person or entity who is entitled to the IRA at the death of the IRA owner. The IRA owner's will does not control the disposition of the IRA unless the IRA owner has named his estate as the beneficiary of the IRA. In the event that the IRA neglects to name a beneficiary of the IRA or in the event the IRA beneficiary designation form cannot be located, the IRA agreement between the IRA custodian and the IRA owner will most likely contain default language that indicates who is entitled to the IRA. The default language in some agreements names the decedent's estate as the default beneficiary of an IRA. Some other IRA agreements may name the spouse, if there is one, as the default beneficiary, followed by the IRA owner's children, followed by the IRA owner's estate. Thus, if the IRA owner has neglected to name an IRA beneficiary or the IRA beneficiary designation form has been misplaced, the IRA agreement will indicate who is the beneficiary of the IRA and that will probably not be to anyone's liking. In any event, a charitable organization will not be one of the default beneficiaries. If the IRA owner wants the IRA to go to a certain charity, the IRA owner should name the charity as the primary beneficiary of the IRA.

C. Name individual as primary beneficiary, name charity as contingent beneficiary and rely on individual to disclaim in favor of charity.

1. In some cases an IRA owner wants an individual (e.g. spouse or child) to be the primary beneficiary of the IRA and to have the IRA pass to charity only if the individual predeceases the IRA owner or the individual decides for tax or personal reasons that they don't want or need the funds in the IRA. In these cases, the IRA owner may name an individual as the primary beneficiary of the IRA followed by a charity as the contingent beneficiary.

2. If the IRA owner is confident that his spouse will name charity as beneficiary of the IRA balance remaining at the spouse's death, the spouse could be named as the primary beneficiary of the IRA with the

charity (or a charitable remainder trust) named as the contingent beneficiary.

a. No rollover. If the spouse does not treat the IRA as her own or roll it over to an IRA in her name, the spouse will receive payments from the IRA and upon her death the amount remaining in the IRA will pass to whomever she names as beneficiary of the IRA (assuming the IRA custodian allows the spouse to name the beneficiary of the IRA after her death.) In this case, in order for the IRA to pass to charity upon the spouse's death, the spouse will have to execute a new beneficiary designation form affirmatively naming the charity as the beneficiary of the IRA upon her death. If the spouse neglects to do so, the charity will not receive the balance of the IRA upon her death. Minimum required distributions during the spouse's life will be based on the spouse's life expectancy.

b. Rollover. Upon the IRA owner's death the surviving spouse could rollover the IRA into his or her own IRA or treat the IRA as his or her own IRA. In this case, the IRA will be deemed to be the IRA of the spouse and the spouse may name a beneficiary of the IRA. If the spouse wants the IRA to go to charity at death, the spouse should complete a beneficiary designation form naming the charity as the beneficiary of the IRA.

(1) Spouse could a name a charity or charitable remainder trust as his or her beneficiary.

(2) The minimum required distributions do not have to begin until the spouse's required beginning date (generally April 1 of the year after the spouse reaches age 70 ½).

(3) When the spouse dies, the balance in the IRA would go to charity or a charitable remainder trust as the named beneficiary of the spouse's IRA.

(4) The IRA is included in the surviving spouse's gross estate for federal estate tax purposes but, if left to a charity, would qualify for the estate tax charitable deduction. If left to a charitable

remainder trust, the IRA would qualify for at least a partial estate tax charitable deduction.

(5) Charity, as a tax exempt organization, would pay no income tax on the receipt of the balance. A charitable remainder trust, exempt from income tax under §664, would pay no income tax upon receipt of distributions from the IRA.

3. Alternatively, the IRA owner could name his spouse as the designated beneficiary of the IRA and a charity or a charitable remainder trust as the contingent beneficiary. When the IRA owner dies, the spouse can disclaim the IRA and the IRA will fall to the contingent beneficiary i.e. charity or the charitable remainder trust.

   a. When the IRA owner dies and the spouse disclaims, the remaining balance of the IRA goes to charity and the surviving spouse will no longer receives distributions from the IRA. While the IRA owner is alive the minimum required distributions are based on the Uniform Table or, if the spouse is more than 10 years younger than the IRA owner, on the actual joint life expectancy of the IRA owner and his spouse.

   b. If the surviving spouse wants or needs distributions from the IRA after the IRA owner's death, consider naming a charitable remainder trust for the benefit of the surviving spouse as the contingent beneficiary. When the IRA owner dies the spouse can disclaim and the surviving spouse will receive payments from the charitable remainder trust after the IRA owner dies. Despite the requirement under §2518 that the disclaimed interest must pass to a person other than the disclaiming party, there is an exception for spouses. When the disclaiming person is the surviving spouse of the decedent, such spouse may disclaim an interest in property, even if, as a result, the property passes to a trust in which the spouse has an interest. §2518(b)(4). Note that someone other than the decedent's spouse (e.g. a child) could not disclaim in favor of a charitable remainder trust and be the beneficiary of the charitable remainder trust as this would violate the disclaimer rules.

4. In GCM 39858, the IRS held that a disclaimer (which meets the requirements of §2518 and state law) of a retirement plan benefit or an IRA could effectively transfer the account to the next successor beneficiary without adverse tax consequences to the first successor beneficiary. The GCM considered three issues. First, the GCM

concluded that the disclaimer did not violate the prohibition against assignment or alienation of plan benefits under §401(a)(13). Second, it concluded that the disclaimer would not be a taxable event to the person disclaiming the benefits or account as an assignment of income. Third, the GCM stated that the income from the plan or account will be IRD under §691(c) to the beneficiary who actually receives the payments from the plan or account, and that the recipient would be entitled to the §691(c) deduction for the estate taxes paid upon the plan or account. See also PLR 9319029 and PLR 9303027 (disclaimer of pension plan); PLR 9016026 (disclaimer of money purchase plan) and PLR 9226058 and PLR 9037048 (disclaimer of IRA).

a. The IRA owner would be able to designate an individual as a beneficiary and a charitable organization as the next successor beneficiary and the IRA would go to the charitable organization if, upo n the IRA owner's death, the beneficiary disclaimed his or her interest in the IRA.

b. This solution puts the charity at risk if the individual chooses not to disclaim or if, for example, the disclaimer is not made within the applicable 9 month period or if it fails to meet some other requirement for a qualified disclaimer.

c. A problem exists if a parent names an individual as a beneficiary of an IRA and through the individual's disclaimer the property passes to a private foundation where the individual is a director. The individual's participation in the private foundation's selection of charitable grant recipients could prevent the disclaimer from being a qualified disclaimer. This is because the individual would be normally involved in selecting the ultimate charitable beneficiaries of the private foundation, which could violate the requirement that the interest in property passes "without any direction on the part of the person making the disclaimer." Reg. 25.2518-2(d)(1) & (2); 25.2518-2(e)(1)(i). See Rev. Rul. 72-552, 1972-2 C.B. 525, PLR 9350033 and Rifkind v. U.S., 5 Cl. Ct 362 (1984) for analogous situations. In that case, the estate may not be able to claim an estate tax charitable deduction for the amounts that are transferred to the private foundation.

(1) One solution to deal with this is for the private foundation to amend its bylaws so as to prohibit the individual and the individual's spouse from participating in the selection of grant recipients from amounts that are attributable to the disclaimed property.

See PLR 9317039 and 9141017. This is a fairly clumsy solution that interferes with a parent's desire to allow, for example, children to be involved with a private foundation.

(2) A better solution may be to have a child disclaim property to an advised fund of a community foundation. The IRS concluded in PLR 9532027 that the advisory nature of a child's grant recommendations did not pose a problem. The IRS approved the estate plan that allowed each child to disclaim as much property as he choose from his father's estate so that all of the disclaimed property would be transferred to an advised fund. The terms of the fund permit the father's son and daughter-in-law and, eventually, his grandchildren to make grant recommendations. The IRS concluded that such a disclaimer would be a valid "qualified disclaimer" and that the estate could claim an estate tax charitable deduction for whatever amounts would be contributed to the advised fund. This was the case even though his son would make grant recommendations from the fund and he was a director of the foundation that administered the advised fund (the son agreed to abstain from voting on his own recommendations at board meetings).

The father in the ruling had two sons and each son would make recommendations to an advised fund administered at a different foundation. One son was a director at one foundation, but he agreed to abstain from voting on any of his own grant recommendations. The fund for the other son was apparently at a community foundation, where the staff investigated whether recommendations were consistent with the foundation's "specific charitable needs." The IRS reached a similar conclusion for a disclaimer by a brother to an advised fund, including a disclaimer of the brother's outright bequest as well as his income interest in a charitable remainder unitrust. PLR 9635011. See also PLR 200518012.

d. Other practical disclaimer examples.

(1) Example: IRA owner designates son as the IRA beneficiary with charity as the contingent beneficiary.

Son disclaims and the IRA passes to charity as the contingent beneficiary. This is permissible. See PLR 200149015.

(2) Example: IRA owner designates son as the IRA beneficiary with charity as the contingent beneficiary. The son does a partial disclaimer so that the son takes half the IRA and the charity takes the other half of the IRA. In this case there is one IRA with both the son and the charity as the beneficiaries of the IRA so the IRA has no designated beneficiary. In this case the son would be required to take a distribution of his balance of the IRA either (1) by December 31 of the fifth year after the IRA owner's death if the IRA owner died before his required beginning date or (2) over the remaining life expectancy of the IRA owner if he died after his required beginning date. See the discussion of the multiple beneficiary rule in the section dealing with the minimum required distribution rules for an explanation of how naming a charity as one of multiple beneficiaries of an IRA affects the timing of distributions.

(3) Example: IRA owner designates wife as the IRA beneficiary with charity as the contingent beneficiary. The wife does a partial disclaimer so that the wife takes half the IRA and the charity takes the other half of the IRA. In this situation the wife could take her half of the IRA and roll it over into her own IRA and take the minimum required distributions over her life expectancy.

(4) Example: IRA owner designates son as the IRA beneficiary with a charitable remainder trust for the benefit of the son as the contingent beneficiary. The son does a partial disclaimer in favor of the charitable remainder trust for the benefit of the son. The disclaimer is invalid as the son cannot benefit from the property disclaimed.

5. It the IRA owner names an individual as the primary beneficiary of the IRA and a charity as the contingent beneficiary, if the IRA owner dies survived by the primary beneficiary, the primary beneficiary is entitled to the IRA and the charity gets nothing. The only way the charity will be entitled to the IRA in this situation is if the primary beneficiary

predeceases the IRA owner or the primary beneficiary survives the IRA owner but disclaims his or her interest in the IRA and the charity is named as the contingent beneficiary of the IRA.

6. If a charity is named as the contingent beneficiary of an IRA, the charity is at the mercy of the primary beneficiary. If the primary beneficiary does not predecease the IRA owner or disclaim, the charity does not get the IRA.

D. Name and estate or trust as the primary beneficiary of an IRA with the estate or trust leaving all or part of the estate or trust to charity.

1. An IRA owner may name his estate or trust as the beneficiary of his IRA and his estate or trust may leave some or all of the estate or trust to a charity. The major problem with this type of planning is trying to secure an fiduciary income tax charitable deduction for the distribution from the estate or trust to charity. The receipt of a distribution from the IRA to the estate or trust will cause the estate or trust to include in its income the amount distributed from the IRA which will be taxed to the estate or trust unless it is distributed to the beneficiaries. If the income is not distributed, it will be taxed to the estate or trust. The income tax rates for estate and trusts are extremely compressed. For 2008, an estate or trust reaches the maximum income tax rate of 35% at taxable income of only $10,700 whereas a married individual filing a joint return reaches the maximum 35% tax rate at a taxable income of $357,700. If the estate distributes income to an individual beneficiary, the estate or trust will get a distribution deduction for the amount of income distributed to the individual and the individual will report the income distributed from the estate or trust. If the estate or trust makes a distribution to a charity, the only deduction available to the estate or trust is the fiduciary income tax charitable deduction allowed by §642(c). As will be discussed in detail below, there are rather complex requirements for an estate or trust to qualify for an income tax charitable deduction.

2. If the IRA owner names his estate or trust as the beneficiary of his IRA and the estate or trust leaves part or all of the estate or trust to charity, there are basically four ways to avoid having any IRA distributions made to the estate or trust from being taxed to the estate or trust. They are: (1) qualify for the fiduciary income tax charitable deduction under §642(c), (2) "assign " the IRA to charity, (3) have the estate pay the charity last or (4) bypass the estate entirely and have the IRA owner name the charity directly as the primary beneficiary of the IRA. The issue is how to avoid having the charity's share of the estate or trust being taxed at the estate or trust level.

3. Qualify for the fiduciary income tax charitable deduction under §642(c).

   a. In order for an estate or trust to qualify for the fiduciary income tax charitable deduction under §642(c), two requirements must be met: (1) the bequest to charity is paid out of gross income and (2) the charitable bequest is paid pursuant to the terms of the governing instrument. The requirement that the charitable bequest be paid out of "gross income" means income in the tax sense, not income in the accounting sense. §643(b). Thus, regardless of how a distribution from an IRA is classified for fiduciary accounting purposes, the distribution is taxable income and thus the distribution of an IRA from an estate or trust satisfies the first requirement of §642(c) that the distribution is paid out of gross (taxable) income. The difficultly is satisfying the second requirement of §642(c) that the distribution of the IRA from the trust or estate to charity is "paid pursuant to the terms of the governing instrument." Even though the charitable bequest is paid out of gross (taxable) income, the fiduciary income tax charitable deduction will be denied unless the will or trust directs that the IRA be paid to charity i.e. the bequest is made "pursuant to the governing instrument" The United States Supreme Court has held that if the fiduciary has the discretion to pay the amounts to charity and does, in fact, pay it to charity, it will be considered to have been paid pursuant to the terms of the governing instrument. Old Colony Trust 301 U.S. 379 (1937). Unless the requirements of §642(c) are satisfied, the IRA distribution will be taxed at the estate or trust level and the charity's bequest will take a "haircut" for income tax paid at the estate or trust level. If the charitable deduction were allowed, the tax "haircut" would be avoided.

   b. To secure the fiduciary income tax charitable deduction, the language in the estate or trust should state specifically that the IRA is left to charity. Reg. 1.642(c)-3(b)(2). The bequest should not be drafted as a "percentage of the residue" unless the instrument provides that the IRA (or other forms of income in respect of a decedent) is required to be used first to fund the charitable percentage of the residue. If the bequest is drafted as a "percentage of the residue" then according to Reg. 1.642(c)-3(b)(2) the distribution to charity would be "deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes" i.e. only a portion of the distribution would be deemed to consist of the IRA. The following language would establish specificity requirement.

Sample Language: "...provided, however, that to the extent possible, gifts to charitable organizations shall be satisfied by distribution of property constituting income in respect of a decedent as that term is defined by §691(a) of the Internal Revenue Code of 1986 as amended from time to time." This clause will require an IRA (income in respect of a decedent) be used to fund a charitable gift.

(1) If the estate or trust fails to satisfy the requirements of §642(c) so that the fiduciary income tax charitable deduction is lost, the executor or trustee cannot claim an income distribution deduction under §651 or §661 for the amount distributed to charity. Generally, the IRA will escape income taxation only if the estate or trust qualifies for a fiduciary income tax charitable deduction under §642(c). In general, an estate or trust will not be able to take an income distribution deduction for an amount distributed to charity. Reg. 1.663(a)-2; United States Trust Company v. United States 803 F.2d 1363 (5th Cir. 1986); Rebecca K. Crown Income Charitable Fund v. Comm. 98 T.C. 327 (1992); Estate of O'Connor v. Comm 69 T.C. 165 (1977); Mott v. United States 462 F.2d 512 (Ct. Cl. 1972); Weir Foundation v. United States 508 F.2d. 894 (2d Cir. 1974); Pullen v. United States 80-1 USTC ¶9105 (D. Neb. 1979), aff'd mem. 634 F.2d 632 (8th Cir. 1980); Rev. Rul. 68-667, 1968-2 C.B. 289.

(2) The idea is to get the IRA to charity without paying an income tax at the estate or trust level. §642(c) allows a charitable deduction for both estates and trusts if the IRA is (1) payable from "gross income" (in the tax sense) and (2) is paid pursuant to the terms of the governing instrument (e.g. the will or trust names the charity as the recipient of the IRD). For an example of how an IRA payable to an estate or trust would qualify for a fiduciary income tax charitable deduction under §642(c), see PLR 9826040. In that ruling a trust instrument provided that all income in respect of a decedent be distributed to charity. The grantor's profit

sharing plan was payable to the grantor's trust. While not ruling on the issue, the ruling points out the possibility that the trust may qualify for a fiduciary income tax charitable deduction under §642(c) if the trust made a timely distribution to a private foundation of the amount distributed from the profit sharing plan to the trust. The trust would qualify for a §642(c) deduction as the charitable contribution was made out of "gross income" (the profit sharing plan assets) and they were made "pursuant to the terms of the governing instrument" (the trust mandated that IRD be distributed to charity). See also PLR 200336020 where an IRA distribution was included in the gross income of an estate but qualified for a fiduciary income tax charitable deduction under §642(c).

(3) There may be a problem in securing a fiduciary income tax charitable deduction for the transfer of an IRA from an estate or trust to a charitable remainder trust (CRT). There is no authority allowing a fiduciary income tax charitable deduction for the transfer of an IRA (or other income in respect of a decedent) from an estate or trust to a CRT. However, see TAM 8810006 where the Service allowed a distribution deduction under §661(a) for a distribution to a CRAT. See also GCM 39707 in which the IRS said that a charitable remainder trust is not eligible for a charitable deduction but is eligible for an income distribution deduction.

Example: Decedent names his estate as the beneficiary of his $200,000 IRA. The decedent's will specifies that the IRA is to be transferred to a charitable remainder trust which is for the benefit of the decedent's child for life. Assume that the value of the charitable remainder interest is equal to 60% and the value of the income interest is 40% of the amount contributed. The estate's fiduciary income tax return will report $200,000 in income from the IRA distributed to the estate. Presumably, $120,000 ($200,000 x 60%) will qualify for a fiduciary income tax charitable deduction as that amount is permanently set aside by the estate for charity. If a trust were involved, the fiduciary income tax charitable deduction generally would be allowed only if the amount were actually paid to charity in the year of receipt of the IRA distribution or in the following year.. Reg. 1.642(c)-3(a) and (b). Presumably, the other \$80,000 will not qualify for a fiduciary income tax charitable deduction and would generate an income tax on the fiduciary income tax return. There is no legal authority directly on point to support this example – the results are what should logically happen. An income distribution deduction should be allowed for the amount distributed from the estate to the charitable remainder trust.

(a) A fiduciary income tax *charitable* deduction will not be allowed for the transfer from an estate or trust to a charitable remainder trust that allows for invasions of principal to make the payments to the noncharitable beneficiary because the ability to invade principal means that the amount is not permanently set aside for charitable purposes. Reg. 1.642(c)-2(d). See also PLR 8604005. With the exception of an "income only" unitrust, there is always a "possibility" of an invasion of principal to meet the charitable remainder trust annuity or unitrust payout requirements and thus, a fiduciary income tax *charitable* deduction would not be available .

(4) There are, however, additional charitable deduction requirements which differ for estate and trusts. The following rules apply:

(a) IRA left to estate, estate distributes to charity. Generally, the estate is allowed a charitable deduction if the IRA proceeds are <u>paid or permanently set aside</u> pursuant to the terms of the governing instrument. §642(c)(2). Thus, a fiduciary income tax charitable deduction is allowed for IRA proceeds that are actually paid to charity in the current year or that is permanently set aside by the estate for charity. Thus, if an IRA is payable to an estate and the estate makes a distribution to charity, it is not necessary that the IRA proceeds are paid to charity in the year it is received by the estate - the charitable deduction is allowed if the amount is permanently set aside for charity i.e. the IRA proceeds are received by the estate in one year and the IRA proceeds are actually paid to charity in a future year.

(b) IRA left to trust, trust distributes to charity. Generally, a trust is allowed a fiduciary income tax charitable deduction if the IRA proceeds are actually paid in the current year or is paid in the following year and the trustee elects to have it deducted in the preceding year. §642(c)(1). Thus, if an IRA is payable to a trust, the IRA proceeds will be taxed at the trust level unless the trustee distributes the IRA proceeds in the year the IRA proceeds are received by the trust or in the following year. A trust is not like an estate – it cannot receive a distribution of the IRA proceeds and accumulate the IRA proceeds and claim a fiduciary income tax charitable deduction because the IRA proceeds are permanently set aside. The trust has to distribute the IRA proceeds in the year of receipt or in the following year. The only exception to this rule is that some pre-1969 trusts are still able to take a charitable deduction for amounts permanently set aside for charity but this exception is rare. §642(c)(2). Since there are relatively few of these "grandfathered" trusts, they are not discussed here.

4. "Assign" the IRA from the trust or estate to charity.

a. A second alternative to get an IRA to charity without having the income included in the income of an estate or trust and taxed to an estate or trust is to have the fiduciary "assign" the IRA from the estate or trust to the charity. The IRS has allowed this technique in a number of private letter rulings. PLR 200234019 (assignment of IRA and §403(b) annuity from estate to charity), PLR 200452004 (assignment of IRA and deferred annuity contract from estate to charity), PLR 200633009 (assignment of IRA from estate to charity) PLR 200652028 (assignment of IRA from trust to charity), PLR 200526010 (assignment of IRA from trust to charity), PLR 200618023 (assignment of deferred annuity contract from estate to charity), PLR

200617020 (assignment of IRA from estate to charity) and PLR 200803002 (assignment of annuity to charity). Note that the IRS takes the position that an assignment of an IRA to satisfy a pecuniary (fixed amount) charitable bequest results in the recognition of income as discussed below under the topic "Avoid Using an IRA to Satisfy a Pecuniary Bequest to Charity."

Example: D names his estate as the beneficiary of his IRA. D's will leaves a portion of the residue of his estate to various charities. The will authorized non-pro rata distributions. (Rev. Rul. 69-486 says that there are no income tax consequences if non-pro rata distributions are made to the beneficiaries of an estate or trust if non-pro rata distributions are allowed by the instrument or by state law). Rather than take a distribution from the IRA, have the IRA distribution included in the estate income and have the distribution of the IRA proceeds from the estate to charity qualify for the fiduciary income tax charitable deduction under §642(c), the executor would like to "assign" the IRA, intact, to the charity. According to the IRS, the executor can assign the IRA directly to the charity and (1) neither the estate or the individual beneficiaries are required to recognize any taxable income, (2) the IRA is not included in the estate's distributable net income (DNI) and (3) there is no taxable income to the charity. The IRA is income in respect of a decedent (IRD) and under the regulations if IRD is transferred to a specific or residuary legatee, only the recipient is required to report such income and only reports that income when it is received. The charities will realize income when they take distributions from the IRA but such income is not taxable by reason of the charities exempt status under §501(c)(3). Even though IRD is taxable if it is *transferred*, the term "transfer" does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise or inheritance from the decedent. §691(a)(2). Thus, the executor is successfully able to have the IRA transferred to the charities without having the IRA included in the estate's gross income.

5. Pay the charity last.

a. A third alternative is to satisfy all expenses and other bequests with non-IRA assets in a previous taxable year so that the only assets remaining are the IRA assets and the only beneficiary remaining to be paid is the charity. In this situation the IRS has allowed a fiduciary income tax charitable deduction. PLR 200221011 (IRA payable to estate permanently set aside for charity), PLR 200336020 (IRAs and Series H bonds payable to estate permanently set aside for charity); PLR 200526010 (IRA and Series E bonds liquidated by and paid to trust with the trust actually distributing the proceeds to charity in the year of receipt); PLR 200537019 (deferred annuity payable to estate and distributed and permanently set aside for charity).

b. Note the difference in the fiduciary income tax charitable deduction allowable for an estate under §642(c)(2) if the amount is *permanently set aside* for charity and the fiduciary income tax charitable deduction for a trust under §642(c)(1) which must actually pay the amount to charity in the year of receipt or in the immediately following year. In other words, a "set aside" deduction under §642(c)(2) is applicable only to estates subject to a narrow exception for trusts executed before 1969. A trust must actually pay the IRA proceeds to charity in the year of receipt or in the immediately following year to qualify for a fiduciary income tax charitable deduction under §642(c)(1). However, a trust that meets the requirements of §645 can make the so-called §645 election to have a revocable trust treated as part of the estate and take the fiduciary income tax charitable deduction under §645 if the IRA proceeds are permanently set aside. In other words, a trust that makes a §645 election gets the §642(c)(2) deduction if the amount is permanently set aside – the trust doesn't actually have to pay the IRA proceeds to charity in the year of receipt or the immediately following year to get the charitable deduction.

Example: Decedent's will leaves various specific bequests to certain individuals and charities and the residue to charity. The estate is named as the beneficiary of an IRA. In year 1 the executor pays the administration expenses and all the specific bequests to the individuals so that the charity is the only remaining beneficiary of the estate at the end of year 1. In year 2 the estate receives the IRA proceeds. The IRS held that the estate is entitled to a charitable "set aside" deduction (apparently the estate accumulated the IRA proceeds and had not distributed them to the charity) that would offset the inclusion of the IRA proceeds in the gross income of the estate. Note that a fiduciary income tax "set aside" deduction under §642(c) is generally not available to trusts. The trust must actually distribute the IRA proceeds to the charity in the year of receipt of the IRA proceeds or in the immediately following year. PLR 200221011.

Note: PLR 200221011 didn't specify whether the specific bequests and the administration expenses were paid in the same year as the receipt of the IRA proceeds or in year preceding the receipt of the IRA proceeds. To be on the safe side, an executor would probably want to pay the specific bequests and administration expenses in a taxable year preceding the receipt of the IRA proceeds so that the only asset in the estate in that year is the IRA and the only possible estate beneficiary in that year is the charity.

6. The final alternative is to avoid naming an estate or trust as the beneficiary and name the charity directly as the beneficiary of the IRA. Doing so ensures that the IRA will qualify for the estate tax charitable deduction and the income tax will be avoided when the tax-exempt charity takes distributions from the IRA.

E. Individual gets lifetime benefit of IRA with charity enjoying the remainder interest – use either a qualified terminable interest property (QTIP) trust or a charitable remainder trust (CRT)

1. If the account holder is concerned that upon his death the spouse may not name charity as the beneficiary of the IRA or treat the IRA as her own or roll it into her own IRA and then name someone other than charity as the beneficiary of the IRA, the IRA owner may insure that the balance of the IRA at the death of the surviving spouse will pass to the charitable organization through the use of either a QTIP trust with a charitable remainder or a CRT i.e. instead of naming the spouse as the beneficiary of the IRA, the IRA owner could name either a QTIP

trust or a CRT as the beneficiary of the IRA. The IRA would then be distributed to a QTIP trust or CRT upon the IRA owner's death.

2. Using a QTIP. A QTIP, which qualifies for the federal estate tax marital deduction, requires all income be paid to the surviving spouse at least annually and that no one other than the spouse receive anything from the trust while the spouse is alive. §2056(b)(7)(B)(ii). The surviving spouse may also (but is not required to) have rights to principal in the trustee's discretion.

    a. It is important to structure an IRA payable to a QTIP trust in a manner that will qualify for the marital deduction. This is usually done by paying the greater of the IRA's accounting income or minimum required distribution (MRD) to the QTIP, which, in turn, distributes the income to the spouse. However, an IRA (or any other asset) can qualify for the marital deduction in at least four different ways under the marital deduction regulations. See Reg. 20.2056(b)-5(f)(4), (5), (7) and (8). See generally Rev. Rul. 2006-26, 2006-22 I.R.B. 939 for how to qualify an IRA payable to a QTIP trust for the marital deduction. Generally, payments do not have to be made from the trust to qualify for QTIP treatment as long as the spouse has the power to demand payments from the IRA.

    b. Assets remaining in the QTIP trust at the surviving spouse's death will be paid to the beneficiary designated by IRA owner i.e. the charity as remainder beneficiary of the QTIP. This enables the deceased spouse to retain control over the disposition of the remaining assets including the principal portion of the distribution from the IRA that is payable to the QTIP trust and accumulated at the QTIP trust level and not distributed to the spouse.

    c. Principal portions of any MRD distributed from the IRA to the QTIP trust and retained in the QTIP trust will most likely be taxed at a higher income tax rate than if it were distributed to the spouse because of the high trust tax rates. For 2008, a trust reaches the 35% bracket at taxable income of $10,700. Rev. Proc. 2007-66, 2007-45 I.R.B. 1.

    d. The value of QTIP trust will be included in the surviving spouse's gross estate but the value of the assets passing to charity will qualify for the federal estate tax charitable deduction under §2055.

e. QTIP with remainder to charity

(1) Spouse gets all income from the QTIP, not just a percentage of the trust corpus

(2) Spouse could have access to principal for his/her needs or to make gifts to others.

(3) At the death of surviving spouse, any remaining assets in trust pass to charity under direction of the IRA owner. Thus, the IRA owner controls the disposition of the principal at the surviving spouse's death.

(4) Any remaining balance in the IRA is includible in the surviving spouse's gross estate under §2044 if the QTIP qualifies for the marital deduction under §2056(b)(7) but it is also deductible from the surviving spouse's gross estate as a charitable deduction.

(5) The disadvantages of a QTIP with remainder to charity: (1) the ability to do a spousal rollover to an IRA is lost, (2) the amount payable to the QTIP trust is taxed at the high trust tax rates (unless distributed), (3) loss of the ability to defer distribution until the IRA owner reaches age 70 ½ (spouse must be sole beneficiary of the IRA to be able to enjoy this exception and the spouse is not the sole beneficiary and (4) loss of ability to defer payment of IRA to trust over surviving spouse's life expectancy i.e. there is an acceleration of the recognition of the income. The surviving spouse, as the beneficiary of a QTIP trust with a charitable remainder, does not qualify as a "designated beneficiary." Thus, if the account holder dies before his "required beginning date" (RBD), the balance of the IRA has to be distributed to the QTIP trust by the end of the fifth year after the account holder's death. If the account holder is past his RBD, only his life expectancy can be used in calculating the MRD. Thus, a QTIP with a charitable remainder may result in the payout from the IRA to the QTIP being accelerated and taxed before it goes to charity. Thus, unless the surviving spouse dies before the IRA is required to be distributed to the QTIP trust, the IRA will take an income tax "haircut" before it is paid to charity.

(a) Under one interpretation of the MRD *proposed* regulations (which were subsequently finalized on April 16, 2002), where the IRA is payable to a QTIP with a charitable remainder, the account holder would be treated as having no designated beneficiary. This is due to the fact that charity is deemed to have a vested interest in the QTIP. If the charity's interest in the QTIP is vested, it is deemed to be a "co-beneficiary" with the surviving spouse. Since the charity's interest is not contingent on the death of the surviving spouse, the contingent beneficiary exception of the multiple beneficiary rule does not apply. As we know from the MRD rules, if a charity is one of multiple beneficiaries, the IRA is deemed to have no "designated beneficiary." As a result, if the account holder dies before his RBD, the entire IRA would have to be paid to the QTIP trust by the end of the fifth year following the year of the account holder's death. Also, once the account holder reached his RBD, only the account holder's life expectancy could be used to determine the required distribution each year, rather than the life expectancy of the spouse which could have been used if the IRA owner had named the spouse as the designated beneficiary rather than naming the QTIP trust with the charity as the remainderman. This would cause significant income tax to be paid by the QTIP trust before the corpus reached the charity.

(i) This interpretation of the regulation is based on the "multiple beneficiary rule" where the account holder names more than one beneficiary and one of the beneficiaries (charity) doesn't qualify as a "designated beneficiary". In that case, the account holder is treated as not having a "designated beneficiary." Reg. 1.401(a)(9)-5, Q&A A-7(c).

(ii) A charity that is named as a remainder beneficiary of a QTIP trust is treated as a beneficiary under the multiple beneficiary rule if it has a vested, rather than contingent, right to the IRA. The charity will presumably be in existence at the surviving spouse's death regardless of how long the spouse lives, so it will be entitled to whatever IRA balance remains at the death of the surviving spouse as well as any distributions of principal that remain in the QTIP trust. Thus, charity is viewed as having a vested interest in the IRA. See Reg. 1.401(a)(9)-5, Q&A A-7(c).

(b) A counter argument could be made that the charity's interest in the IRA is a contingent interest. There would be no remaining balance in the IRA if the surviving spouse outlives his/her life expectancy. Also, if the trustee of a QTIP trust has paid out all of the distributions from the IRA to the surviving spouse, including the principal, none of the IRA would pass to the charitable organization at the surviving spouse's death. Thus, the charity's interest could be viewed as contingent on the surviving spouse not outliving his/her expectancy or the trustee not making discretionary distributions of principal. However, this argument will not avoid the "multiple beneficiary rule" of Reg. 1.401(a)(9)-5, Q&A A-7(a). A contingent beneficiary is ignored for purposes of the minimum required distribution rules only if the charity's entitlement to the IRA is contingent on the *death* of a prior beneficiary. Under Reg. 1.401(a)(9)-5, Q&A A-7(c), a beneficiary's interest is not considered contingent if the beneficiary's interest depends on how much principal may be distributed during the primary beneficiary's life.

(c) The IRS recently came up with another reason why a QTIP with a charitable remainder will result in the QTIP trust having no "designated beneficiary" with the resulting accelerated distribution of the IRA to the QTIP and income taxation at the QTIP level. In PLR 9820021, the Service ruled that a surviving spouse was not the designated beneficiary of qualified plan benefits of a participant who died before his RBD. The participant designated a QTIP trust with a charitable remainder as the plan beneficiary. Since the qualified plan distributions to the QTIP could exceed the amounts that the QTIP was required to distribute to the surviving spouse during her lifetime, the charity was treated as a "co-beneficiary" of the plan and the plan was deemed to have no "designated beneficiary within the meaning of §401(a)(9). Thus, the entire account had to be distributed within five years of the date of the deceased participant's death. The Service reasoned that the spouse was not entitled to all amounts required to be distributed from the plan to the QTIP, but only to the income of the QTIP and principal for her health and medical needs. Specifically, the QTIP did not require the spouse to receive any MRD that had been distributed from the plan to the QTIP, if greater than the QTIP trust income. Additional amounts distributed from the plan as a result of the MRD could remain in the QTIP (subject to discretionary distributions for the spouse's health and medical needs) for the spouse's lifetime. In that case, the Service reasoned that the charity's entitlement to the plan benefits was not contingent on the spouse's death. Instead, the charity's access to the funds was simply deferred until her death. As a result, the Service ruled that the charity had to be taken into account as named beneficiaries. Since the charity was not an individual, the plan was deemed to have no valid "designated beneficiary." As a result, the plan assets were required to be distributed to the QTIP within five years of the participant's death where they would be subject to income tax in the year of distribution. It appears that this result might have been avoided by specifying that all amounts (not just the income) distributed from the plan be distributed to the surviving spouse. As an alternative, the participant could have used a CRT as the designated beneficiary of the plan benefits.

(d) Again, note the problem with the QTIP trust with a charitable remainder. The QTIP with a charitable remainder doesn't qualify as a DB. Thus, if the account holder dies before his RBD, the balance of the IRA has to be distributed to the QTIP trust by the end of the fifth year after the account holder's death. If the account holder is past his RBD, only his life expectancy can be used in calculating the MRD. Thus, a QTIP with a charitable remainder may result in the payout from the IRA to the QTIP being accelerated and taxed before it goes to charity.

3. Using a CRT – In general terms, a CRT is a split interest trust where one or more non-charitable beneficiaries receive, at least annually, either a fixed dollar amount of at least 5% of the *initial* value of the assets (charitable remainder annuity trust or CRAT) or a fixed percentage of at least 5% of the *current* value of the assets (charitable remainder unitrust or CRUT) in the trust. The payments continue for the life of the income beneficiary (or beneficiaries) or for a stated term not exceeding 20 years. No additional amounts may be paid from the trust until it terminates. When all of the non-charitable beneficiaries die or the trust term expires, the assets remaining in the trust are paid to or held for the benefit of one or more designated charities.

a. If the surviving spouse is the only non-charitable beneficiary, the *entire value* of the IRA passing to the CRT is deductible from the federal gross estate when the IRA owner dies. The surviving spouse's interest qualifies for the marital deduction and the charitable remainder interest qualifies for the charitable deduction. Under §2056(b)(8), if the surviving spouse is the only permissible recipient of benefits, the spouse's interest in the CRT *automatically* qualifies for the marital deduction.

(1) If the CRT qualifies under §2056(b)(8), none of the balance of the CRT remaining at the surviving spouse's death would be includible in the surviving spouse's gross estate. This is because there is no provision comparable to §2044 requiring inclusion in the spouse's estate of trust assets for which a marital

deduction was taken at the first spouse's death. This is logical because the entire trust passes to charity and would qualify for the charitable deduction anyway.

b. Advantages of Naming a CRT as the Beneficiary of an IRA:

(1) A Federal estate tax charitable deduction is allowed for the present value of the remainder interest that passes to charity. PLR 9253038.

(2) Since the CRT is a tax-exempt entity, no income tax is payable on the IRA assets when they are distributed to the CRT. PLR 9237020; PLR 9253038; PLR 9634019, PLR 199901023.

(3) A CRT can provide income that will be protected from the claims of the beneficiary's creditors while in the hands of the CRT.

(4) Due to the income tax savings (IRA paid to CRT will incur no income tax) and estate tax savings (IRA paid to CRT will receive a Federal estate tax charitable deduction equal to the present value of the remainder interest) the income beneficiaries will enjoy a stream of income from a larger fund using the CRT than if they had received the after-tax value of the retirement assets outright.

(5) Note that the significance of paying an IRA to a CRT is not the size of the federal estate tax charitable deduction but the deferral of income taxation of the IRA.

c. If there is concern that the charity's right will be vested if the IRA is left to a QTIP trust, the acceleration of income can be avoided by using a CRT rather than a QTIP trust.

(1) Because the CRT is tax exempt, there is no income tax when the IRA is paid to the CRT on account of the account holder's death i.e. the principal of the CRT is never diminished by income taxes.

(a) Acceleration of income (due to charity having a vested interest in the QTIP due to the multiple beneficiary rule) can be avoided by using a CRT rather than a QTIP.

(2) Two drawbacks to naming CRT as beneficiary of IRA.

(a) Drawback #1: CRT distributions are limited to fixed dollar amounts or fixed percentages. Using a CRT rather than a QTIP trust eliminates the ability of the trustee to make distributions to the surviving spouse for his or her support, health or other needs or to enable the spouse to make gifts to other beneficiaries. In other words, the trust does not have to meet the "all income" requirement of a QTIP and the trustee is not permitted to make discretionary distributions of principal as would be allowed with a QTIP trust.

(b) Drawback #2: Income in respect of a decedent (IRD) payable to a CRT presents a problem. In a CRT, the beneficiary will not actually be receiving a portion of the IRD unless the payout from the CRT exceeds the income of the CRT. For example, in a $500,000 CRT earning 7% and paying out 10%, 3% of the payout would be considered a distribution of principal. If a qualified plan or an IRA was the only asset contributed to the CRT, the 3% paid out of principal would be a distribution of the IRD. (Query - what if the CRT was funded with not only with the qualified plan/IRA but with other assets? That would create an accounting nightmare to determine what portion, if any, of the payout consisted of IRD). If the 3% was a distribution of principal, the recipient of that amount should be entitled to the §691(c) deduction i.e. an income tax deduction for the estate tax attributable to the IRA. However, the taxation scheme for CRTs does not provide a method to allocate the §691(c) deduction to the beneficiary. CRTs are taxed under a four tier system set forth in §664. Under Reg. 1.664-1(d)(2) it seems that the §691(c) deduction generated by the 3% distribution of principal would reduce the ordinary income earned by the CRT. Thus, as long as the CRT has "taxable income," it appears that the §691(c) deduction would be trapped at the CRT level and not be available to the beneficiary. A CRT that is funded with an IRA or qualified plan would have to eat through the ordinary income tier (where the qualified plan or IRA income would reside) as well as the capital gain and tax-exempt tiers before any distribution would be a return of principal and, perhaps, allow the §691(c) deduction to be taken by the beneficiary.

(i) The IRS addressed this issue in PLR 9634019 concluding that IRD is assigned to the first tier as ordinary income of a CRT rather than fourth tier income as corpus. In PLR 199901023 the IRS came to the same conclusion that amounts from a qualified retirement plan are IRD characterized as first tier ordinary income. However, the IRS went further by concluding that the §691(c) deduction reduces the amount of the IRD that the CRT includes in its first tier ordinary income. Thus, the §691(c) deduction is not directly available to the CRT beneficiaries. In this PLR, the decedent established a CRUT to be funded at his death. The beneficiaries of the CRUT were the decedent's two children. The CRUT was the beneficiary of the decedent's qualified plan. Upon the decedent's death the qualified plan benefits were payable in a lump sum to the CRUT. The Service ruled that: (1) the lump sum payment from the qualified retirement plan will be included as gross income of the unitrust under the income in respect of a decedent ("IRD") rules of section 691(a)(1)(B), and will not be IRD of the decedent's estate, (2) in computing the section 691(c) deduction, the estate must take into account the charitable deduction resulting from the contribution of qualified plan amounts to the unitrust i.e. in computing the hypothetical estate tax excluding the IRD, the estate must also exclude the charitable deduction resulting from the contribution of the distribution of the qualified plan benefits to the trust, (3) amounts from the qualified retirement plan that are IRD will be characterized as "first tier" ordinary income, as described in section 664(b)(1) and (4) the section 691(c) deduction reduces the amount of IRD that the unitrust includes in its first tier ordinary income. The section 691(c) deduction is not directly made available to the unitrust beneficiaries.

(ii) In a situation where the IRA owner will be subject to Federal estate tax, it may be cheaper income tax-wise to leave the IRA to an individual and take periodic distributions from the IRA. The ability for the individual to take the §691(c) deduction may make the effective rate of income tax lower then it would be for a CRT to distribute payments to the CRT beneficiary when those payments will most likely be classified as ordinary income in the CRT beneficiary's hands. The allocation of the §691(c) deduction to the fourth tier under the CRT tier system of taxation as a result of PLR 199901023 means that the CRT beneficiary will not get the benefit of the §691(c) deduction and the effective rate of tax for the CRT beneficiary will be higher.

VI. Minimum Required Distribution (MRD) Rules

A. The income tax deferral available for IRA and other retirement plan assets does not last forever. IRS regulations establish the rules for mandatory distributions from IRAs and other retirement plans. These rules are known as the minimum required distribution (MRD) rules. They are governed by Reg. 1.401-(a)(9).

B. The MRD distributions dictate (1) when the distributions must commence, (2) once begun, how fast the distributions have to be made and (3) who is a "designated beneficiary."

C. In general, the entire IRA must be paid to the account holder by April 1 of the calendar year following the calendar year in which the IRA owner reaches age 70 1/2 (the so-called "required beginning date" (RBD)). Qualified plan participants must commence distributions by the later of April 1 of the calendar year following the calendar year in which (1) he reaches age 70 ½ or (2) retires. If the qualified plan participant is a 5% owner in the business, his RBD is April 1 of the year after he reaches age 70 ½, regardless of whether he is still working.

1. If the entire plan benefit or IRA is not distributed by the RBD, the plan benefit or IRA must begin to be paid over the life or life expectancy of the participant or account holder or the joint life or life expectancy of the participant or account holder and a designated beneficiary (DB).

D. Naming a charity as the beneficiary of an IRA will not affect the IRA owner's lifetime MRD. The IRA owner's lifetime MRD are based on a life expectancy contained in an IRS table known as the "Uniform Table." The uniform table bases the distribution period on the joint life expectancy of the IRA owner and a hypothetical person 10 years younger than the IRA owner. This uniform table is used by the IRA owner is all cases except where the IRA owner names his spouse as the IRA beneficiary and the IRA owner's spouse is more than 10 years younger than the IRA owner – in that case the distribution period is over the actual life expectancy of the IRA owner and his more than 10 year younger spouse using a joint life expectancy table.

1. During the IRA owner's lifetime, the uniform table (or, if the spouse is more than 10 years younger than the IRA owner, the joint life expectancy tables) is used to calculate the IRA owner's lifetime minimum required distribution. This is so regardless of who is named as the beneficiary of the IRA. Thus, the fact that a charity is named as the beneficiary of an IRA will not affect the IRA owner's lifetime MRD. They will always be based on the uniform table or, in the case of a spouse more than 10 years younger than the IRA owner, the joint life expectancy tables.

E. A different set of rules apply once the IRA owner dies.

1. If the IRA owner has named a "designated beneficiary," the MRD rules dictate that the IRA be distributed over the life expectancy of the

designated beneficiary. If there are multiple designated beneficiaries, the IRA is distributed over the life expectancy of the oldest designated beneficiary.

   a. Generally, a designated beneficiary is an individual, a group of individuals or a qualifying trust (basically a trust with all individual beneficiaries). An estate or a charity is not a designated beneficiary.

2. If the IRA owner does not name a valid designated beneficiary, the distribution period depends on whether the IRA owner dies before his required beginning date (RBD, generally April 1 of the year after the IRA owner reaches age 70 ½) or dies after his RBD.

   a. If the IRA owner dies before his RBD without a designated beneficiary, the IRA must be completely distributed to the named beneficiary by December 31 of the year that contains the fifth anniversary of the IRA owner's death – in effect the IRA has to be completely distributed within 5 years of the IRA owner's death.

   b. If the IRA owner dies after his RBD without a designated beneficiary, the IRA must be distributed over the remaining life expectancy of the IRA owner. For example, an IRA of an IRA owner who dies at age 79 without a designated beneficiary has a 10.8 year life expectancy.

3. Under these rules there is no drawback to leaving all of an IRA to charity or a charitable remainder trust or all or part of the IRA to the IRA owner's spouse.

   a. If the entire IRA is left to a charity or a charitable remainder trust, the IRA can be distributed immediately to the charity or the charitable remainder trust with no adverse tax consequences because the charity and charitable remainder trust are tax exempt entities that will not incur income taxes on the receipt of an IRA distribution.

   b. If part or all of the IRA is left to the IRA owner's surviving spouse, the spouse can roll over an IRA distribution into his or her own IRA income tax-free or can elect to treat the IRA owner's IRA as his or her own IRA.

4. The problem occurs when there are multiple beneficiaries and one or more of them is a charity. Since all of the multiple beneficiaries do not

qualify as a designated beneficiary (generally, they are not individuals or a qualifying trust), the IRA distribution is accelerated. In effect, the IRA owner dies without a designated beneficiary and the rules governing the death of an IRA owner without a designated beneficiary apply i.e. if the IRA owner dies before his RBD, the IRA must be distributed within 5 years of the IRA owner's death or, if the IRA owner dies after his RBD, the IRA must be distributed over the IRA owner's remaining life expectancy. Thus, when the IRA owner dies naming multiple beneficiaries and one of those beneficiaries is not a designated beneficiary (e.g. a charity), the MRD distributions for the IRA are accelerated.

a. Watch this potential trap when naming a revocable trust as the beneficiary of an IRA or qualified plan benefit as part of an attempt to have the proceeds paid out over the life expectancy of the trust beneficiaries. IRA owner (or plan participant) wants to name his revocable trust as the beneficiary of his retirement plan or IRA, name his children as beneficiaries of his revocable trust and have the IRA (or plan) proceeds paid out in installments over the life expectancy of his oldest child. To be able to use the life expectancy of the beneficiaries in calculating the plan or IRA payout, all of the beneficiaries of the trust must be individuals. Any charitable gift payable from the trust would cause the trust to fail as a "designated beneficiary". Even language such as "this trust shall pay any bequest under my will, if my probate estate is not adequate to pay the same," could disqualify the trust as a "designated beneficiary" if in fact the probate estate is not adequate and the will contains charitable bequests.

(1) Thus, when drafting a trust which contains charitable gifts, or which may be used to fund charitable bequests under the will, it is advisable to determine whether any retirement benefits may be payable to that trust, and if so, to draft appropriate language to either:

(a) State the intent in the will or trust that the retirement benefits are not to be used to fund the charitable gifts if the intent is for the retirement benefits to be paid out over the life expectancy of the individual trust beneficiaries – PLR 199947036 indicates that it is permissible to include language in a trust document directing who may or may not be able to receive certain assets under the trust document;

Sample language: "Notwithstanding any other provision hereof, and except as provided in this paragraph, the Trustee may not distribute to or for the benefit of my estate, any charity or any other non-individual beneficiary any benefits payable to this trust under any qualified retirement plan, individual retirement account or other retirement arrangement subject to the "minimum distribution rules" of §401(a)(9) of the Code, or other comparable provisions of law. It is my intent that all such retirement benefits be distributed to or held for only individual beneficiaries, within the meaning of §401(a)(9) and applicable regulations. Accordingly, I direct that such benefits may not be used or applied for payment of my debts, taxes and other claims against my "estate" except to the minimum extent that would be required under applicable state or federal law in the absence of any specific provision on the subject in my will or this trust. This paragraph shall not apply to any charitable bequest which is specifically directed to be funded with retirement benefits by other provisions of this instrument."

(b) Make a specific gift of the retirement benefits to charity if the goal is to have the retirement benefits pass to the charity free of income taxes; or

(c) If some of the benefits are to go to charity and some are to be paid out over the life expectancy of individuals, such benefits should come from different plans (or "accounts").

5. The regulations provide some wiggle room for situations where the IRA owner dies with a charity named as one of multiple beneficiaries. The regulations allow certain post-mortem estate planning alternatives to eliminate the sting of the acceleration of MRD from the IRA. Generally speaking, the regulations state that the final determination of who is a beneficiary of the IRA for MRD purposes is determined not at the date of death but on September 30 of the year after the IRA owner dies. Thus, if the IRA dies without naming a valid designated beneficiary, there is some time to correct the mistake so that by

September 30 of the year after the IRA owner's death only valid designated beneficiaries remain and the potential acceleration of the IRA can be avoided. The three things that can be done prior to the September 30 date to remedy the lack of a valid designated beneficiary is to (1) set up separate accounts for the IRA with charity as beneficiary of one IRA and an individual or individuals as beneficiary of the other IRA, (2) have the charity disclaim its interest in the IRA or (3) to distribute to the charity its share of the IRA.

a. First solution: Set up separate IRAs, one with a charitable beneficiary and the other with an individual beneficiary.

(1) Reg. 1.401(a)(9)-8, A-3 defines a separate account as "...separate portions of an employee's benefit reflecting the separate interests of the employee's beneficiaries under the plan as of the date of the employee's death for which separate accounting is maintained. The separate accounting must allocate all post-death investment gains and losses, contributions and forfeitures, for the period prior to the establishment of the separate accounts on a pro rata basis in a reasonable and consistent manner among the separate accounts."

Example: A 79 year old IRA owner dies on January 31, 2008 with a $500,000 IRA. The designated beneficiary form names charity as a 1/5 beneficiary of the IRA and the IRA owner's 49 year old child as the beneficiary of 4/5 of the IRA. Since a charity is one of multiple beneficiaries, the IRA does not have a valid designated beneficiary. As a result the distribution from the IRA to the IRA owner's 49 year old son cannot be spread over his 35.1 year life expectancy. Since the IRA owner died after his RBD (April 1 of the year after he reached age 70 ½) and charity is one of multiple beneficiaries, the balance of the IRA must be distributed over the remaining 10.8 year life expectancy of the deceased IRA owner. (If the IRA owner died before his RBD, the IRA would have to be completely distributed within 5 years of the IRA owner's death.) However, if the IRA were split into two IRAs by September 30, 2009, one worth $100,000 with charity as the sole beneficiary and the other worth $400,000 with the son as the sole beneficiary, the son would be able to take MRD from his $400,000 IRA over his 35.1 year life expectancy rather than over his dad's remaining 10.8 year remaining life expectancy. This allows the son to take the MRDs from his IRA over a longer distribution period. The charity doesn't really care about when they have to take distributions from the IRA as any distribution made to the charity is not subject to income tax.

b. Second solution: The charity disclaims its interest in the IRA

Example: Same facts as in the previous example except that instead of establishing separate accounts before September 30, 2009, the charity disclaims their interest in the IRA. In that event the only beneficiary remaining after the disclaimer is the IRA owner's son so that as of September 30, 2009 (that date to determine if the IRA has a valid designated beneficiary) the IRA has a valid designated beneficiary and the son may take his MRD from the IRA over his 35.1 year life expectancy rather than being force to take the distributions over his dad's much shorter life expectancy of 10.8 years. This alternative is not very realistic as it is unlikely that the charity would be willing to disclaim its interest in the IRA.

c. Third solution: Distribute to the charity its share of the IRA

Example: Same facts as in the first example except that instead of establishing separate accounts before September 30, the IRA custodian distributes to the charity its share of the IRA ($100,000). Since the only remaining IRA beneficiary as of September 30 of the year after the IRA owner's death is the decedent's 49 year old son, the son is permitted to take his MRD over his 35.1 year life expectancy. The $100,000 distribution to the charity before the September 30 date removes the "tainted" beneficiary – only the remaining beneficiary (son) in taken into consideration in determining if the IRA has a valid designated beneficiary.

VII. Avoid Using an IRA to Satisfy a Pecuniary Bequest to Charity

A. If an estate or trust uses an IRA to satisfy a pecuniary bequest (fixed amount) to charity, the estate or trust may be required to recognize income equal to the amount of the IRA paid to the charity to satisfy the bequest. The IRS may treat the estate or trust as receiving a distribution from the IRA and using it to satisfy its obligation to pay the pecuniary bequest.

B. In C.C.A 200644020 the IRS determined that a trust recognized income on an assignment of part of a decedent's IRA to charities in satisfaction of a pecuniary bequest. In C.C.A. 200644020 the decedent died owning an IRA which was payable to his revocable trust as the IRA beneficiary. The trust provided that upon the decedent's death $100,000 was payable to three charities with the residue passing to the decedent's children outright or in trust. The trustee completed the distribution of part of the IRA to the charities by instructing the IRA custodian to divide the IRA into shares so that each charity became the owner and beneficiary of an IRA equal in value to the dollar amount it was entitled to under the trust i.e. the IRA was divided into separate shares and the separate shares equal to the amounts going to charity were assigned to the charity. The IRS concluded that the trust was required to recognize income under §691(a)(2) on the assignment of a portion of the decedent's IRA to the charities to satisfy the pecuniary bequest. Furthermore, the IRS concluded that the trust was not entitled to a fiduciary income tax charitable deduction under §642(c)(1) for the portion of the IRAs assigned to charity on the basis that the terms of the trust did not direct or require the trustee to pay the pecuniary legacies from the trust's gross income.

Example: Decedent's estate is named as the beneficiary of the Decedent's IRA. Decedent's will provides for a specific bequest of $100,000 to a charity. The estate will have $100,000 of taxable income if the bequest is satisfied by a $100,000 distribution from an IRA or if the executor assigns the right to receive distributions from an IRA to the charity.

C. For fiduciary income tax purposes, an estate or trust is required to recognize income if the estate or trust distributes appreciated property in satisfaction of a pecuniary bequest. Kenan v. Commissioner 114 F.2d 217 (2nd Cir 1940). Reg. 1.661(a)-2(f)(1) provides that an estate or trust can have taxable income if a distribution of property is made in satisfaction of a right to receive a distribution of a specific dollar amount (e.g. a specific bequest), of specific property other than the property that was distributed or of income (as defined in §643(b) and the applicable regulations) if income is required to be distributed currently. In GCM 39388 (May 25, 1984) the IRS concluded that a trust had to recognize gain when it distributed appreciated stock in satisfaction of a direction in the trust instrument to pay net income to the beneficiary. See also Rev. Rul. 83-75, 1983-1 C.B. 114 in which the IRS concluded that a distribution of appreciated securities by a trust to a charity in lieu of current income resulted in taxable gain to the trust. The trust was entitled to an offsetting charitable deduction for the amount of income. A similar result was reached in PLR 9044047 (Aug. 4, 1990).

D. The authority cited above applies to estates and trusts using appreciated assets that do not constitute income in respect of a decedent (IRD) to fund a pecuniary bequest. In C.C.A. 200644020 the IRS tried to extend the tax consequences of funding a pecuniary bequest with appreciated property to funding a pecuniary bequest with IRD. However, the tax consequences associated with income in respect of a decedent are governed by §691, not by §661 as is the case when appreciated property is used to fund a pecuniary bequest. The taxation of income in respect of a decedent appears to be governed exclusively by §691. Rollert Residuary Trust 752 F2d 1128 (6th Cir. 1985); Estate of Jack Dean v. Commissioner 46 TCM 184 (1983).

   1. §691(a)(2) taxes the "transfer" of IRD. A transfer under §691(a)(2) is defined as a "sale, exchange or other disposition." Thus, funding a pecuniary charitable bequest with IRD could be taxed as a "transfer" of IRD under §691(a)(2). However, §691(a)(2) says that a transfer of IRD made to a "person pursuant to the right of such person to receive such amount by … bequest, devise or inheritance" is not a taxable transfer under §691(a)(2). It would seem that funding a pecuniary charitable bequest with IRD is excepted from a §691(a)(2) taxable transfer because the transfer of the IRD to the charity is made to the charity pursuant to charity's right to receive the IRD by bequest, devise or inheritance i.e. the funding fits within the scope of the §691(a)(2) exception of the word "transfer." Thus, it is questionable whether the funding of a pecuniary bequest with IRD would result in the same recognition of income. There is nothing in §691 that would lead to this conclusion. It appears that most people assume that funding a pecuniary bequest with IRD will be treated the same as a bequest funded with non-IRD assets (i.e. gain will be required to be recognized). However, there doesn't appear to be statutory authority for this result. Thus, it appears to be a "stretch" to conclude that funding a pecuniary bequest with IRD results in the recognition of income.

   2. Previously, the IRS issued three private letter rulings that held that income was recognized on the transfer of IRD in satisfaction of a pecuniary bequest. PLR 9123036 (installment sale notes); PLR 9315016 and PLR 9507008 (savings bonds). However, the IRS has also issued four private letter rulings where an IRA was used to fund pecuniary marital formula

bequests and the IRS did not discuss the recognition of income. PLR 9524020, PLR 9608036, PLR 9623056 and PLR 9808043.

3. Taxing an IRA upon funding of a pecuniary bequest is inconsistent with other sections of the Internal Revenue Code such as §691 (discussed above) and §402(a) that was formally used to cause taxation if the beneficiary was deemed to be in constructive receipt of benefits. In 1981 Congress deleted the words "made available" from §402(a) negating the possibility of being in constructive receipt and specified in the statute that amounts are taxable only when the benefits are actually distributed. §408(d)(1) likewise provides that an amount must be paid or distributed to be included in gross income. Thus, §691, §402(a) and §408(d)(1) conflict with the IRS's theory that the recognition of IRD is accelerated if it is used to fund a pecuniary bequest.

4. The IRS's position would lead to absurd results. There would be double taxation if the IRD is taxed once upon the funding of a pecuniary bequest with IRD and then again upon actual distribution. If appreciated assets (e.g. stock) are used to fund a pecuniary bequest, the assets receive a step-up in basis equal to the fair market value of the asset used to satisfy the pecuniary bequest to prevent further taxation of the gain. Rev. Rul. 67-74, 1967-1 C.B. 194. There is no provision in the Internal Revenue Code to give an IRA a step-up in basis upon income recognition due to the funding of a pecuniary bequest with IRD to prevent taxation of the IRA upon distribution. Under the IRS theory, the IRA would be subject to tax upon funding the pecuniary bequest, would not receive any adjustment in basis as a result of the recognition event and would be subject to taxation under §691, §402(a) and §408(d)(1) upon actual distribution to the beneficiary. Obviously, this would be irrelevant if charity receives a distribution from the IRA as the charity is exempt from income taxation but the issue is relevant if the IRA beneficiary is an individual or other taxable entity.

E. The acceleration of income problem for an estate or trust using IRD to fund a pecuniary bequest can be avoided by more artful drafting i.e. if the bequest is drafted as a fractional share formula or percentage (instead of a fixed dollar amount) or (2) if a specific bequest of an IRA is made to charity i.e. name the charities as designated beneficiaries of the IRA thereby bypassing the trust or estate and avoiding the IRD issue.

1. Generally, the distribution of a right to receive IRD (as opposed to distributing the IRD that has been collected) will not accelerate the recognition of the IRD by the distributing trust or estate if (1) the items of IRD is specifically bequeathed (name the charity as the beneficiary of the IRA) and the fiduciary distributes the claim to the legatee or (2) if the IRD is structured as a fraction or percentage of the IRA or is part of the residue of the trust or estate and the fiduciary distributes the claim to the residuary legatee i.e. if the entire balance of the IRA is not going to be paid to charity, the account holder should name the charity as a beneficiary of a specific fraction or percentage of the IRA to avoid the acceleration of income on funding a pecuniary bequest with IRD. Reg. 1.691(a)-4(b); Reg. 1.691(a)-2(b) Ex. 1 and 2.

2. Thus, the fiduciary can fund a specific bequest, fractional or percentage bequest or residuary bequest with the right to receive future payments of IRD without triggering income to the distributing estate or trust. Reg. 1.691(a)-4(b)(2); PLR 9537005; PLR 200336020.

3. Sample Language: "I direct that [all or ____ percent] of my IRA be distributed in a lump sum to the ________ charitable organization provided it then qualifies under IRC §170(c)(2) and §2055(a)(2)."

4. Precautionary Language: To prevent the funding of a pecuniary bequest with income in respect of a decedent from resulting in the recognition of income, consider including the following language in the section of a will or trust that deals with the administration of the estate or trust: "...provided, however, that to the extent possible, pecuniary gifts to charitable organizations shall be satisfied by distribution of peoperty constituting income in respect of a decedent." This establishes the decedent's intent to make a specific bequest of the IRA to charity rather than have it treated as a pecuniary bequest funded with income in respect of a decedent. Such a clause will also serve as a direction to satisfy a charitable bequest with IRD which will satisfy the "paid pursuant to the governing instrument" requirement and entitle the trust to a fiduciary income tax charitable deduction under §642(c).

VIII. IRA to CRT for the benefit of child or other non-spouse beneficiary - name CRT as beneficiary of IRA.

A. This alternative may provide more income to a child during the child's life than would an outright bequest of the IRA to the child.

1. If a child is named as the beneficiary of an IRA, he or she has two choices. First, the child could withdraw the entire balance of the IRA, pay the resulting income tax and reinvest the balance. Second, the child could leave the assets in the IRA and use the MRD rules to stretch the payments out over his or her life expectancy. The amount not distributed could be invested inside the IRA on a tax-deferred basis. In analyzing this second option, an assumption would have to be made about the disposition of the MRD. Is the child going to spend that distribution or reinvest the distribution outside the IRA? If they reinvest, is the income tax-free (municipal bonds) or taxable? If taxable, is it taxed as ordinary income (dividends and interest) or capital gain?

2. Generally, a CRT with a longer term (or a lower annual payout) can perform better for the noncharitable beneficiary than a shorter CRT (or higher payout). The longer period of compounding tax-free often outweighs the higher income of the shorter trust (or of the trust with the higher initial payout).

B. Since the bequest of an IRA to a CRT will result in a partial charitable deduction for federal estate tax purposes, less federal estate tax will be payable on death of the account-holder.

1. If someone other than a spouse (e.g. child) is named as noncharitable beneficiary of CRT, there is not a full FET charitable deduction. The FET charitable deduction is equal to the present value of the charitable remainder.

    a. However, the significance of the IRA to CRT plan lies not in the size of the federal estate tax charitable deduction but in the deferral of income taxation on the IRA.

    b. If an estate tax is attributable to the inclusion of a portion of the IRA in the IRA owner's gross estate, who will pay the estate tax attributable to the IRA? Does the IRA owner have separate funds available to pay this tax? The tax allocation clause in the IRA owner's estate planning documents is important. If a CRT is responsible for estate taxes, it fails to qualify as a CRT. Rev. Rul. 82-128, 1982-2 C.B. 71.

C. Payment of an IRA to a CRT will not cause immediate income taxation.

D. Payment of IRA to CRT will save federal estate tax and federal income tax. Some additional income can be used to buy life insurance on the life of the child or the joint life of the child and the child's spouse, to replace the balance of the IRA that passes to the charitable organization when the child or the survivor of the child and his/her spouse dies. The life insurance proceeds would be payable to the child's descendants or other intended beneficiaries. If advanced planning is done, the insurance proceeds can be sheltered from estate taxation in the insured's estate by having an irrevocable life insurance trust be the owner and beneficiary of the life insurance proceeds.

E. An alternative to leaving the entire IRA to charity or a CRT is to do a "vertical split" of the IRA i.e. split the IRA into two accounts. For one share, chose the children as the "designated beneficiary" which will allow the IRA proceeds remaining at the IRA owner's death to be distributed over the life expectancy of the designated beneficiary. For the other share, choose the charity or CRT as the beneficiary. This keeps both the children and the charity happy.

1. The vertical split could be used by an unmarried client to leave an IRA equal to the client's remaining exemption equivalent to his children with the balance to charity. This would result in no Federal estate tax being payable. Of course, separate accounts should be established for the children and the charity prior to the client's death.

IX. Retirement Equity Act of 1984

A. Any charity named as the beneficiary of a qualified retirement plan (or, in some cases, an IRA) must make sure they have complied with the Retirement Equity Act of 1984.

B. As a result of The Retirement Equity Act of 1984 a non-participant spouse has rights in their participant spouse's qualified plan. If the plan participant dies prior to the "annuity starting date" the spouse must be provided with a qualified pre-retirement survivor annuity (QPSA) (which doesn't have to be as much as the participant's entire accrued benefit). If the participant dies after the annuity starting date, the payments must be exclusively in the form of a qualified joint and survivor annuity (QJSA). Reg. 1.401(a)-20, Q&A 8. These rules do not apply if the participant elects to waive the particular benefit (QPSA or QJSA, whichever is applicable) and the waiver is consented to by the participant's spouse. The waiver of a QJSA and consent must be executed not more than 90 days before the payment date. §417(a)(1)(A), (6)(A). On the other hand, a waiver of a QPSA and spousal consent may be made at any time after the participant reaches age 35 and remains effective until death with respect to amounts for which the annuity starting date has not yet occurred. Details on the types of waivers and consents are contained in Reg. 1.401(a)-20 beginning with Q&A 30.

C. The Act requires a married participant who intends to name someone other than their spouse (including a charity or CRT) as beneficiary of a qualified plan to waive the QPSA or the QJSA and have the spouse consent to the waiver. If the consent and waiver is not obtained in a timely matter in accordance with the statute, the non-participant spouse retains distribution rights under the plan. Thus, if a plan participant is married, naming a charity as the beneficiary of the proceeds of a qualified plan requires compliance with the participant waiver and spousal consent rules of IRC §401(a)(11) and §417. Otherwise, the charity may discover that its rights as beneficiary under the plan are trumped by the non-participant spouse's rights.

D. If the participant dies before the participant begins receiving benefits under the plan, the participant's spouse has the right to receive a portion of the participant's benefit in the form of a qualified pre-retirement survivor annuity (QPSA), which provides for annual or more frequent payments for his or her lifetime.

E. Once the participant begins receiving benefits under the plan, the benefits must be paid to the participant, and to the spouse if the spouse survives the participant, in the form of a qualified joint and survivor annuity (QJSA). The QJSA rules provide that annual or more frequent payments be made to the participant during his/her life and if the spouse survives, annual or more frequent payments would continue to the spouse for his/her life.

   1. Participants in profit sharing plans are generally exempt from the requirements of the Retirement Equity Act of 1984 but only if the plan provides that on the participant's <u>death</u> the entire vested benefit is payable in full to the surviving spouse and the participant does not elect an annuity benefit (i.e., it is paid in a lump sum at death). In other words, the only way for a profit sharing plan to be exempt from the Acts requirements is provide a distribution of 100% of the participant's account to the spouse at the participant's death unless the spouse consents

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I. INTRODUCTION

The term "non-traditional family" is a catchall phrase that includes unmarried couples, either homosexual or heterosexual, with or without children. It may include a stepfamily, children from the prior marriages or relationships of one or both of the parents, and possibly mutual children of the couple, as well.

Increasingly, American adults reside in a household as members of an unmarried couple. These couples may be heterosexual or homosexual, or they may not be involved romantically in any way, such as in the case of siblings or close friends. Furthermore, these couples may wish to include each other and their respective descendants as part of their estate plans.[1]

State and federal laws contain default statutes giving spouses rights, including the right to handle funeral arrangements, rights under intestacy statutes, and Social Security survivor benefits. As of December 31, 2003 there were 1,138 federal statutory provisions under the United States Code pursuant to which marital status is a factor in determining eligibility for rights, benefits or privileges.[2]

For the most part, unmarried couples -- unlike their married counterparts -- do not have a set of laws governing the division of property or providing for support payments upon the dissolution of their relationship.

In the estate planning realm, unmarried couples cannot take advantage of transfer tax marital deductions under Sections 2056 or 2523 of the Internal Revenue Code of 1986 (referred to herein as the "Code" or "I.R.C."), or gift splitting under I.R.C. §2513. Members of unmarried couples may be subject to gift tax for supporting one another or dividing shared property. Unmarried couples must prepare wills or other estate planning vehicles to assure a distribution of their assets upon death in a manner different from that provided by the intestacy statute of the decedent's resident state. In addition, unmarried couples, especially same-gender couples, often experience legal difficulties when arranging funerals for deceased partners.

As with estate planning for any individual or couple, the issues may be divided into five categories: (i) practices to ensure that property is distributed appropriately; (ii) methods to minimize transfer taxes; (iii) charitable gift planning; (iv) planning for personal needs such as appointment of financial and healthcare decision makers, funeral arrangements, guardianship and custody of minors; and (v) strategies to minimize conflict. Each of these topics will be dealt with below. This paper will begin with an examination of the current state of the law with respect to same-gender marriage, and a discussion of ethical issues in connection with the representation of unmarried couples.

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[1] *See* Ralph C. Brashier, *Inheritance Law and the Evolving Family* (2004) for an excellent examination of the historical and evolving concept of family as it relates to U.S. inheritance law.

[2] *See Letter from Dayna K. Shah, Associate General Counsel of the GAO, to The Honorable Bill Frist, Senate Majority Leader* (January 23, 2004) *available at* http://www.gao.gov/new.items/d04353r.pdf.

Estate planning for the non-traditional family is only a special application of general estate planning principles and practices. However, unmarried couples often require a more individualized and resourceful approach to their estate planning. There are also a number of techniques only available to unmarried unrelated adults, and those opportunities will also be discussed. The purpose of this paper is not to provide a detailed analysis of particular technical aspects of estate planning. Instead, it focuses on various estate planning tools and the objectives that they accomplish, with an emphasis on their use in connection with planning for the client in a non-traditional family.

II. ETHICAL ISSUES OF JOINT REPRESENTATION

Like married couples, non-married couples tend to seek estate planning with their partners. So long as the estate planning process is limited to planning for the disposition of assets upon death, and planning for incapacity, the interests of the two parties are not likely to conflict. However, the process often extends to consideration of current ownership and transfer of assets, which are areas in which each party may have potentially adverse interests.

Lawyers and clients are relatively free to define the nature of their legal representation: (i) individual representation; (ii) separate simultaneous representation of both members of a couple; (iii) joint representation; or (iv) intermediary representation. The same conflict analysis applies to each of the four forms of representation, which are discussed below.[3]

A. Types of Representation.

When determining the appropriate type of representation, ABA 2007 Model Rule of Professional Conduct (hereinafter "RPC") 1.7(b), concerning conflicts of interest with current clients, should be considered. It provides, in part, that:

> Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.

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[3] *See* Jennifer Tulin McGrath, "*The Ethical Responsibilities of Estate Planning Attorneys in the Representation of Non-Traditional Couples*," 27 Seattle U. L.Rev. 75 (2003) for a thorough analysis of the various forms of representation .

RPC 1.6, concerning confidentiality, affects the extent to which the lawyer for joint clients may disclose to one client relevant information that was communicated to the lawyer by the other client. RPC 1.6(a) provides, in part, that "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, and the disclosure is impliedly authorized in order to carry out the representation...." Pursuant to RPC 1.6, under certain circumstances, the same lawyer may represent two unrelated individuals with related, but not necessarily identical interests. The fact that the goals of the clients are not identical does not necessarily create a conflict that precludes the lawyer from representing both members of the couple. Withdrawal from representation may be required in conjunction with any of the four options if disclosure issues arise.

It is important to note that the marital privilege, which bars a spouse from testifying as to any communications between spouses without the consent of the other spouse, does not apply to unmarried couples.[4]

1. <u>Separate Representation.</u>

Separate representation by different attorneys presents serious limitations on either attorney's abilities to plan for a couple. Neither attorney has access to full and complete information for both parties. Thus, effective gift and tax planning is difficult, if not impossible. However, this may be the only model of representation available if clients are unwilling to share confidences with each other and where separate representation of both individuals is not possible because the attorney determines that the parties are directly adverse under RPC 1.7(a). RPC 1.7(a) provides that:

> [A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> > (1) the representation of one client will be directly adverse to another client; or
> >
> > (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

2. <u>Separate Simultaneous Representation.</u>

Separate simultaneous representation of both individuals by one attorney is possible if the requirements of RPC 1.7(b) can be met: The attorney determines that the clients will not be adversely affected by joint representation and they consent. However, it is likely that rather than enhance an attorney's ability to represent both clients, the risks of breaching the confidentiality of either client under separate simultaneous representation may hinder the attorney from representing either client effectively.

3. <u>Joint Representation.</u>

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[4] *See, e.g.*, RCW 5.60.060(1).

By far the most common form of representation is joint representation. RPC 1.7 requires an attorney to determine whether the interests of both parties may be met with this type of representation, and the attorney must believe that the potentially conflicting interests of the parties are subordinate to their common objectives.[5] With this model of representation, the clients must consent to the sharing of information between them and the attorney, which substantially eliminates the risk that the attorney will violate the duty of confidentiality under RPC 1.6 by revealing confidences of one member of the couple to the other.[6]

4. Intermediary Representation.

Under certain circumstances, RPC 1.7 permits an attorney to represent two clients simultaneously, as the intermediary, if the attorney reasonably believes that this form of representation will benefit both clients, and will not materially prejudice either client.[7] However, the nature of the relationship is not as an advocate for either party. It is unclear whether representation as an intermediary may be provided within the scope of RPC 1.7 in the estate planning context; between two unmarried adults, it may be difficult to distinguish business planning from estate planning. Representation in this capacity is barred where litigation is a possibility or where negotiations are likely to be hostile. The lawyer should insist on separate representation when the parties' interests are clearly adverse.

B. Memorialization of Form of Representation in an Engagement Letter.

Ideally, at the initial meeting with a client, the lawyer should describe the various models of representation available and determine what type of representation will best serve the client. An agreement as to the type of representation to be used should be memorialized in writing in the form of an engagement letter. A client's expectations of confidentiality, and any agreement or understanding concerning the lawyer's ability to disclose, should also be defined in the engagement letter. The letter should be signed by the attorney and countersigned by the client or clients.

In the absence of a shared understanding of the lawyer's relationship with the clients, the lawyer should presume that the representation is joint.[8] All confidences are presumed shared in joint representation.[9]

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[5] McGrath, *supra* note 3, at 121.

[6] *Id.* at 122.

[7] McGrath, *supra* note 3, at 124.

[8] *See American College of Trust and Estate Counsel Commentaries on the Model Rules of Professional Conduct* 66 (3d ed. 1999).

[9] *Report of the Special Study Committee on Professional Responsibility: Comments and Recommendations on the Lawyer's Duties in Representing Husband and Wife*, 28 Real Prop. Prob. & Tr. J. 765, 771 (1994).

III. <u>SAME-GENDER MARRIAGE AND THE DEFENSE OF MARRIAGE ACT</u>

A. The Defense Of Marriage Act.

1. <u>Federal Legislation.</u>

The federal Defense of Marriage Act,[10] (hereinafter "DOMA"), specifically defines marriage as a legal union between one man and one woman as husband and wife. It further provides that a state shall not be required to give effect to any public act or judicial proceeding of any other state respecting marriage between persons of the same sex if the state has determined that it will not recognize same-gender marriages.

2. <u>State Legislation.</u>

To date, 46 states have adopted the DOMA, or have legislation banning same-gender marriage predating the federal DOMA. Washington was the 36th state to adopt the DOMA in 1998, when it passed legislation defining marriage as a civil contract between a male and a female.[11] To reinforce its position, the legislature concurrently passed a law specifically prohibiting marriage for couples consisting of "other than a male and a female."[12]

3. <u>Comity.</u>

Generally, states are required by the U.S. Constitution and by federal law to give full faith and credit to the acts, records, and proceedings of other states.[13] There is a limited exception where the strongly held public policy of a state would be violated.[14] Thus, the DOMA allows states to refuse to grant full faith and credit to same-gender marriages, even if lawful in the state entered into. Whether this is constitutional is the crux of many of the lawsuits brought to allow same-gender marriage.[15]

Whether foreign same-gender marriages will be recognized is a separate issue. Comity is the recognition that one nation allows to the legislative, executive, or judicial acts of another nation. Comity is discretionary when recognition of foreign law does not violate public policy.[16]

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[10] Pub.L. No. 104-199, 110 Stat. 2419 (1996) (codified at 1 U.S.C. §1 and 28 U.S.C. §1738C).

[11] RCW 26.04.010(1).

[12] RCW 26.04.020(1)(c).

[13] U.S. Const. art. IV, §1. ("Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. And the congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be provided, and the effect thereof.") *See* Joseph W. Singer, *Same Sex Marriage, Full Faith and Credit, and the Evasion of Obligation*, 1 Stanford Journal of Civil Rights and Civil Liberties 1 (Spring 2005) for a thorough discussion of the application of the full faith and credit clause to same-sex marriage.

[14] *Pacific Employers Ins. Co. v. Indus.l Accident Comm'n*, 306 U.S. 493, 501, 59 S.Ct. 629, 83 L.Ed. 940 (1939).

[15] *See Restatement (Second) of Conflicts of Laws* §283(2) (1971) providing that a marriage will be recognized as valid if legal at the time it was entered into, unless it violates the strong public policy of another jurisdiction having the most significant relationship to the couple at the time they entered into the marriage.

[16] Generally, marriages that are valid in the place entered into are valid elsewhere unless recognition of such marriage would offend a strong public policy of the jurisdiction asked to recognize it. *Restatement (2d) of Conflict*

Comity implies that the U.S. should recognize a foreign same-gender marriage if entered into legally.[17] But a state may use its DOMA as its rationale for denying legal recognition of a foreign same-gender marriage as against public policy.

B. Same-Gender Marriage in Selected Jurisdictions.

Ten states and the District of Columbia recognize reciprocal beneficiaries, domestic partnership or civil unions, which provide same-gender couples some of the rights afforded opposite-sex couples. Exhibit A lists the status of same-gender marriage, domestic partnership and civil union legislation in the U.S. and abroad.[18] The status of legislation in Washington, Massachusetts, Vermont, California, Hawaii, New Jersey and Connecticut is discussed below. Maine permits same-gender and opposite-sex couples to register as domestic partners, affording these couples limited spouse-like rights.[19] In addition, New Hampshire's civil union act[20] and Oregon's domestic partnership act[21] are both scheduled to go into effect on January 1, 2008.

1. Washington.

In two cases brought by the ACLU in Washington, its DOMA was ultimately found to be constitutional. The first case, *Andersen v. King County*,[22] was brought by eight same-gender couples seeking the right to marry in Washington. Judge William L. Downing held in their favor and ruled that Washington's prohibition against same-gender marriage is an unlawful violation of the plaintiffs' constitutional rights to equality, liberty and privacy.[23]

Both sides agreed to a direct appeal to the Washington State Supreme Court, and the Order was stayed pending that review. The appeal was filed on September 1, 2004 and consolidated with *Castle v. Washington*,[24] in which the Court ruled in favor of eleven same-gender couples, and

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of Laws §283(2) (1971). A related issue beyond the scope of this paper is whether the DOMA prohibits a transgender marriage. *See* John A. Fisher, *Sex Determination for Federal Purposes: Is Transsexual Immigration Via Marriage Permissible Under the Defense of Marriage Act?*, 10 Mich. J.Gender & L. 237 (2003). *See also* Elena P. Bishop & Noel Myricks, *Sex Reassignment Surgery: When Is a "He" a "She" for the Purpose of Marriage in the United States?"* 18 Am. J. Fam. L. 30 (Spring 2004). For an analysis of the cases that have dealt with the legality of transgender marriage, *see* Helen G. Berrigan, *Transsexual Marriage: A Trans-Atlantic Judicial Dialogue*, 12 Law & Sexuality 87, 116 (2003). *See also* Exhibit C for additional Internet resources on this and other related topics.

[17] Bernard L. McKay, *Estate Planning for the Gay and Lesbian Couple*, 6 CCH Journal of Practical Estate Planning 43, 44 (Feb./March 2004).

[18] *See* Leslie J. Harris, *Same-Sex Unions Around the World: Marriage, Civil Unions, Registered Partnerships – What Are the Differences and Why Do They Matter?*, 19 Probate & Property 31 (Sept./Oct. 2005) and the references therein for a survey of same-sex partner rights internationally.

[19] 2003 Me. Laws 672, codified in scattered sections of the Maine Code.

[20] 2007 N.H. Laws ch. 457A.

[21] The Oregon Family Fairness Act, 2007 Or. Laws ch. 99.

[22] No. 04-2-04964-4 SEA, 2004 WL 1738447 (King Cty. Super. Ct. Wash. 2004), reversed by, 158 Wn. 2d 1 (2006).

[23] *Memorandum Opinion and Order on Cross Motions for Summary Judgment* 22 (August 4, 2004).

[24] No. 04-2-00614-4, 2004 WL 1985215 (Thurston Cty. Super. Ct. Wash. 2004).

found the DOMA unconstitutional, in violation of Washington's Privileges or Immunities Clause.[25]

In the consolidated appeal, the State Supreme Court reversed the lower courts and found that the legislature is not prohibited from defining marriage as a civil union between a man and a woman, to the exclusion of same sex couples.[26]

In response to this ruling, Washington's legislature passed a domestic partner registry act that went into effect on July 22, 2007.[27] The Act allows certain same gender couples and unmarried different gender couples, one of whom is over age 62, to register as domestic partners with the Washington Secretary of State as of July 23, 2007.[28] The Act grants 29 rights, including the following:

> The ability to grant informed consent for health care for a patient who is not competent;[29] Health care facility visitation rights;[30] The ability of health care providers to disclose financial information about a patient without the patient's authorization to the patient's registered domestic partner;[31] Automatic revocation of the designation of a domestic partner as the beneficiary of non-probate assets upon termination of the domestic partnership (but not revocation of a gift under a Will);[32] Automatic revocation of a power of attorney granted to the registered domestic partner upon termination of the domestic partnership;[33] Title and rights to cemetery plots and rights of interment;[34] Rights to authorize autopsies and to request copies of autopsy reports and records;[35] Rights to control the disposition of the remains of the deceased domestic partner;[36] The right to consent to the removal of human remains from a cemetery plot;[37] The ability to make anatomical gifts;[38] The right to have one's name on the death certificate of a deceased registered domestic partner as the survivor;[39] The ability to

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[25] Washington Constitution art. 1, §12.

[26] *Andersen v. King County*, 158 Wn. 2d. 1, 138 P.3d 963 (2006) (*en banc*) Justice Barbara Madsen wrote for the plurality that "limiting marriage to opposite-sex couples furthers procreation, essential to survival of the human race, and furthers the well-being of children by encouraging families where children are reared in homes headed by the children's biological parents." *Id.* at 10.

[27] Substitute Senate Bill 5336, 2007 Wash. Sess. Laws ch. 156, codified at RCW 26.60.

[28] RCW 26.60.030.

[29] RCW 7.70.065.

[30] RCW 48.43.005.

[31] RCW 70.02.050.

[32] RCW 11.07.01.

[33] RCW 11.94.080.

[34] RCW ch. 68.32.

[35] RCW 68.50.101 & 68.50.105.

[36] RCW 68.50.160.

[37] RCW 68.50.200.

[38] RCW 68.50.550.

[39] RCW 70.58.175.

inherit assets of the estate under intestate laws when the registered domestic partner dies without a will;[40] The right to become administrator of the estate of the registered domestic partner if the registered domestic partner dies without a will or if the named personal representative declines or is unable to serve;[41] The right to file a wrongful death action and be a beneficiary;[42] The right to serve as attorney-in-fact for the registered domestic partner, even though he or she may be the principal's physician, physician's employee or the owners, administrators or employees of the healthcare facility or long-term care facility where the principal resides or receives care;[43] and, The right to fulfill eligibility requirements to receive same benefits accruing to a spouse of a public employee of Washington State.[44]

2. Massachusetts.

Massachusetts is the only state that recognizes same-gender marriage. In *Goodridge v. Dept. of Public Health*,[45] the Massachusetts Supreme Court granted same-gender couples the right to marry as of May of 2004. Massachusetts began issuing marriage licenses to same-gender couples on May 17, 2004. Those married couples have all of the rights and responsibilities of marriage under Massachusetts state law including the automatic right of inheritance, exemption from state inheritance tax, and child custody and visitation rights.

3. Vermont.

Vermont's civil union statutes became effective July 1, 2000.[46] While civil union is not marriage, eligible couples are allowed many of the benefits and protections of married couples, including the right to: (i) inherit without estate tax; (ii) file a joint state tax return; and (iii) make medical decisions for each other. Civil union statutes apply as if the Federal Income Tax Code recognized civil union as a valid marriage. While a marital deduction applies to parties in a civil union for Vermont estate taxes, there is no reduction in federal estate tax. Dissolution of a civil union is equivalent to a marital dissolution. However, to dissolve a Vermont civil union, at least one party must reside in Vermont for one year, which has created a hardship for non-Vermont residents who have entered into a civil union and now seek a dissolution.

4. California.

California's domestic partnership laws predate the recent same-gender marriage cases.[47] California's statewide domestic partnership registry became effective on January 1, 2000.[48]

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[40] RCW 11.104.015.

[41] RCW 11.28.120.

[42] RCW 4.20.020 & .060.

[43] RCW 11.94.010.

[44] RCW ch. 41.05.

[45] 440 Mass. 309, 798 N.E.2d 941 (2003).

[46] Vt. Stat. Ann. tit. 15, ch. 23.

[47] *See Marriage Cases*, No. CJC-04-004365 (San Francisco Super. Ct. 2004), *sub nom.* Proposition 22 Legal Defense & Education Fund v. City & County of San Francisco, appeal docketed, No. S135603 (Cal. filed June 9, 2005).

Since January 1, 2002, California has offered domestic partner benefits to state employees, as well as a domestic partner registry.[49] California's domestic partner laws grant legal rights to same-gender couples (and to unmarried heterosexual couples age 62 years and older) who file a Declaration of Domestic Partnership with the Secretary of State.[50] These rights include hospital visitation, medical decision-making, estate administration, partial inheritance rights, wrongful death standing and the ability to use the stepparent adoption process.[51]

As of January 1, 2005, California's Domestic Partner Rights and Responsibilities Act of 2003 expanded the rights of domestic partners to include nearly all rights and also responsibilities of spouses under state law.[52] These rights and obligations include hospital visitation,[53] rights to be appointed conservator[54] and make medical decisions,[55] for an incapacitated partner, inheritance rights equivalent to the rights of a surviving spouse,[56] the right to use the stepparent adoption procedure,[57] joint responsibility for debt,[58] and the right to request support from each other upon dissolution of the relationship.[59]

The 2003 Act afforded couples the same community property rights as married couples.[60] Unless opted out of, these rights are retroactive to the date the couple registered as domestic partners.[61] Because the gift tax marital deduction of I.R.C. §2523 does not apply to domestic partners, the creation of community property may trigger a federal gift tax liability.[62]

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[48] 1999 Cal. Stat. 588.

[49] 1999 Cal. Stat. ch. 588, relating to domestic partnerships, added Calif. Family Code §297-299.6, Calif. Govt. Code §22770 (formerly Calif. Govt. Code §22867), and Calif. Health & Safety Code §1261.

[50] Cal. Fam. Code §297.

[51] *See* 2001 Cal. Stat. 893.

[52] 2003 Cal. Stat. 421. For a thorough analysis of the current state of the law as well as its historical development, *see* Sondra I. Allphin, *New Domestic Partnership Legislation and Its Impact on Estate Planning and Administration*, 10 California Trusts and Estates Quarterly 4 (Spring 2004).

[53] Cal. Health & Safety Code §1261.

[54] Cal. Probate Code §2681(b).

[55] Cal. Probate Code §4716.

[56] Cal. Probate Code §6401.

[57] Cal. Fam. Code §9000-9007.

[58] Cal. Fam. Code §910.

[59] Cal. Fam. Code §4330-4339.

[60] Cal. Fam. Code §760.

[61] Opting out must be done in a written agreement similar to a premarital agreement, prior to becoming domestic partners, the form of which is governed by Cal. Fam. Code §1600-1620. Cal. Fam. Code §297.5(k)(2).

[62] *See* Allphin, *supra*, at 7-11 for an analysis of this risk and planning suggestions, as well as a discussion concerning other pitfalls as a result of the creation of community property. *See also* Robert W. Laversin, *Tax Pitfalls for Domestic Partners*, 25 California Lawyer 20 (May 2005).

Beginning for the 2007 tax year, California registered domestic partners may file their State income tax returns as "married filing jointly," or "married filing separate."[63]

For domestic partnerships of less than five years in duration, and not involving children, property interests or debt, and meeting a number of other requirements, the partnership may be dissolved by filing a form with the Secretary of State.[64] If the partnership does not meet all of the requirements for a nonjudicial dissolution, the superior courts have jurisdiction over the dissolution of a domestic partnership, as with marital dissolution.[65]

5. Hawaii.

In 1997, Hawaii adopted legislation granting equal rights to same-gender couples and their families in many areas of the law, now known as "The Reciprocal Beneficiaries Act."[66] Additional rights have been granted since then.

Hawaii law allows same-gender couples to become "reciprocal beneficiaries." The Hawaiian legislation applicable to reciprocal beneficiaries is broken into three categories:

(i) The first group conveys intangible, but great emotional value. These include the ability to visit a partner in the hospital (Haw. Rev. Stat. §323-2), the right to make anatomical gifts on behalf of a partner (Haw. Rev. Stat. §327-3) and make medical decisions under certain circumstances (Haw. Rev. Stat. §323-2 and §327E-2).

(ii) The second group carries substantial value, and represents a commitment to provide rights substantially similar to those provided by marriage. These rights include equal inheritance rights (Haw. Rev. Stat. §560:2-301), rights to health insurance similar to married couples (Haw. Rev. Stat. §431:10A-601), other insurance benefits such as discounts to public workers (Haw. Rev. Stat. §87A-23(5)), general equality in many areas of retirement benefits (Haw. Rev. Stat. §88-1), the ability to bring a wrongful death lawsuit (Haw. Rev. Stat. §663-1 and §663-3), the ability to own property in tenancy by the entirety (Haw. Rev. Stat. §509-2), and the same application of state estate tax as applicable to married couples (Haw. Rev. Stat. §560:3-916).

(iii) The third group grants rights of a more general nature with limited economic value or great value but limited application. These include the right to receive payment for saved up vacation days on behalf of a deceased public employee (Haw. Rev. Stat. §388-4), the right to paid bereavement time off for the death of a family member

[63] 2006 Cal. Stat. 802, eff. Jan. 1, 2007.

[64] Cal. Fam. Code §299(a).

[65] Cal. Fam. Code §299(b).

[66] 1997 Haw. Sess. Laws 383. This Act represents the reaction of Hawaii's legislature to the decision in *Baehr v. Lewin*, 74 Haw. 530, 852 P.2d 44 (1993), in which Hawaii's Supreme Court found that there was no fundamental right to same-sex marriage under the Hawaiian Constitution, but it did determine that the marriage law denied the same-sex couples equal protection, in violation of art. 1, §5 of the Hawaii Constitution.

(Haw. Rev. Stat. §386-34), and the same eligibility for disaster loans as married couples (Haw. Rev. Stat. §209-28 & §209-29).

6. New Jersey.

New Jersey's Domestic Partnership Act, N.J. Stat. Ann. §26:8A (2005), went into effect on July 10, 2004. To be eligible for domestic partnership treatment, applicants may not be married, and they must either be of the same sex or heterosexual and over the age of 62, and they must file an affidavit of domestic partnership.[67] Domestic partners must also provide proof of a joint financial responsibility (evidenced by a joint mortgage, joint bank account, designation of one in the will of the other, designation of one as primary beneficiary on the life insurance or retirement benefits of the other, or joint ownership of a motor vehicle), and share a common residence in New Jersey, or in any other jurisdiction if one member of the couple is a member of a New Jersey State-administered retirement system.[68]

The Act imposes obligations,[69] and gives domestic partners several new rights, including guaranteed hospital visitation; the right to make medical or legal decisions for an incapacitated partner; and the ability to file state personal income tax and estate tax returns on the same basis as married spouses.[70] The Act also extends New Jersey's Law Against Discrimination (N.J. Stat. Ann. tit. 10, ch. 5) to domestic partners.[71]

The Act also requires New Jersey insurance companies to offer benefits to domestic partners on the same basis offered to married couples.[72] However, the Act does not require private employers to offer benefits to domestic partners.

In emergency medical situations, the Act provides that two adults who have not filed an Affidavit of Domestic Partnership shall be treated as domestic partners for the purposes of allowing one adult to accompany the other for emergency transport, for visitation on the same basis as a family member and for certain medical decisions.[73]

7. Connecticut.

Same-gender couples in Connecticut have been able to enter into Civil Unions since October 1, 2005.[74] The form of the statute is similar to New Jersey's, but it does not apply to same-gender couples. The Act confers upon couples to a Civil Union the same state benefits, protections and

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[67] N.J. Stat. Ann. §26:8A-4.

[68] *Id.*

[69] N.J. Stat. Ann. §26:8A-6.

[70] N.J. Stat. Ann. §26:8A-2.

[71] *Id.*

[72] N.J. Stat. Ann. §26:8A-12.

[73] N.J. Stat. Ann. §26:8A-6(f).

[74] 2005 Conn. Acts 05-10 (the "Act") at §2.

responsibilities that apply to married couples.[75] However, Section 14 of the Act also adopted a form of the DOMA, by defining a marriage as "the union of one man and one woman." As a result, same-gender marriages from other jurisdictions will not be recognized. Connecticut is the first state to establish civil unions voluntarily, without having been ordered to do so by a court. The Act requires that one member of the Civil Union must be a resident of the state.[76]

C. Income Tax and Other Ramifications of Same-Gender Marriage and Civil Unions.

The federal tax ramifications of civil unions, domestic partnerships and same-gender marriage are still relatively untested. Below is an analysis of a few of the issues that may arise.[77]

1. Joint Return Filing.

The Code provides, in part, that "[A] husband and wife may make a single return jointly of income taxes under subtitle A."[78] Thus, it is not likely that the IRS will allow same-gender married couples (or couples in a civil union or domestic partnership) to file jointly. Even where same-gender couples are permitted to file state returns jointly, because they are married under applicable state law, it is likely that the Federal Government will use the DOMA to deny joint filing status for federal purposes.

Ironically, unmarried couples may pay less income tax in the aggregate in some circumstances than married couples, because of the "marriage penalty." But, because married couples may aggregate both income and deductions, they still have many advantages when determining alternative minimum tax, and deductibility of various types of losses and deductions.

2. Head-of-Household Status.

To qualify for head of household status, two tests must be met: (i) The tax payer may not be married or a surviving spouse at the end of the taxable year, and (ii) must maintain a household which constitutes, for more than one-half of the taxable year, the principal residence of a child, step-child, or a descendant of a child of the taxpayer, or any other person who is a dependent of the taxpayer under I.R.C. §152, if the taxpayer is entitled to a deduction for the taxable year for such person under I.R.C. §151.[79]

It may be possible for one partner in a civil union to claim head-of-household status for purposes of federal income tax. However, head-of-household status is not permitted absent a legal relationship under state law. Thus, it may not be available to members of a civil union in states that do not recognize that legal status.

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[75] The Act at §§14-15.

[76] The Act at §7.

[77] *See* Frank S. Berall, *Tax Consequences of Unmarried Cohabitation*, 18 Practical Tax Lawyer 55 (Winter 2004) (hereinafter "Berall, *Tax Considerations*"), for a thorough discussion of this topic.

[78] I.R.C. §6013(a).

[79] I.R.C. §2(b)(1)

3. Dependency Exemptions.

I.R.C. §151(e) allows a taxpayer to claim a dependency exemption if: (i) the cohabitant receives 50% or more of his or her support from the taxpayer; (ii) is considered a household member of the taxpayer; and the (iii) relationship of the taxpayer and the cohabitant does not violate local law.[80] Like head-of-household status, dependency exemptions are only allowed to cohabitants whose relationship is legal under local law. Thus, parties to a civil union or same-gender marriage may be ineligible for a dependency exemption if residing in a state that has passed DOMA legislation, even if the other prongs of the test can be met.

4. Obligation of Support.

Donative transfers between non-spouses may be taxable gifts if in excess of the annual exclusion, which is $12,000 in 2008. Yet, parties to a civil union or same-gender marriage have a legal obligation to support each other. Accordingly, support in excess of the annual exclusion from one partner to the other could still be characterized as a gift under I.R.C. §2503(b) or taxable compensation under I.R.C. §61 even if required by state law.[81]

5. Division of Property Upon Separation or Divorce.

There are generally no tax consequences for a division of property at divorce.[82] Transfers of property and payments between ex-spouses pursuant to a written settlement of marital property rights, or for support of minor children of the marriage, are deemed for adequate consideration, and therefore not a gift, even if the transferor did not actually receive adequate consideration in return for payments to the transferee.[83] These rules do not apply to couples terminating a non-marital relationship.[84] But, these rules should apply to same-gender married couples if the relationship of the parties is legal in the jurisdiction where they reside, unless the IRS uses the DOMA as a rationale for disregarding the relationship.

If the IRS does not recognize same-gender marriages, gain and loss will be recognized on the transfer of appreciated property, at the termination of the relationship.[85] It is not yet clear how the law will be applied upon dissolution of a civil union or a domestic partnership.

IV. COHABITATION AGREEMENTS AND SIMILAR ARRANGEMENTS

A. Background.

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[80] I.R.C. §152(b)(5).

[81] Berall, *Tax Considerations*, *supra*, at 58.

[82] I.R.C. §1041.

[83] I.R.C. §2516. The parties must divorce within the three-year period that begins one year before the agreement is executed.

[84] *See Reynolds v. Commissioner.*, TC Memo 1999-62 in which the Tax Court held that settlement proceeds upon termination of a non-marital relationship were treated as sale proceeds, not compensation.

[85] I.R.C. §1001.

Unmarried couples are able to enter into legal relationships through bilateral contracts that define the rights, duties, obligations, responsibilities, and other parameters of their relationship. Like a prenuptial agreement, the purpose of a cohabitation agreement is to create a degree of certainty for a couple with respect to how expenses will be handled, how income will be shared or separated, how assets will be acquired and under whose name, what will happen to assets in the event the relationship terminates, and how disputes are to be resolved. The parties have tremendous flexibility in deciding how comprehensive they want the agreement to be. Most courts now enforce explicit agreements between unmarried persons as long as the consideration is severable from the sexual aspect of the relationship. Consideration based on sexual services will invalidate any agreement.[86]

B. Washington Law in the Absence of a Written Agreement.

Whereas California confers rights of cohabitants based on an implied or an express contract, Washington confers rights on cohabitants based merely on their status as such.[87] A line of cases has developed in Washington that has the effect of eliminating unjust enrichment when an unmarried couple separates with no prior agreement.[88] These cases all depend upon whether an intimate committed relationship existed.[89]

The relevant factors for finding an intimate committed relationship in Washington include, but are not limited to: "[c]ontinuous cohabitation, duration of the relationship, purpose of the relationship, pooling of resources and services for joint projects, and the intent of the parties."[90] Additional factors include: whether the parties held themselves out as a couple, whether the parties named each other as beneficiaries on life insurance and employee benefits, and in their estate planning documents, and whether the couple parented children together. Not all of the factors are required but, taken as a whole, they must show the existence of a stable marital-like

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[86] Frank S. Berall, *Estate Planning Considerations for Unmarried Same or Opposite Sex Cohabitants*, 23 Quinnipac L.Rev. 361, 383 (2004) (hereinafter "Berall, *Estate Planning Considerations*"). *See also* Linda J. Ravdin, 849 Tax Mgmt. (BNA), *Marital Agreements*, A-48-49 (2003).

[87] But Washington confers the rights afforded by the Registered Domestic Partnership Act only to domestic partners registered pursuant to the Act. *See supra* notes 28-44 and accompanying text.

[88] *See, e.g., Vasquez v. Hawthorne*, 145 Wn. 2d 103, 33 P.3d 735 (2001); *In re Marriage of Pennington*, 142 Wn. 2d 592, 14 P.3d 764 (2000); *Connell v. Francisco*, 127 Wn. 2d 339, 898 P.2d 831 (1995); *In re Marriage of Lindsey*, 101 Wn. 2d 299, 678 P.2d 328 (1984); and *In re Meretricious Relationship of Sutton*, 85 Wn. App. 487, 933 P.2d 1069, *rev. denied*, 133 Wn. 2d 1006 (1997).

[89] Various terms have been used to describe relationships meeting the legal standard for the just and equitable distribution of property. Earlier cases used the term "meretricious relationship." *See In re Relationship of Eggers*, 30 Wn. App. 867, 871 n.2, 638 P.2d 1267, 1270 n.2 (1982). Washington state courts have defined a meretricious relationship as, "a stable, marital-like relationship where both parties cohabit with knowledge that a lawful marriage between them does not exist." *Connell v. Francisco*, 127 Wn. 2d at 346, 898 P.2d at 834. However, this term carries with it a negative connotation. More recently, the Court has used the phrase "intimate committed relationship." *Oliver v. Fowler*, 131 Wn. App. 135, 140, 126 P.3d 69, 73 (2006).

[90] *Pennington*, 142 Wn. 2d at 601, 14 P.3d at 770 (citations omitted).

relationship.[91] Washington law does not distinguish between same gender and different gender unmarried couples when applying these factors.[92]

In the absence of a prior agreement, a court must examine the relationship of the parties, and the property accumulated during the relationship, and make a "just and equitable" distribution of that property.[93] Property acquired during the relationship is presumed to belong to both parties.[94] If the presumption of joint ownership is not rebutted, the court may look to RCW 26.09.080, Washington's dissolution statute, for guidance as to the fair and equitable distribution of property acquired during the relationship.[95] The distinction between marital dissolution cases and cohabitation property division cases is that property that would have been separate property had the couple been legally married is *not* subject to equitable division.[96]

C. Illinois Law

Illinois is one of the few remaining states to deny property rights to unmarried cohabitants.[97] This position was recently affirmed in *Costa v. Oliven*.[98] *Costa* involved a man seeking property rights from a woman after a 24-year relationship. Eugene Costa gave up his career to raise and home-school the couple's daughter. He asked the court to impose a constructive trust for his benefit, and he asked for an accounting of Catherine Oliven's income and assets, and payment of wages for his services while he essentially acted as Oliven's employee. He referred to their arrangement as a '"quasi-marital relationship," with all the indicia of a marital type relationship, including love, trust, mutual responsibilities and intimacy.'[99] The Illinois Court of Appeals affirmed the lower court's dismissal of the Costa's complaint and in doing so, relied on the 1979 Illinois Supreme Court's decision in *Hewitt v. Hewitt*.[100]

In *Hewitt*, the trial court had dismissed a woman's claim for an equitable share of the couple's property based on implied contract, constructive trust, and unjust enrichment.[101] The trial court dismissed her complaint and indicated that such claims must be based on a valid marriage.[102] The appellate court reversed, based on the reasoning of *Marvin v. Marvin* that the woman had a

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[91] *Id.* at 603, 14 P.3d at 770.

[92] *Gormley v. Robertson*, 120 Wn. App. 31, 38, 83 P.3d 1042, 1046 (2004).

[93] *In re Marriage of Lindsey*, 101 Wn. 2d 299, 304, 678 P.2d 328, 331 (1984) (citations omitted).

[94] *In re Pennington*, 142 Wn. 2d at 602, 14 P.3d at 770 *citing Connell*, 127 Wn. 2d at 351.

[95] *Id.* at 607-608.

[96] *Connell*, 127 Wn. 2d at 351-2, 898 P.2d at 837.

[97] Two states – Illinois and Georgia -- do not recognize the legal rights of cohabitants. Lindey I. Parley & Alexander Lindey, *Lindy and Parley on Separation Agreements and Antenuptial Contracts* (2d ed. 2000).

[98] 365 Ill. App. 3d 244, 849 N.E.2d 122, appeal denied, 221 Ill. 2d 633 (2006).

[99] *Id.* at 245, 849 N.E.2d at 123.

[100] 77 Ill. 2d 49, 394 N.E.2d 1204 (1979).

[101] *Id.* at 53, 394 N.E.2d at 1205.

[102] *Id.* at 54, 394 N.E.2d at 1206.

valid cause of action based on an express oral contract.[103] The Illinois Supreme Court reversed based on public policy considerations. It held that the woman's "claims are unenforceable for the reason that they contravene the public policy, implicit in the statutory scheme of the Illinois Marriage and Dissolution of Marriage Act, disfavoring the grant of mutually enforceable property rights to knowingly unmarried cohabitants."[104]

Notwithstanding *Hewitt* and its progeny, the Illinois court has recognized claims based on constructive trust where assets have been titled in the name of one partner but actually paid for by the other partner.[105]

In Illinois, it is incumbent upon the parties to enter into a written agreement regarding the ownership of their party. Better yet, unmarried couples ought to title their property in both of their names and document the financial contributions of the parties.

Even when a couple is willing to rely on a state's default rules, because of the migratory nature of individuals, the fact that the laws of multiples states may apply and the fact that oral agreements are both difficult to prove and to enforce, the couple's intent should be clearly stated in a written agreement.

D. Drafting Cohabitation Agreements

Cohabitation agreements may be oral in some states.[106] Because the goal of the domestic partnership agreement or cohabitation agreement is to eliminate any factual disputes and ambiguities about what the parties intended, a written agreement is preferable. The following are some of the more important issues that should be addressed in the agreement.

1. Recitals. The agreement should contain recitals that document the circumstances of the parties at the time the agreement is entered into and outline their intention with respect to creating the agreement. The recitals should set forth the date the parties began living together and a brief history of the couple's relationship together. The recitals should demonstrate, based on the facts, and not on boilerplate provisions, that an enforceable contract with good and valuable consideration exists between the parties.

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[103] *Id.* at 55, 394 N.E.2d at 1206 *citing Marvin v. Marvin*, 557 P.2d 106 (Cal. 1976).

[104] *Hewitt* at 66, 394 N.E.2d at 1206.

[105] In *Spafford v. Coates*, 118 Ill. App. 2d 566, 455 N.E.2d 241 (Ill. App. Ct 1983), the court recognized claims by one cohabitant against another where one had contributed funds toward a purchase titled in the other's name and the fact of their relationship was not a basis for the claim. *But see Ayala v. Fox*, 206 Ill. App. 3d 538, 564 N.E.2d 920 (1990) (plaintiff's claim to an interest in joint purchases denied because the relationship of the parties could not be separated from the monetary consideration invested).

[106] *See In re Relationship of Eggers*, 30 Wn. App. 867, 638 P.2d 1267 (1982) (the court held that express oral contracts between persons living together are enforceable) and *Whorton v. Dillingham*, 202 Cal. App. 3d 447 (1988). *See also,* Richard M. Horwood *et al.*, 813-2nd Tax Mgmt. (BNA), *Estate Planning for the Unmarried Adult*, A-44 (2003).

2. <u>Disclosure of assets and liabilities</u>. As with prenuptial agreements, both parties must disclose the nature and value of their property. Depending upon the applicable state law, it is possible that the same principles applicable to prenuptial agreements may also apply to cohabitation agreements, including the ability to set aside the agreement could be set aside in the absence of full and fair disclosure.

3. <u>Expenses while living together</u>. The agreement should address how expenses will be handled during the relationship, how assets purchased will be titled, and any post-termination support commitments. Many of these issues can and should be provided for in the Will of the partners as well as in the cohabitation agreement.

4. <u>Provisions for children and pets</u>. Agreements regarding parenting violate public policy.[107] However, the agreement of the parties may still carry some weight with the court. Accordingly, the couple may want to try to agree in advance, and document, how they will handle issues such as primary parent/custody, visitation and how the children will be raised, keeping in mind that the best interest of the children, as determined by the court, will ultimately prevail.[108] Similar provisions for pets may also be documented.

5. <u>Dispute resolution</u>. It is advisable to include dispute resolution provisions. If the parties agree to mediation or arbitration, the agreement should specify who would pay the mediator/arbitrator. The agreement should also indicate when the parties might abandon mediation for either arbitration or going directly to court. In addition, if attorneys or court costs are involved, it should cover how these costs will be paid for as well.

6. <u>Marriage</u>. If marriage is a legal option for a couple, they should indicate whether they intend the agreement to remain in effect should they marry. Alternatively, the agreement may terminate upon marriage, at which time the couple would be required to enter into a new agreement or rely on the state default rules applicable to married couples. If marriage would not be legal, a couple should not state an intent to live as husband and wife, thereby creating a possibility in certain states that the agreement will be found void because it violates public policy.[109]

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[107] *See, e.g.*, RCW 26.09.070(3). *See also, Unif. Premarital Agreement Act* §3(b) (1983), 9C U.L.A. 35, 43 (2001) ("The right of a child to support may not be adversely affected by a premarital agreement.").

[108] "The agreement may be considered by the court, in light of the circumstances and knowledge of the parties when the agreement was made, but it is not enforceable." *Marriage of Littlefield*, 133 Wn. 2d 39, 58, 940 P.2d 1362, 1372 (1997).

[109] Berall, *Estate Planning Considerations*, *supra* note 86, *at* 383-384.

7. Choice of Law. Because of the mobile nature of couples in our society, a choice of law provision is also advisable. Confirm that the state law where the parties reside at the time of execution allows such agreements and its particular provisions.[110] Assuming that the agreement is enforceable in the state where executed, the parties may want to include a provision such as the following: "To establish reasonable certainty in their respective financial affairs, the parties agree that, without regard to where they may reside or be domiciled in the future, or where any or all of their real or personal property may be located, all property rights of the parties and their rights under this Agreement shall be determined according to the substantive laws of [state where executed], without regard to conflict of law rules applicable in [state where executed] or in any state in which they may later reside."

8. Assisted Conception. If the couple has or plans to store genetic material, they may want to deal with its use and or disposition in the cohabitation agreement, if they have not already entered into a separate agreement covering these issues. The couple should document their plans to use that material to conceive children, and whether those plans should be altered if the couple does not stay together or if one member of the couple dies. The law is in flux, and inconsistent from state to state, with respect to children conceived after the death of a parent.[111]

V. Wills, Revocable Trusts, And Nonprobate Transfers

A. Wills.

Wills present a problematic area for same-gender couples. A testamentary gift to an unmarried partner, especially a same-gender partner, is often subject to challenge by the decedent's relatives.

There are certain powers that are often statutorily limited to exercise under a will, including: the ability to name a guardian of minor children[112]; the exercise of a testamentary power of

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[110] Linda J. Ravdin, 849 Tax Mgmt. (BNA), *Marital Agreements*, at B-1101-1107 (2003), for a table by state indicating the enforceability of domestic partnership agreements regarding property and support. *See also* William A. Reppy, Jr., *Choice of Law Problems Arising When Unmarried Cohabitants Change Domicile*, 55 SMU L. Rev. 273 (Winter 2002) for an examination of the issues affecting cohabitants with respect to choice of law rules after the termination of the relationship or the death of one member of the couple.

[111] *See* Carole M. Bass, *What If You Die, And Then Have Children? Know How to Plan for Offspring Who Are Born – Sometimes Even Conceived – Posthumously. A State-by-State Guide*, 145 Trusts & Estates 20 (April 2006). It may be possible, in come jurisdictions, for a non-biological parent who has not adopted a child, to seek custody under the doctrine of de facto parentage. *See, e.g., In re Parentage of L.B.*, 155 Wn. 2d 679, 122 P.3d 161 (2005), *cert. den.*, 126 S. Ct. 2021, 164 L.Ed. 2d 806 (2006).

[112] RCW 11.88.080. However, effective July 24, 2005, RCW 11.88.080 was amended to permit the designation of a guardian for a minor child in a durable power of attorney, effective either upon the death or incapacity of the parent/principal. This designation may also authorize an agent to make health care decisions on behalf of the minor if no other parent or legal guardian is available to give consent.

appointment;[113] and gifts of tangible personal property by separate writing.[114] Thus, in some instances, having a will is critical. Under certain circumstances, other forms of testamentary transfers, such as joint tenancy with right of survivorship or revocable living trusts, both discussed below, may also be used as will substitutes.

B. Revocable Trusts.

Many clients establish revocable trusts to transfer assets to a partner outside of probate. Revocable trusts are also useful as vehicles for the management of a client's assets in the event of incompetence. Some practitioners advise that if a client anticipates that his or her will may be contested, it may be prudent to establish a revocable trust, which may be more difficult to challenge on theories such as incompetence or undue influence. If the estate is not taxable, then the beneficiary need not ever report receiving the gift. But, if there is a taxable estate, estate tax apportionment between family members and a surviving partner may compromise a beneficiary's ability to keep the receipt of assets entirely confidential from a decedent's family members.

C. Beneficiary Designations.

Clients should confirm beneficiary designations for bank accounts, investment accounts, life insurance and retirement accounts. They may also consider restating those designations in their will or revocable trust as additional evidence in the event of a challenge by hostile family members.

D. Miscellaneous Considerations and Definitions.

With any estate planning document, definitions need to be carefully considered.

1. Partner.

In Washington, RCW 11.12.051 provides for the revocation of a provision in a will for a spouse upon divorce, and RCW 11.07.010 provides for the revocation of a beneficiary designation naming a spouse as beneficiary of certain nonprobate assets. No equivalent statutes apply to a partner upon separation. Therefore, it is important to define "partner" carefully. A partner may be "the person with whom the testator is living at the time of death," but consideration should also be given to the possibility of temporary job relocation or one person having moved to a residential care facility.[115] One option is to provide specific guidelines for the personal representative, who would make a final and binding determination as to whether an individual was a partner at the time of death.

2. Parent and Child.

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[113] RCW 11.95.060(2).

[114] RCW 11.12.260.

[115] Gail E. Cohen, *Estate Planning for the Unique Needs of Unmarried Partners*, 30 Estate Planning 188, 189 (April 2003).

Similarly, the terms "children" and "descendants" should be defined to include children of a partner, who are neither biologically related nor adopted, but whom the testator intends to provide for. It should also be kept in mind that anti-lapse statutes[116] may not protect descendants of a predeceased child of a partner. Consideration should be given as to whether those individuals should still be provided for even if the relationship with the partner has ended.[117]

Assisted conception raises a number of moral, ethical as well as legal issues for clients. The definition of "parent" and "child" should also be carefully considered when science may have made those definitions ambiguous. One issue that must now be considered is whether any genetic material has been stored, and what the plans are to use that material to conceive children. The law is in flux, and inconsistent from state to state, with respect to children conceived after the death of a parent.[118]

3. <u>Tax, Debt and Expense Allocation.</u>

Another important component of an estate plan is the tax, debt and expense allocation clause in the will or revocable trust. Estate plans often allocate tax, debts and expenses of administration to the residue. Alternately, a plan may rely on the state's default statutes,[119] which generally provide that each beneficiary of an asset will bear a pro rata share of taxes and expenses of administration.

The effect of the state statute regarding abatement of assets to pay tax, debts and expenses should also be considered when drafting a will or revocable trust.[120]

Even when a client elects to rely on a state's default allocation rules, because of the migratory nature of clients and the fact that the laws of multiples states may apply, the client's intent should be clearly stated in the testamentary documents.

VI. <u>METHODS TO MINIMIZE TAXES</u>

A. Defining the Rights of Unmarried Partners to Jointly Owned Property.

1. <u>General Federal Estate and Gift Tax Considerations.</u>

The rules allowing transfers between spouses to avoid transfer or income taxes do not apply to unmarried couples.[121] Accordingly, any transfers between partners may be taxable (subject to

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[116] *e.g.* RCW 11.12.120.

[117] Cohen, *supra* note 115, at 189-190.

[118] Bass, *supra* note 110, at 21.

[119] E.g., RCW ch. 83.110A, Washington Uniform Estate Tax Apportionment Act.

[120] *See, e.g.*, RCW ch. 11.104A, Washington's Principal and Income Act; RCW ch. 83.110A, Washington's Uniform Estate Tax Apportionment Act; and RCW 11.10.010, Washington's general abatement scheme that applies when no other specific rule applies.

[121] I.R.C. §2056(a), §2523(a), and §1041.

the I.R.C. §2503(b) annual exclusion, the donor's available applicable exclusion, and the exclusion from gift tax for tuition and medical expenses under I.R.C. §2503(e)).

2. Indirect Gifts Arising From Pooled Expenses.

The value of taxable gifts between unmarried partners becomes difficult to quantify in the context of shared living expenses. When partners pool income and one party receives more income than the other, pooling may cause a net transfer to the party with less income, resulting in a taxable gift. This result may be partially ameliorated by entering into a contractual arrangement between the partners providing for mutual and adequate consideration. The amount of the gift is the difference between the value of the property transferred and the consideration received.[122] However, the exchange of consideration sufficient to make a promised transfer enforceable for state contract law purposes will not necessarily prevent some part of the transfer from being a gift for federal tax purposes, unless the transferor receives consideration having an economic value equal to the property transferred.

To the extent a net transfer from the greater income earner to the lower income earner is viewed as being paid in consideration for the lower income earner's love, emotional support, or other services upon which a monetary value may not be placed, the transfer is a gift.

If the contractual arrangement provides that the net transfer from the higher income earner to the lower income earner is an advance to be repaid upon the happening of some event, i.e. the lower income partner finishing school, or becoming gainfully employed, or the higher income partner retiring, the couple will be treated as being in a debtor-creditor relationship. These types of arrangements should be avoided unless the arrangement provides for adequate stated interest and the advanced sums will actually be repaid. Sections 163(h), 1274 and 7872 of the Code address below-market interest and gift loans by imputing interest income in the amount of the applicable federal rate to the creditor, taxing the creditor as making a gift of the interest, and denying the debtor's interest deductions. If the debt is never repaid, I.R.C. §61(a)(12) treats the amount advanced as income to the debtor from the discharge of indebtedness. Section 7872(c)(2)(A) of the Code provides a *de minimis* exception for gift loans between individuals for amounts of $10,000 or less. Thus, generally, for smaller loans there is neither imputed interest nor a taxable gift.

3. Joint Tenancies.

Joint tenancy ownership of assets is one of the most popular estate planning devices for unmarried couples. When contributions by both parties are equal, and where the intentions of both parties with regard to management and disposition of the assets are identical, joint tenancy is an efficient and economical estate planning tool. Joint tenancy in the nontaxable estate may avoid the need for disclosure to family members at the time of the disposition. And if a joint

[122] I.R.C. §2512(b).

tenancy is challenged, the presumption of a gift of funds in joint tenancy must be rebutted by clear and convincing evidence of a contrary intent, which is typically difficult to overcome.[123]

(a) Joint Tenancy May Result In An Unintended Gift.

For the client with a taxable estate, joint tenancy can result in unintended consequences. When an asset, such as a house, is purchased in joint tenancy, if the parties contribute equally to the purchase, then acquiring the asset in joint tenancy is not a taxable event. However, if one partner purchases or contributes to an asset (other than a bank account or U.S. bonds), and has it conveyed to himself and his partner in joint tenancy with right of survivorship, then the purchase constitutes an immediate gift of the value of the transfer in excess of the annual exclusion.[124]

Upon the death of one joint tenant, the entire value of the jointly held property is included in the decedent's gross estate, unless it can be shown that the surviving joint owner actually contributed to the acquisition of the asset.[125] The burden of proof is on the taxpayer and may be difficult to sustain without meticulous record keeping. If clients intend to own real property in joint tenancy, they should document their intentions, their contributions to points and the down payment, mortgage payments, and home improvements.

There is an exception to the present gift rule for joint bank accounts and U.S. bonds: The transfer, and thus a completed gift, does not occur until the joint holder withdraws money from the account.[126]

(b) Non-Tax Disadvantages of Joint Tenancies.

In addition to the tax disadvantages, there are other problems with joint tenancies. A joint owner of a bank account can withdraw the other party's money from the account without the party's consent or knowledge.[127] This could be avoided by requiring two signatures on an account.

Assets titled jointly, such as real estate, stock, or a motor vehicle, cannot be sold without the consent of both joint owners. This protects the owners, but it also often results in a deadlock between partners on the appropriate disposition of an asset.

(c) Drafting Recommendations.

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[123] RCW 30.22.100(3).

[124] Treas. Reg. §25.2511-1(h)(5) and I.R.C. §2503(b).

[125] I.R.C. §2040(a) and Treas. Reg. §20.2040-1(a)(2).

[126] Treas. Reg. §25.2511-1(h)(4).

[127] RCW 30.22.110. Washington does not have a statutory equivalent to RCW 30.22.110 applicable to securities accounts. Rev. Rul. 69-148 provides that a joint tenancy securities account constitutes a completed gift except when the account agreement allows the donor to remove assets from the account without the consent of the donee. Thus, unless an account agreement allows for a unilateral withdrawal, a securities account does not constitute a completed gift.

Some practitioners recommend that partners establish a partnership or limited liability company to take title to a home, to facilitate accurate record keeping, and also to provide protection against a creditor or a partner forcing partition. But, using an entity for a principal residence acquisition will prevent the partners from using the exclusion for capital gain on sale under I.R.C. §121.[128] This exclusion is available to persons, but not entities.

Alternatively, legal title could be held in a revocable title holding trust with a separate schedule of beneficial interests. The trust agreement could further define how the beneficial interests are to be adjusted over time based on the relative financial contributions of the partners.

B. Adult Adoption.

1. Purpose of Adult Adoption.

One method by which same-gender couples have sought to obtain some certainty with respect to their estate planning intentions is to have one partner adopt the other. There are several motivations behind this planning technique, including establishing a family relationship for purposes of entitlements and other benefits (i.e. Social Security, health insurance, survivor benefits), the desire to create a legal bond with another individual, and to establish a legal heir and secure inheritance rights.[129] Because estate intestacy laws do not allow for the distribution of a decedent partner's estate to his or her surviving partner, some unmarried couples resort to adoption, rather than rely solely upon other more conventional estate planning techniques.

The effectiveness of this technique varies from jurisdiction to jurisdiction. Adult adoptions may provide an effective means of nullifying the status as heirs of the adopter's relatives so that they are without standing to contest an assignment of property. Considering the frequency of challenges by relatives claiming that a decedent's partner exerted undue influence over the decedent, the adoption strategy appears attractive to many unmarried partners.[130]

Another reason an adult may wish to adopt a partner is to bring the adoptee within the class of beneficiaries under a pre-established estate planning instrument. One partner may be a beneficiary of a trust providing for distribution of her share to her descendants upon her death, but if she has none, then to some other specified group of individuals. In this case, adoption may bring the partner into the permissible class of recipients of the trust share upon the death of the current income beneficiary. Before reaching the conclusion that adoption will bring an individual into a class of beneficiaries, there must be a careful examination of the dispositive intent set forth in the instrument.

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[128] The Taxpayer Relief Act of 1997, Pub.L. No. 105-34, 111 Stat. 788, amended I.R.C. §121 (formerly providing a one-time exclusion of gain from sale of a principal residence by an individual who has attained age 55) and permits exclusion of up to $250,000 of gain by an individual or $500,000 by a married couple on the sale or exchange of a principal residence, if the property was a principal residence for 2 of the last 5 years.

[129] *See* Gwendolyn L. Snodgrass, *Creating a Family Without Marriage: The Advantages and Disadvantages of Adult Adoption Among Gay and Lesbian Partners*, 36 Brandeis J.Fam.L. 75 (1997-1998).

[130] For information concerning adoption in Washington, *see Washington Family Law Deskbook*, ch. 60 (Wash. St. Bar. Assoc. 2d ed. 2001 and Supp. 2006).

The statutory treatment of adoption differs from state to state. Not all states permit adult adoption, and some require the adoptee to be younger than the adopter. The possibility of prosecution for incest in the applicable state should also be considered before opting for this planning method. Washington's incest statute, RCW 9A.64.020, only applies to adopted descendants *under* the age of eighteen.[131]

It is important to carefully consider who will adopt from whom. The partner who is likely to die first should be the adopter. Another concern is that an adoptee loses the right to inherit by intestacy from biological relatives. Adult adoption also triggers income tax considerations such as dependency exemptions and head of household status that should be considered, and clients need to understand that it is unlikely that an adoption may later be revoked or renounced once final.

2. <u>Estate Planning Opportunities Following the Adoption of a Partner – Transfers of a Trade or Business.</u>

Many estate planning opportunities arise once a partner has been adopted. Two particularly notable techniques are discussed below:

(a) Special Valuation Rules of Section 2032A.

Section 2032A of the Code provides a special valuation rule for real property used in farming or a trade or business, with a maximum reduction in value of $960,000 in 2008. Section 2032A allows the qualified real property to be valued at its actual use, rather than its highest and best use. To qualify, the "decedent or a member of the decedent's family" must have owned and used the property for the qualifying use before death, the property must pass to a "member of the decedent's family," and the property must continue to be used for the qualifying use by a "member of the decedent's family."[132] Members of the decedent's family are defined to include: (i) an ancestor; (ii) the decedent's spouse; (iii) a lineal descendant of the decedent, the decedent's spouse, or the decedent's parents; or (iv) the spouse of such lineal descendants.[133] Although the definitions of I.R.C. §2032A are based on legal relationships, and therefore do not recognize informal relationships, they do include adopted children, stepchildren, sons- and daughters-in-law, and half-blood relations.[134] Thus, I.R.C. §2032A may provide planning opportunities to non-traditional families in the right circumstances.

(b) Section 6166 Election to Pay Estate Taxes on Qualified Businesses in Installments.

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[131] *But see Restatement (Second) of Conflicts of Law* §290 cmt. c (1971) (providing that a state may disallow inheritance in connection with out-of-state adoption where inheritance would violate strong local public policy); *Restatement (First) of Conflict of Laws* §143 cmt. a, illus. (1934) (providing an example when adoption in one state will not be recognized for inheritance purposes in another state that does not permit such adoption).

[132] I.R.C. §2032A(b).

[133] I.R.C. §2032A(e)(2).

[134] *Id.*

Section 6166 of the Code was passed to mitigate the pressure on an illiquid estate to sell a decedent's interest in a closely held company in order to pay estate taxes. Section 6166 allows a personal representative to pay estate tax in installments, on that portion of the estate tax for a decedent who was a U.S. citizen or resident that is attributable to a closely held business interest, over a maximum 14-year period. Section 6166 is highly technical, but some of its provisions are summarized below.[135]

The first payment of tax is due not more than five years after the date the estate tax return is due. A portion of the property ($1,280,000 in 2008 plus the applicable exclusion amount) is subject to estate tax at 2%.[136] The interest rate on deferred estate tax in excess of the 2% portion is 45% of the underpayment rate determined under I.R.C. §6621.

Section 6166 requires that at least 35% of the adjusted gross estate must consist of an interest in a closely held business that was an active trade or business in which the decedent or a member of his family holds a minimum percentage ownership interest.[137]

An interest in a closely held business is defined, for purposes of Section 6166, as (i) an interest as a sole proprietorship carrying on a trade or business, (ii) an interest as a partner/member in a partnership/LLC carrying on a trade or business, if 20% or more of the partnership/LLC is included in the gross estate, or if the partnership/LLC had no more than 15 partners/members, and (iii) stock in a corporation carrying on a trade or business if 20% or more of the value of the corporations stock is included in the gross estate or if the corporation had no more than 15 shareholders.[138]

"Member of the family" is defined as including only brothers and sisters, spouses, ancestors, and lineal descendant, including adoptees.[139] Again, because of this restrictive definition, under the right circumstances, this may provide an excellent estate planning opportunity.

An estate will often attempt to claim the benefit of both I.R.C. §2032A and I.R.C. §6166. The differences between the family relationship definitions of these two sections may result in a non-traditional family qualifying for one, but not the other.

C. The Generation-Skipping Transfer Tax.

1. Background.

In addition to estate and gift taxes, there is a generation-skipping transfer ("GST") tax on transfers to grandchildren and other persons "assigned to a generation which is 2 or more

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[135] *See* Louis A. Mezzullo, 809-2nd Tax Mgmt. (BNA), *Estate Planning for Owners of Closely Held Business Interests* at Section III (2002) for an analysis of this topic.

[136] I.R.C. §6166(j).

[137] I.R.C. §6166(b).

[138] I.R.C. §6166(b)(1).

[139] I.R.C. §6166(b), I.R.C. §267(c)(4).

generations below the generation assignment of the transferor."[140] The GST tax is a flat rate equal to the maximum estate tax rate (45% in 2008).[141] The IRS imputes a generation as 25 years for unrelated beneficiaries. Every taxpayer has a $2,000,000 exemption from the GST tax.[142] Like the exemption equivalent sheltered by the unified credit, the GST exemption can be allocated to transfers during life, to transfers upon death, or partly to each.

(a) Generation Assignment -- Family Members.

Each person is assigned to a particular generation to determine if a transfer is a generation skip.[143] Generation assignments are based on lineage for transfers to family members, and age for transfers to non-family members.[144] The age of an individual is irrelevant for generation assignments based upon family relationships.

(b) Generation Assignment -- Non-Family Members.

Transfers to someone other than a family member are based on the transferee's age relative to the transferor. Any person not more than 12 ½ years younger than the transferor is assigned to the transferor's generation.[145] Any person between 12 ½ and 37 ½ years younger is assigned to the first generation below the transferor.[146] Each 25-year increment thereafter represents a new generation.[147]

Where unmarried partners are separated by a great age difference, a transfer in excess of the exemption may result in the application of the GST.

> Example: Bill, age 75, leaves $5 million to Bob, age 35. Because Bill is more than one generation older than Bob, under the generation assignment rules for unrelated persons, the amount in excess of Bill's $1.5 million exemption is subject to GST tax, as well as estate tax.

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[140] I.R.C. §2613(a)(1).

[141] I.R.C. §2641.

[142] The GST exemption amount is now equal to the estate tax applicable exclusion amount under I.R.C. §2010(c) for the year in which the generation-skipping transfer is made ($2 million in 2006, and $3.5 million in 2009), and for year 2010, the GST tax will be repealed in its entirety (and thus there will be no GST exemption amount). I.R.C. §2641. In 2011, the GST exemption is scheduled to revert back to $1,100,000 (plus post-2002 inflation adjustments). I.R.C. §2664. *See* Sebastian V. Grassi, Jr., *Income, Gift and Estate Tax Aspects of Crummey Powers After the 2001 Tax Act, Part 1*, 18 Probate & Property 37 (Jan./Feb. 2004) and Sebastian V. Grassi, Jr., *Income, Gift and Estate Tax Aspects of Crummey Powers After the 2001 Tax Act, Part 2*, 18 Probate & Property 48 (March/April 2004).

[143] I.R.C. §2651.

[144] *Id.*

[145] I.R.C. §2651(d)(1).

[146] I.R.C. §2651(d)(2).

[147] I.R.C. §2651(d)(3).

2. Adoption to Avoid the Application of the GST.

A valid adoption of an unrelated individual, who would otherwise be considered a skip-person, may avoid the generation assignment rules based on age, and allow application of the generation assignment rules based upon lineage from the transferor.

However, under regulations that went into effect on July 18, 2005, the IRS will analyze whether there is a bona fide parent/child relationship, or if the adoption was primarily for GST tax-avoidance purposes. This determination is made based upon all of the facts and circumstances, but the following requirements must be satisfied: (i) a legal adoption took place between the adoptee and the adoptive parent; (ii) the adoptee is a descendant of a parent or the adoptive parent (or the adoptive parent's spouse or former spouse); (iii) the adoptee is under the age of 18 at the time of the adoption; and (iv) the adoption is not primarily for GST tax-avoidance purposes.[148]

D. Partnerships and Limited Liability Companies.

One way to leverage transfers from one partner to the other is to establish a partnership or LLC for federal income tax purposes. If a couple can show they are a "syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on," they may establish a partnership under Subchapter K of the Code.[149] An arrangement may be classified as a partnership for federal income tax purposes even if it does not qualify as a partnership for state law purposes.[150]

Given a good faith business venture, an unmarried couple could enter into a partnership/LLC agreement, open a joint partnership/LLC account, acquire an employer's identification number from the Service, and file income tax returns for the entity. Partnership/LLC agreements allow for great flexibility and, assuming certain conditions are met, the couple can take advantage of the nonrecognition provisions contained in Subchapter K, such as the ability to distribute out partnership/LLC assets without the recognition of gain or loss, so long as the value of the assets received by a partner/member do not exceed his or her basis in the entity.[151] Note, however, a joint undertaking merely to share expenses is not a partnership absent a business purpose.[152]

In addition to the opportunities discussed above, a partnership/LLC can provide asset protection. The creditor of a partner or member may receive an assignee interest in any distributions from the entity to the partner/member. But assuming the entity is treated as a partnership for income tax purposes, when income is not actually distributed, the potential for the receipt of "phantom income" often serves as a deterrent to creditors. An entity may similarly serve as a deterrent to hostile family members.

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[148] Treas. Reg. §26.2651-2(b).

[149] I.R.C. §761(c).

[150] Treas. Reg. §301.7701-1(c).

[151] I.R.C. §731(a).

[152] Treas. Reg. §1.761-1(a).

Partnerships and LLCs can be advantageous where one partner/member wants to give property to the other without giving up control over that property. Gifts of partnership or LLC interests from one partner/member to the other, if structured properly, may be discounted for lack of control and lack of marketability to leverage the amount of property that may be transferred within the I.R.C. §2503(b) annual exclusion amount.[153] Furthermore, as discussed below, unmarried partners are not subject to the limitation on restrictive agreements imposed by I.R.C. §2703.

E. Life Insurance.

Life insurance, if available, is an excellent way to: (i) provide liquidity for the payment of estate taxes; (ii) give a surviving partner the funds necessary to create a stream of income; and (iii) afford a surviving partner the funds to buy out a business partner or associate. When clients are relying on the pension and/or social security benefits of one partner for their retirement years, and neither would be available to the surviving partner, life insurance is an important consideration for replacement of that income.

By purchasing life insurance and naming a partner as beneficiary, a couple may accomplish a wealth transfer at death similar to a testamentary disposition. An advantage of life insurance is that it allows the insured to retain inter vivos power to cancel the policy or alter the beneficiary designation.

Life insurance may also afford a couple privacy and confidentiality that may not be available with other estate planning tools. If the beneficiary of a policy, instead of the insured, holds all incidents of ownership of that policy, and if there are no estate tax considerations, the beneficiary of the proceeds does not have to report the receipt of the proceeds. However, if estate tax is an issue, privacy and confidentiality will be lost: A Form 712 must be filed with the federal estate tax return indicating the recipient and amount of the proceeds.

1. Insurable Interest.

I.R.C. §7702 requires life insurance policies to be "life insurance" under applicable state law. State insurance law generally provides that a contract of life insurance is not valid unless the policyholder has an "insurable interest" in the life of the insured.[154]

Traditionally, a policyholder is treated as having an insurable interest if any of the following exist: (i) a familial relationship with the insured; (ii) a reasonable expectation of advantage from the continuance of the insured's life; (iii) common ownership of property; or (iv) a business relationship between the beneficiary and the insured.[155] The policy behind the insurable interest requirement is to discourage wagering arrangements and abusive uses of insurance.[156]

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[153] *See* Richard L. Lavoie, 831-3d Tax Mgmt. (BNA), *Valuation of Corporate Stock* (2006) for a discussion of valuation discounts.

[154] *See* RCW 48.18.060.

[155] *See* RCW 48.18.030.

[156] *See* Mary Ann Mancini & Howard M. Zaritsky, *Insurable Interests? Après Chawla, le Deluge?*, 32 ACTEC Journal 194 (Winter 2006).

An insurable interest must exist at the time the insurance is issued.[157] Some states also require that the policyholder have an insurable interest at the time the proceeds are collected.[158] Provided that the latter rule does not apply, an insured may procure a policy on his own life and transfer it to someone who does not have an insurable interest. Where an irrevocable life insurance trust is involved (discussed below), it has been suggested that insurable interest issues may be avoided by procuring the life insurance and creating the trust under the laws of a state where an insurable interest exists.[159]

2. Income and Estate Tax Consequences of Life Insurance.

Life insurance proceeds paid by reason of the death of the insured are not generally subject to income tax.[160] Proceeds are included in an insured's gross taxable estate if they are payable to or for the benefit of the insured's estate, or if the insured retained any incidents of ownership in the policy.[161] Because the marital deduction does not apply to an unmarried couple, the proceeds of a life insurance policy could be subjected to estate tax twice: Once upon the death of the insured and a second time upon the death of the survivor, if the money has not previously been spent.

When the owner of a life insurance policy predeceases the insured, the policy is an asset of the deceased owner's estate, and as such, is subject to estate tax like any other assets owned by the decedent at the time of his or her death. This consequence can be avoided by having a trust own a policy.

3. Irrevocable Life Insurance Trusts.

One technique for excluding life insurance proceeds from an insured's estate is to have a third person or trustee own all incidents of ownership in a policy. The transfer of a policy to a trust, or the purchase of a policy by a trustee, is preferable to an outright gift. An outright transfer of a policy to a domestic partner may be problematic if the relationship terminates. If the transferor is the one paying the premiums, he or she always has the option of allowing the policy to lapse.

The taxation of life insurance proceeds can be avoided under present law if a trust owns all incidents of ownership in a policy (*e.g.*, the right to surrender, revoke, assign, pledge or borrow against the policy or change the beneficiary).[162] A trust holding life insurance is commonly referred to as an irrevocable life insurance trust ("ILIT").

A trust may be drafted to exclude the partner as a beneficiary if the relationship terminates. Moreover, the terms of the ILIT may provide that, at the death of the insured, the proceeds may

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157 *Id.* at 196.

158 *See e.g.*, N.Y. Ins. Law §3205.

159 *Insurable Interests?*, *supra* note 156, at 224.

160 I.R.C. §101(a)(1).

161 I.R.C. §2042(1) & (2).

162 I.R.C. §101(a)(1).

be made available to the insured's estate to create liquidity through loans between the trustee of the trust and the insured's personal representative.

In most states, a fiduciary may use trust funds to purchase life insurance on the life of a beneficiary or the life of another in whose life a beneficiary has an insurable interest.[163] In addition, an insured may obtain a policy on his or her own life and freely transfer ownership of that policy to a new owner.[164] In some states, it is not clear whether a trust can obtain a policy that will ultimately benefit someone without an insurable interest, in all states. In those states where insurable interest is an issue, in spite of the potential estate tax consequences, it may be preferable to have the insured purchase a policy and gift it to an ILIT.

(a) The Mechanics of the Irrevocable Life Insurance Trust.

An ILIT is operated as follows: Each year, the grantor transfers money to the trust in an amount slightly greater than the amount sufficient to cover the annual premium on the policy.[165] The beneficiaries are given withdrawal rights each year (the right to demand distribution of a stipulated amount of the trust corpus) for a limited period of time following the gifts to the trust, so that each transfer qualifies for the gift tax annual exclusion. This right is known as a "Crummey" right of withdrawal, and its purpose is to qualify the gift as a present interest and therefore eligible for the annual exclusion from gift tax.[166] Once the beneficiary's demand power expires (assuming it goes unexercised), the funds may be accumulated in the trust. In the first year, the trustee uses the cash to purchase life insurance, typically on the life of the grantor. Thereafter, the trustee uses the cash to pay the annual premium. There are several additional technical requirements that must be observed in order for the proceeds to be excluded from estate taxation.[167]

A trust agreement may provide that the grantor's partner is to be the beneficiary of the policy proceeds, provided that the insured and her partner are in a committed relationship at the time of her death. If not, the trust agreement could provide for the proceeds to be distributed to other beneficiaries.

A potential insured can allocate a portion of his or her generation-skipping transfer tax exemption to the trust each year that is equal to the value of the year's gifts to the trust, and by these allocations, the entire trust corpus (including the insurance proceeds payable upon the insured's death) can be sheltered from the GST tax for multiple generations. The GST

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[163] *See, e.g.*, RCW 11.100.120.

[164] *See, e.g.*, RCW 48.18.360.

[165] For a more detailed explanation, *see* Howard M. Zaritsky & Stephan R. Leimberg, *Tax Planning With Life Insurance: Analysis With Forms 2d* (1998) and Richard C. Baier, *Drafting Flexibility Into An Irrevocable Life Insurance Trust*, 19 Probate & Property 62 (Sept./Oct. 2005).

[166] In *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968), the court held that by creating a window of time during which beneficiaries of certain trusts may exercise a demand power to withdraw funds that are added to the trust, the gifts subject to the withdrawal are present interests that qualify for the gift-tax annual exclusion under I.R.C. §2503(b).

[167] *See* Zaritsky & Leimberg *supra* note 165.

exemption is allocated (on a timely filed Form 709 United States Gift (and Generation-Skipping Transfer Tax Return), only to the cash transferred to the trust to pay the premiums.[168] The insurance proceeds typically exceed the total premiums by a substantial amount. As a result, the life insurance trust offers an opportunity to "leverage" the use of the GST exemption.

(b) The Transfer of a Preexisting Policy.

Whether the insured is expected to die within three years is a critical consideration when planning for an insurance trust. Where a preexisting policy is transferred to a trust, if the insured does not survive for three years following the date of the transfer, the proceeds generally will be subject to tax in the insured's estate.[169] However, if the trustee purchases the insurance from its inception, the proceeds will be excludable from the insured's estate, without the application of the three-year rule applicable to transferred policies, provided that the insured did not retain any incidents of ownership that would cause inclusion of the trust property in his or her estate.

4. <u>Using Partnerships and LLCs With Life Insurance.</u>

Partnerships and LLCs can be useful for domestic partners who desire to transfer life insurance policies between themselves. Where an existing life insurance policy is transferred for valuable consideration, the transfer for value rule provides that proceeds received at the insured's death are exempt from income tax, but only to the extent of the sum of the consideration paid and the premiums subsequently paid by the purchaser of the policy.[170] The transfer for value rule does not apply, however, where the transfer is to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder. Thus, a life insurance policy may be transferred, with or without consideration, to a partnership, without causing the life insurance proceeds to lose their tax-free character.

The IRS concluded in PLR 9309021 (March 5, 1993) that a partnership could be created solely for the purpose of owning insurance. The anti-abuse rules (Treas. Reg. §1.701-2), however, are intended to eliminate the use of a partnership when the principal purpose of the partnership is to reduce substantially the partners' aggregate federal tax liability in a manner that is inconsistent with Subchapter K of the Code. In order to avoid running afoul of the anti-abuse rules, it is a good idea to use an entity that has some other purpose besides owning insurance.

5. <u>Private Split Dollar Life Insurance Arrangements.</u>

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[168] Alternatively, allocation of GST exemption may be made on a late filed return, in which case GST exemption would be allocated in an amount equal to the actual value of the insurance purchased, as of the first day of the month of filing the late return, which in most cases is less than the amount of cash contributed to purchase that insurance. Treas. Reg. §26.2642-2(a)(2). *See* Kathryn G. Henkel, *Estate Planning and Wealth Preservation: Strategies and Solutions* at §5.05(2)(a) (1997). However, a late allocation cannot be made if the insured individual dies before the actual date of filing the return. *Id.*

[169] I.R.C. §2035(a)(2).

[170] I.R.C. §101(a)(2). *See* Lawrence Brody & Stephan R. Leimberg, *Avoiding the Tax Trap of the Transfer for Value Rule*, 32 Estate Planning 3 (October 2005) and Lawrence Brody & Stephan R. Leimberg, *Using a Transactional Analysis to Avoid the Transfer for Value Rule*, 32 Estate Planning 3 (Nov. 2005) for a through analysis of the transfer for value rule.

Split dollar is a method used to finance life insurance premiums where the owner of the policy and a third party agree to split the responsibility for paying premiums and the right to receive the policy proceeds.[171] Split dollar is most commonly used in the employment context, where the employer provides the money for most or all of the premiums, but the employee's beneficiary gets most of the death benefit. In exchange for paying the premiums, the employer retains the right to a portion of the prematurity cash value, or the death benefit, equal to the premiums paid by the employer. Thus, the employer ultimately gets all of its money back.

Split dollar insurance may be used in non-employment situations as well, in which case it is referred to as "private split dollar." A common structure for this arrangement between unmarried couples is for the wealthier partner to make annual exclusion gifts to an ILIT owning a policy on his life. The less wealthy partner is named beneficiary of the trust, but has no control over the incidents of ownership in the policy. The trustee of the ILIT uses the amounts gifted to the trust to pay a portion of the premium equal to the economic benefit to the beneficiary (the value of the pure life insurance protection). The wealthier partner will pay the remainder of the premium directly. In exchange for the direct premium payments, the Trustee agrees to repay the premiums out of the policy proceeds or cash surrender value. Each year, the amount paid directly by the wealthier partner is treated as a loan to the trust. If interest is paid at or above the AFR, the imputed interest rules of I.R.C. §7872 would not apply. If the interest is at a below-market rate, the annual forgone interest will be treated as an additional gift to the trust. Alternatively, the arrangement could be treated as an economic benefit, in which case the economic buildup in the policy would be taxed annually.[172]

As a result of the final split dollar regulations released jointly by the Treasury and the IRS on September 17, 2003,[173] it is recommended that the arrangement be treated as a series of loans, where interest is paid or accrued at the applicable federal rate, and not as an economic benefit arrangement, to avoid taxation on the equity buildup in the policy.[174] When an ILIT is structured as a grantor trust and the payments are treated as a series of loans, the grantor would typically make a gift to the trust equal to the loan interest or, but the interest payments from the trust back to the grantor/insured would not be treated as income to the grantor.

Unlike in the employment situation, it has been suggested that the policy should not be assigned as collateral. This prevents the entire insurance proceeds from being included in the insured's estate under I.R.C. §2042(2), because of a retained incident of ownership in the policy. Instead, the trust would retain all rights and interests with respect to the term insurance component of the

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[171] For a complete explanation of the income, estate and gift tax consequences of split dollar arrangements, *see* Donald O. Jansen, *Taxation of Split Dollar Life Insurance Arrangements under the Final Regulations*, 29 ACTEC Journal 285 (Spring 2004), Charles Ratner, *The Post-Split Dollar World*, 142 Trusts & Estates 18 (December 2003), and Charles L. Ratner & Stephan R. Leimberg, *A Planner's Guide to Split-Dollar After the Final Regulations*, 31 Estate Planning 3 (January 2004).

[172] *See also* PLR 200747011 for a discussion of private split dollar arrangements between individuals and a revocable trust.

[173] TD 9092, 2003-46 I.R.B. 1055 (codified at Treas. Regs. §§1.61-22(j)(1)(ii), 1.83-6(a)(5)(iii)(A), 1.301-1(q)(4)(i) & 1.7872-15(n)).

[174] Ratner, *The Post-Split Dollar World supra* note 171, at 20.

policy. But, there is a significant risk that without a collateral assignment, the plan might not qualify as a split dollar arrangement. Treasury Regulation §1.61-22(b)(1) requires that the payor of the premiums must be able to recover those premiums from, or have them secured by, the proceeds of the life insurance policy.[175] Alternatively, it may be possible to provide a collateral assignment limited to the right of repayment to the insured in the event of surrender of the policy or death of the insured.[176]

Private split dollar arrangements may prove useful where a wealthier partner would like to finance the purchase of a life insurance policy by the less wealthy partner, but retain a right to those premium payments. However, the best practices under the new regulations are yet to be determined.

6. Viatical Settlement.

A viatical settlement is the sale or assignment of a life insurance contract to a third party.[177] The third party then becomes the beneficiary under the policy and assumes the premium payments. Similarly, the receipt of accelerated death benefits has allowed terminally ill persons to receive a portion of their life insurance benefits prior to death. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA")[178] addressed the income tax consequences of viatical settlements and accelerated death benefits.[179] Prior to the enactment of HIPAA, sale proceeds and accelerated death benefits generated taxable income to the insured. Furthermore, I.R.C. §2035 applied to such transfers, which provides that if a life insurance policy is transferred by gift by the insured within three years of death, the policy proceeds will be included in the transferor's gross estate.

HIPAA enacted I.R.C. §101(g), which excludes certain death benefits and payments from the insured's gross income. To qualify for this exclusion, the insured must be either "terminally

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[175] Donald O. Jansen, *Split Dollar Has Split – So How Do We Finance Premiums Now?*, 38 Inst. on Est. Plan ¶1300 (2004).

[176] *Id.*

[177] *See* Damien Rios, *An Introduction to the Use of Viatical and Life Settlements*, 31 Estate Planning 533 (Nov. 2004) for a thorough examination of this topic.

[178] Pub.L. No. 104-191, 110 Stat. 1936, 2067.

[179] *See* Bernard Eizen & Victor S. Levy, *New and Expanded Uses of Viatical Settlements in Insurance Planning*, 26 Estate Planning 475 (Dec. 1999).

ill"[180] or "chronically ill"[181] and the sale or assignment must be to a "qualified viatical settlement provider."[182]

Additional rules limit the amounts that may be received tax-free in any year under a viatical settlement arrangement. Amounts in excess of the prescribed limits are subject to capital gains treatment.

The purpose of the HIPAA legislation was to allow the proceeds of a viatical settlement or an accelerated death benefit to be spent on medical expenses or to maintain the insured's standard of living. However, viatical settlements can be used by healthy individuals as well to obtain cash, which can be gifted or spent. If the proceeds do not fall within the scope of I.R.C. §101(g)(2), amounts realized will be included in gross income to the extent of gain from the transaction, under I.R.C. §1001(a).[183] Not all states permit the sale of policies by individuals who are not terminally ill.

If a client anticipates taking advantage of viatical settlement or accelerated death benefits, it is important that he or she retain all of the incidents of ownership in the insurance policy to preserve these planning options.

F. Estate Freezes and Planning Under Chapter 14.

Unmarried couples are able to take advantage of planning opportunities available under Chapter 14 of the Code that are unavailable to married couples.

1. Purpose of Chapter 14.

Chapter 14 deals with transfers among traditional family members, and addresses perceived abuses in certain transactions, known as "freeze" transactions, used to pass property from one generation to the next at a reduced transfer tax cost.[184] This type of transaction essentially involved a gift by a member of the older generation to members of the younger generation to "freeze" the gift at its gift tax value. Any post-gift appreciation was removed from the donor's gross estate and shifted to the donee. Techniques, such as retaining an interest in or imposing

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[180] An individual who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death within 24 months. I.R.C. §101(g)(4)(A).

[181] An individual who is determined by a licensed health practitioner as (i) being unable to perform, without substantial assistance, at least 2 activities of daily living for at least 90 days due to a loss of functional capacity; (ii) having a similar level of disability as defined in regulations; or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. I.R.C. §101(g)(2)(B)(iii).

[182] A qualified viatical settlement provider is defined as a person, meeting certain licensing and disclosure requirements, regularly engaged in the business of purchasing or taking assignments of life insurance contracts on the lives on insured individuals who are terminally ill or chronically ill. I.R.C. §101(g)(2)(B).

[183] *See* Andrew H. Hook & Thomas D. Begley, Jr., *Lawyering for Older Clients: A New Paradigm – Part 1*, 32 Estate Planning 48, 54 (April 2005) for a discussion regarding calculation of gain in this context.

[184] Chapter 14 was added to the Code as part of the Omnibus Budget Reconciliation Act of 1990, Pub.L. No. 101-508, §11602, 104 Stat. 1388, §1388-491, as amended by the Small Business Job Protection Act of 1996, Pub.L. No. 104-188, §1702f, 110 Stat. 1755, §1870, generally effective for transactions after October 8, 1990.

restrictions on the property, were used to maximize the value of the retained interest or restrictions and as a result, minimize the value of the gift. The purpose of Chapter 14 is to ensure that the value assigned to a retained interest or restriction for gift tax purposes comports with the economic reality of the transaction.[185]

Because unmarried partners are not considered family members within the definition of Chapter 14, certain techniques that are limited or no longer available to married partners under Chapter 14 remain available to unmarried couples, such as common law grantor retained interest trusts (GRITs), split-interest purchases, and traditional preferred and common interest freeze transactions.

2. <u>Section 2701 – Transfers of Interests in Corporations and Partnerships.</u>

(a) Types of Transactions Affected by Section 2701.

Section 2701 of the Code imposes gift tax on certain transfers of an interest in a corporation or partnership.[186] Section 2701 is triggered when: (i) the transferor makes a transfer to, or for the benefit of, "a member of the transferor's family,"[187] and (ii) "an applicable family member"[188] retains an interest immediately after the transfer.

(b) Valuation of Interests Subject to Section 2701.

The value of the gift subject to I.R.C. §2701 is equal to the transferor's entire interest before the gift, less the value of the rights and interests retained by the transferor. Unless the retained rights meet certain requirements or are otherwise excluded from the statute, the value of the retained rights will be considered zero and the value of the gift will be equal to the value of the entire interest prior to the transfer.

(c) Transfers Outside of Section 2701.

Transfers between unmarried partners or transfers by one partner to the child of the other partner are not considered transfers between family members under I.R.C. §2701 and thus the special valuation rules should not apply with respect to valuing the interests retained by the donor and transferred to the donee. Instead, normal valuation techniques and rules are used, without taking into account the requirements of Chapter 14. Thus, the partner with greater wealth can transfer assets to a partnership, retain a noncumulative preferred return and a preference upon liquidation,

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[185] *See* Adena W. Testa, 835-2nd Tax Mgmt. (BNA) *Chapter 14* (1999) for a thorough discussion of Chapter 14.

[186] I.R.C. §2701(a)(1)(B).

[187] A member of the transferor's family is defined as the transferor's spouse, lineal descendants of the transferor or the transferor's spouse, and the spouse of any such lineal descendant. I.R.C. §2701(e)(1); Treas. Reg. §25.2701-1(d)(i). Stepchildren are included as members of the transferor's family because they are descendants of the transferor's spouse.

[188] An applicable family member includes the transferor's spouse, an ancestor of the transferor or the transferor's spouse, and the spouse of any such ancestor. I.R.C. §2701(e)(2); Treas. Reg. §25.2701-1(d)(ii). Thus, I.R.C. §2701 applies to a transfer when certain interests are retained by the transferor (or the transferor's spouse) or by persons who are senior to the transferor.

and transfer to his partner, or partner's child, a junior equity interest that carries with it the right to all future appreciation.

Presumably, the gift of the junior equity interest will be small at first, and thus it will have little value for gift tax purposes. All appreciation will accrue to the junior equity interest as the value of the entity increases, and if the rights associated with the preferred interest are not exercised, the shift of wealth is magnified even more.

3. Section 2702 – Transfers in Trust.

(a) Types of Transactions Affected by Section 2702.

I.R.C. §2702 addresses the valuation of transfers in trust where the transferor (or an applicable family member)[189] retains an interest in the trust. Suppose an individual creates a trust for the benefit of his or her family member, with the remainder to his or her children. Unless the interest in trust is a qualified interest, it will be valued under I.R.C. §2702 at zero.[190] In most cases, this means that the entire value of property transferred to the trust would be treated as a taxable gift, even though the value of the gift to the remainder beneficiaries may actually be less (using traditional valuation rules applicable to arm's length transaction that would apply Treasury valuation tables).

If the gift in trust is instead a "qualified interest," it will be valued under I.R.C. §7520 and subtracted from the value of the entire property to determine the value of the property gifted.[191]

(b) Permissible Transfers Under Section 2702.

A qualified interest includes the right to receive an annuity payment from a grantor retained annuity trust (GRAT),[192] the right to receive a unitrust payment from a grantor retained unitrust

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[189] An applicable family member is defined as: (i) an individual's spouse; (ii) any ancestor or lineal descendant of the individual or the individual's spouse; (iii) any sibling of the individual; or, (iv) any spouse of any individual described in the prior categories. I.R.C. §2702(e) (referencing I.R.C. §2704(c)(2)).

[190] I.R.C. §2702(a)(2).

[191] I.R.C. §2702(a)(2)(A).

[192] A GRAT is typically created by transferring (ideally) high-yield assets into an irrevocable trust, while retaining the right to a qualified annuity interest for a specified term. At the termination of which the trust property passes to remainder beneficiaries. The amount of the taxable gift is reduced by the value of the grantor's annuity interest. The value of the retained interest is determined, generally, under IRS actuarial tables which value the interest based on the value of the property transferred, the term of the trust, the size of the annuity, and the I.R.C. §7520 rate in effect in the month of transfer. And, if the trust investments outperform the I.R.C. §7520 rate used to value the gift, the excess inures to the benefit of the remaindermen and will not be subject to transfer tax. If the grantor dies during the retained term, the trust property is included in the grantor's gross estate. If the grantor survives the retained term the trust property, along with any appreciation, passes without further estate or gift tax. *See* T. Randolph Harris, *GRIT's, GRAT's & Grantor Trusts: Be Graciously Greedy While the Grass is Green, Before it Gradually Grows Grisly & Grim*, 29 Inst. on Est. Plan. §901 (2000).

(GRUT),[193] and the right to remain in a residence held in a qualified personal residence trust (QPRT).[194]

Unrelated parties are not subject to the valuation provisions of I.R.C. §2702. Thus, it is not necessary to use a GRAT, a GRUT, or a QPRT. Instead, unrelated parties are still able to use split-interest purchases, establish common law grantor retained interest trusts (GRITs), and some of the restrictions applicable to related parties with respect to QPRTs do not apply.

(1) Grantor Retained Interest Trusts.

A grantor retained interest trust ("GRIT") is an irrevocable trust, in which the grantor retains an income interest for a term of years, and at the end of the term, the trust estate is paid to a named individual or individuals, provided that the grantor is then living.[195]

GRITs were very popular prior to the enactment of Chapter 14. But Chapter 14 eliminated their use if the remainder beneficiary was a "family member." Because an unmarried partner does not fall within the definition of family member as defined in I.R.C. §2702(e), a GRIT can be an excellent way to allow a wealthier partner to provide an income stream during the retained trust term and allow the principal to pass at a reduced transfer tax value at the expiration of the term.

The grantor of a GRIT places property in an irrevocable trust and retains the right to income for a specified term. Ideally, highly appreciating property will be used to fund the trust and the income generated will far exceed the projections for gift tax purposes. At the end of the term, the property may remain in trust or be distributed outright for designated beneficiaries (typically the grantor's partner or the partner's children). If the grantor survives the term, then the property is excluded from the grantor's gross estate. If the grantor dies before the end of the term, the corpus would be includable in the grantor's estate.[196]

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[193] With a GRUT the grantor transfers income-producing assets into an irrevocable trust. The grantor retains the right to receive payments equal to a percentage of the value of the assets, revalued annually. A GRUT is also a qualified interest under I.R.C. §2702(b), but has little estate planning utility, so it will not be discussed here.

[194] The QPRT is a type of irrevocable trust that is used to transfer an interest in a residence at a discounted value at the end of a defined term. Treas. Reg. §25.2702-5. The trust lasts for a term of years (no more than 20), during which time the grantor can retain ownership of the house. At the end of the term the house would pass to the remainderman (presumably, the grantor's partner), shifting any appreciation during the trust term to the remainderman. If properly structured, the value of the gift to the remainderman escapes the valuation provisions of I.R.C. §2702, and instead the gift is valued under valuation rules applicable to third-party transactions. The tax advantages of a QPRT depend on the grantor surviving the trust term. If the grantor does not survive the trust term, the entire value of the trust's interest in the residence at the grantor's death will be included in the grantor's estate for estate tax purposes. Therefore, the estate and gift tax advantages will be lost, but the effect will usually be the same as if the QPRT had not been established. When the grantor establishes the QPRT there is an immediate taxable gift of the remainder interest in the residence, the value of which is less than the value of the residence, because the value of the grantor's right to use the residence for the trust term is subtracted from the fair market value of the residence. The longer the trust term, the lower the value of the reportable gift to the remaindermen.

[195] *See* Mark W. Smith, *Reconsider the GRIT*, 144 Trusts & Estates 24 (Dec. 2005)

[196] I.R.C. §2036(a).

The benefit of the GRIT is that the fair market value of the property transferred is reduced by the value of the grantor's retained interest in determining the gift tax value of the transfer.[197] The value of the retained income interest, like the value of a GRAT's annuity interest, is based on the value of the property transferred, the length of the retained term, the grantor's age (if the grantor retains a contingent reversionary interest), and the I.R.C. §7520 rate in effect in the month of the transfer. Any appreciation in the trust property is transferred to the remainder beneficiaries, provided the grantor survives the trust term.

(2) Split-Interest Purchases.

A split-interest purchase involves the division of the total purchase price: One person contributes an amount equal to his or her life interest value or an interest for a term of years, while the other person contributes an amount equal to the value of the remainder interest following the termination of the term interest. If the joint purchasers are applicable family members for purposes of I.R.C. §2702, the person acquiring the term interest is treated as acquiring the entire property and then transferring the remainder interest to the other purchaser, and the retained interest (generally a life estate) is valued at zero unless the retained interest constitutes a qualified interest.[198] By investing primarily in growth assets, a grantor can use a GRIT to leverage the amount eventually passing to the remainder beneficiary or beneficiaries.[199]

If the joint purchasers are not applicable family members, the valuation rules of I.R.C. §2702 do not apply to the transaction. Again, all appreciation in the purchase is shifted to the survivor at the end of the term of years.[200]

(3) Qualified Personal Residence Trusts.

If one partner establishes a qualified personal residence trust ("QPRT") for the benefit of an unrelated party, they are not subject to the sale prohibitions otherwise applicable to QPRTs.[201] Thus, the opportunity for a sale between a grantor and a trust holding the grantor's personal residence remains available. The grantor may purchase the residence from the trust just prior to the expiration of the grantor's retained term so that cash or other assets pass to the remaindermen in place of the residence. Because this is a transaction between a grantor and his or her wholly owned grantor trust, no gain or loss is recognized by the grantor.[202] Moreover, if the grantor

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[197] Treas. Reg. §25.2512-5(d)(2).

[198] I.R.C. §2702(c)(2).

[199] Mark W. Smith, *supra* note 195, at 26.

[200] *See* Robert S. Schwartz, *IRS Approves Split-Purchase Qualified Personal Residence Trust*, 13 Probate & Property 54, 55 (March/April 1999) for an analysis of this topic.

[201] *See* Jeremy T. Ware, *Using QPRTs to Maximum Advantage for Wealthy Clients*, 32 Estate Planning 34 (Nov. 2005) for a general discussion concerning QPRTs. For trusts created after May 16, 1996, Treas. Reg. §25.2702-5(c)(9) requires a QPRT's governing instrument to prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse, at any time during the original retained term and at any time after the original term interest during which the trust is a grantor trust.

[202] I.R.C. §671 and Treas. Reg. §1.671-2(b). *See also*, Rev. Rul. 85-13, 1985-1 C.B. 184.

owns the residence at death, the grantor's estate, and the ultimate beneficiary, will receive the benefit of a step-up in basis under I.R.C. §1014 to the date-of-death value of the residence.

It is also important to note that it is not entirely clear whether unrelated parties may establish QPRTs with cotenancy interests in a residence. The issue arises because: (i) the property must have its primary use as the grantor's residence, (ii) the grantor must have the exclusive right of occupancy, and (iii) the property may not be used other than as a residence when the grantor is not there.[203] Shared occupancy is permissible, so long as it is at the sufferance of the grantor. There are no rulings concerning QPRTs established by cotenants that are not also spouses.[204] Therefore, the regulations suggest that the exclusive right of occupancy requirement precludes the establishment of QPRTs with cotenancy interests if the cotenants/donors are not also spouses.[205]

Where a cotenant with a non-spouse wishes to establish a QPRT, one approach to accomplish the exclusive occupancy requirement is to have that cotenant lease the property from the other co-tenants during the QPRT term.[206]

4. Section 2703 – Valuation of Restrictive Agreements.

(a) Types of Transactions Affected by Section 2703.

Section 2703 of the Code applies to buy-sell agreements and other options and restrictions on the right to acquire or use property. IRC §2703 provides that certain restrictive agreements will not be considered in valuing corporate or partnership interests for estate and gift tax purposes.

Unlike the other sections of Chapter 14, I.R.C. §2703 applies to all restrictive arrangements, regardless of the identity of the parties. An arrangement covered by I.R.C. §2703 may be contained in a partnership agreement, articles of incorporation, bylaws, or a shareholder agreement.[207] A right or restriction "implicit in the capital structure of the entity" may also trigger the application of I.R.C. §2703.[208] Section 2703 treats the lapse of certain rights, such as voting and liquidation rights, as a gift by, or includible in the gross estate of, the owner of the lapsed right.

The definition of "family member" under I.R.C. §2703 is considerably broader than under the other Chapter 14 sections. A "family member" includes family members as defined in Treas.

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[203] Treas. Reg. §25.2702-5(b)(2)(iii).

[204] Natalie B. Choate, *The QPRT Manual: The Estate Planner's Guide to Qualified Personal Residence Trusts* ¶2.3.02 (2004).

[205] John A. Hartog, *QPRTs for Co-Tenancy Interests – Do they Work?*, 6 California Trusts and Estates Quarterly 4 (Fall 2000).

[206] Natalie B. Choate, *The QPRT Manual, supra* note 204 at ¶2.3.02.

[207] Treas. Reg. §25.2703-1(a)(3). *See* Edward A. Renn & N. Todd Angkatavanich, *Sabotaged: Don't Let a Buy-Sell Agreement Blow Up an Estate Plan*, 145 Trusts & Estates 52 (April 2006) for an analysis of buy-sell agreements in the estate planning context.

[208] *Id.*

Reg. §25.2702-1(a)(1): The transferor's spouse; lineal descendants of the transferor or the transferor's spouse; and the spouse of any such lineal descendant. Thus, nieces, nephews, stepchildren, and siblings-in-law are included in this definition. A "family member" may also be "any other individual who is a natural object of the transferor's bounty."[209]

The regulations do not define "natural objects of the transferor's bounty."[210] Accordingly, it is not clear whether domestic partners may escape the application of I.R.C. §2703, or whether the Service will attempt to use this language to extend this section's coverage.

(b) Valuation Under Section 2703.

Generally, a right, option or agreement which restricts the sale or use of property is disregarded for valuation purposes, unless: (i) it is a bona fide business arrangement; (ii) it is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (iii) its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.[211] If an agreement meets all three tests, then the IRS will consider the agreement in determining value. Furthermore, if unrelated individuals own more than 50% of the interests in the business, the tests are deemed to be satisfied.[212]

Failure to meet all three of the tests may subject the arrangement to I.R.C. §2703(a). Thus, even non-family members may need to show that a business arrangement was the result of an arm's-length negotiation for full and adequate consideration.[213] But, the IRS generally presumes that a person's own self-interest will prevent that person from entering into agreements to transfer property to non-family members for less than full and fair value.

A right or restriction is considered to meet each of the three tests if more than 50% by value of the property subject to the right or restriction is owned directly or indirectly by individuals who are not members of the transferor's family.[214] Thus, the issue as to whether the transferee is a family member will most likely be determinative of whether the restriction will be respected for valuation purposes.

An agreement meeting all three tests may be used to freeze the value of preferred interests, pay out income to the preferred partner/member and deflect future growth to the other class of interests, typically the poorer partner, and/or that partner's children, in this context.

5. <u>Section 2704 – Lapsing Rights and Restrictions.</u>

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[209] Treas. Reg. §25.2703-1(b)(3).

[210] *See* Richard M. Horwood, *et al.*, 813-2nd Tax Mgmt. (BNA), *Estate Planning for the Unmarried Adult* at A-24 (2003) for a discussion of the meaning of this phrase.

[211] I.R.C. §2703(a) & (b).

[212] Treas. Reg. §25.2703-1(b)(3).

[213] Treas. Reg. §25.2703-1(b)(2).

[214] Treas. Reg. §25.2703-1(b)(3).

I.R.C. §2704 treats the lapse of certain rights as a taxable transfer. Between family members, if a lapse occurs at death, the value of the right -- in addition to the individual's interest in the corporation or partnership -- is included in the individual's estate. I.R.C. §2704 also disregards for gift tax purposes "applicable restrictions"[215] on the ability of an entity to liquidate if family members possess the power to remove the applicable restriction.[216]

In certain family-controlled LLCs and partnerships, valuation discounts obtained through restrictions on liquidation may be disregarded for purposes of valuing the transferred interest under I.R.C. §2704(b). Under that provision, if there is a transfer of an interest in a partnership/LLC among family members, and the transferor and members of the transferor's family control the partnership/LLC, then restrictions on the transferor's liquidation rights that are more restrictive than the state law default provision will be disregarded, resulting in a higher transfer tax value.

The restrictions under I.R.C. §2704 should not apply to lapsing rights and restrictions between non-family members.[217]

For example, a restriction on a member's ability to withdraw from an LLC, which lapses upon the death of a certain member, would be ignored for valuation purposes if the LLC were among family members. Similarly, a lapsing right to liquidate the entity, to receive a guaranteed liquidation value, and/or to receive a preferred return, would also be ignored if applied to family members. However, those restrictions will be recognized for purposes of applying discounts when valuing an unrelated partner's interest in the entity for estate tax purposes.

Unmarried partners should be able to take advantage of substantial discounting opportunities through the use of partnerships, LLCs, and other entities with restrictive provisions, allowing interests in these entities to be transferred between partners at death or during their lifetimes at a reduced transfer tax cost.

G. Miscellaneous Strategies To Transfer Wealth Between Partners

Many other transactions prohibited between family members are permitted between unmarried partners. Each of these strategies can be used to transfer wealth to the less wealthy partner.

1. <u>Sale to Recognize Loss.</u>

The disallowance of losses on sale or exchange of property to another family member under I.R.C. §267 does not apply. Thus partners may sell stock to each other to recognize losses so

[215] An applicable restriction is one that limits the ability of an entity to liquidate if: (i) the restriction lapses, in whole or in part, after a transfer of an interest to or for the benefit of the transferor's family; or (ii) after the transfer, the transferor or any member of the transferor's family has the right to remove the restriction. I.R.C. §2704(b)(2); Treas. Reg. §25.2704-2(b).

[216] I.R.C. §2704(b)(1).

[217] I.R.C. §2704(c)(2) defines the term "member of the family" with respect to any individual as: (i) the individual's spouse; (ii) any ancestor or lineal descendant of the individual or the individual's spouse; (iii) any sibling of the individual; and (iv) any spouse of any individual described in the prior categories.

long as there is adequate consideration. As a result, the purchase price becomes the transferee's basis.

2. Use of Professional Service Corporations.

One partner may own a professional services corporation that the other partner provides services for. This avoids the high tax rate professional service corporations are subject to when the services are provided by an owner.

3. Installment Sales.

To create a stream of income for the wealthier partner and transfer assets to the less wealthy partner, one partner may sell rental property to the other in return for a promissory note under I.R.C. §453. This has the effect of transferring income from one partner to the other, while preserving a stream of income to the former owner of the rental property in the form of interest income on a note, which may be recognized over time.

4. Private Annuities.

Another way to create a stream of income for the wealthier partner and transfer assets to the less wealthy one is to have one partner sell property to the other exchange for a private annuity. A private annuity is a contract that provides for specified payments to the named annuitant during the annuitant's lifetime.[218] This is similar to the installment note arrangement, but under a private annuity, the payments never cease so long as the annuitant is alive, even if the annuitant outlives his or her life expectancy. The disadvantage of the private annuity is that, unlike promissory notes used with installment sales, private annuities cannot be secured, putting the annuitant at risk that the buyer may default. Furthermore, under proposed regulations, gain or loss must be recognized at the time of the exchange rather than deferred. The regulations are intended to apply to any property exchanges entered into on or after October 18, 2006, with a delayed effective date of April 18, 2007, for transactions involving an unsecured sale to an individual of property not subsequently disposed of by the individual within two years.[219]

5. Stock Redemptions.

I.R.C. §302(a) provides that a redemption of stock "shall be treated as a distribution in part or full payment in exchange for the stock," if any of the exceptions set forth in I.R.C. §§302(b)(1)-(4) apply. The exceptions apply if the redemption is not essentially equivalent to a dividend (with no reduction for basis), and the redemption proceeds will therefore be taxed as ordinary income, rather than capital gain.[220]

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[218] *See* Edward P. Wojnaroski, 805-2nd Tax Mgmt. (BNA), *Private Annuities and Self-Canceling Installments Notes* (2002).

[219] Prop. Reg. §1.72-6 (Oct. 17, 2006).

[220] I.R.C. §302(b)(1).

Typically, a complete redemption of a shareholder's interest in a company will fall under the exception of I.R.C. §302(b)(3), and result in the proceeds of the redemption being subject to capital gain treatment. Where a member of a family group is redeemed, and other members of the group of related parties owns stock in the company, the attribution of stock ownership rules under I.R.C. §318 prevent the exiting shareholder from falling under the exception of I.R.C. §302(b)(1) (because the redeemed shareholder's stock will continue to be attributed back to the exiting shareholder).

But, where unrelated partners own a closely held business together, the attribution of stock ownership rules do not apply. Thus, the ability to accomplish a substantially disproportionate redemption of stock or a complete liquidation of a shareholder's interest under I.R.C. §302(b) may be available. As a result, the value of the stock redeemed may be treated as capital gain, rather than a dividend.

6. Retirement Benefits.

Most pension plans cease payments at the death of an unmarried employee. However, some plans may provide for a "term certain" form of benefit payout, which allows a set amount to be paid out to the employee, and if not then living, named beneficiaries, over a predetermined number of years. This election is typically less favorable as one for an employee and a surviving spouse. But, it can provide some benefit to an unmarried surviving partner where no other benefits would be available if the employee partner were to die earlier than expected.

VII. Charitable Planning.

When unmarried partners share the same intent with respect to their charitable giving (although conceivably even when they do not), a number of planning opportunities exist. Because they are unable to take advantage of the marital deduction, unmarried couples often perceive that there is less available to give to charity. Some of the vehicles described below may actually allow one partner to transfer more wealth to a partner than he or she would be able to transfer otherwise. Most of the vehicles discussed below also have the benefit of avoiding probate, which often reduces the likelihood of challenges from family members or other individuals who may be hostile to the surviving partner.[221]

A. Charitable Remainder Trusts.

Even though most readers of this article will likely have some familiarity with charitable remainder trusts ("CRTs"), the rules applicable to CRTs can be extremely technical and complex.[222] In general, however, a CRT is an irrevocable trust that makes payments – at least

[221] Chris Yates, *The Unmarried Penalty: Gift, Estate Tax, and Other Considerations for Unmarrieds*, Gift Planner's Digest (Sept. 26, 2000).

[222] *See* Robert J. Rosepink, *Charitable Remainder Trusts and Pooled Income Funds*, 865 Tax Mgmt. Portfolio (2000) and Sanford J. Schlesinger & Martin R. Goodman, *Back to Basics: A Primer for Charitable Remainder Trusts*, 32 Estate Planning 9 (March 2005) for a thorough discussion of this topic. Another useful planning tool, but one beyond the scope of this article is the nonqualified CRT. *See* J. Michael Pusey, *What if the Estate Tax is*

annually – to one or more beneficiaries, at least one of which is not a charitable entity, for a term of not more than 20 years, or for the life or lives of the individual beneficiaries. It is also possible, to a certain extent, to define the trust term with respect to both a term of years and one or more lives.[223] When the non-charitable interest or interests terminate, the remainder interest passes to one or more qualified charitable organizations.[224]

A CRT may be structured as either a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT").[225] A CRAT pays the noncharitable beneficiary a fixed dollar amount that is specified in the trust agreement and that is neither less than 5% nor more than 50% of the initial value of the trust's assets. Thus, the payout from a CRAT does not vary from year to year. A CRUT pays a fixed percentage (no less than 5% and no more than 50%[226]) of the value of the trust property as valued annually, meaning distributions can fluctuate based on the increase or decrease in value of the trust. Because the distributions from a CRAT cannot increase over time, it is less frequently used than is a CRUT.

A CRT is exempt from income tax unless it has unrelated business taxable income.[227] If a CRT has any unrelated business taxable income in a year, all of its income that year will be subject to income tax.[228] If no unrelated business taxable income is generated, tax is paid by each annuity or unitrust beneficiary as distributions are received, according to the four-tier system set forth in I.R.C. §664(b). As a result, the trustee may receive appreciated assets and then liquidate them and reinvest the proceeds, without immediate capital gain tax consequences.

In the year of funding, the grantor of an *inter vivos* CRT may claim an income tax charitable deduction for the present value of the remainder interest that will pass to charity, subject to certain restrictions.[229] One of those restrictions is that, to qualify as a charitable remainder trust, the actuarial value of the remainder eventually passing to charity must be at least 10% of the value of the trust estate at the date the trust is funded.[230] A CRT may have multiple beneficiaries, either concurrently or serially, although additional recipients reduce the likelihood

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Repealed? Part I, http://www.pgdc.com/usa/item/?itemID=73249 (June 24, 2003) and the footnotes thereunder for a discussion of this technique.

[223] I.R.C. §664(*d*).

[224] I.R.C. §§664(d)(1) & (2).

[225] *Id.* Rev. Proc. 2003-53 through 60 (August 4, 2003) contain 8 model CRAT agreements. Rev. Proc. 2005-52 through 59 (August 22, 2005) contain 8 model CRUT agreements. For comments and alternate provisions to consider, *see* Conrad Teitell, *A Closer Look at Those New Specimen CRUTs*, 145 Trusts & Estates 57 (January 2006); Richard L. Fox, *A Guide to the IRS Sample Charitable Remainder Trust Forms*, 33 Estate Planning 13 (January 2006); and J. Michael Pusey, *Exploring the New Model Charitable Remainder Annuity Trust Forms*, posted on the Planned Giving Design Center web site, http://www.pgdc.com/tsf/item/?itemID=91086 (Sept. 18, 2003).

[226] I.R.C. §664(*d*)(1)(A).

[227] I.R.C. §664(c). If a CRT has any unrelated business taxable income in a year, all of its income that year will be subject to income tax. *Id.* *See* Howard M. Zaritsky, *Avoiding UBTI in the Charitable Remainder Trust*, 30 Estate Planning 152 (March 2003).

[228] *Id.*

[229] I.R.C. §170(f)(2) and I.R.C. §2522(c)(2).

[230] I.R.C. §664(*d*)(1)(D) & I.R.C. §664(*d*)(2)(D).

that the trust will meet the 10% threshold. Similarly, a CRT is rarely available for use with very young beneficiaries (unless the trust term is limited to a period of years), because their longer life expectancies will also tend to cause the amount actuarially anticipated to pass to charity to fall below the 10% threshold.

A testamentary CRT can be a useful tool, especially in planning for large retirement accounts. Estate and income tax costs can be mitigated by leaving a retirement plan to a testamentary CRT rather than outright to a surviving partner. Using a CRT will allow the surviving partner to receive income from the retirement account, subject to income tax only upon receipt. The estate of the deceased partner will receive a charitable deduction for the present value what will eventually pass to charity.

An *inter vivos* CRT created by one partner for the benefit of other partner may give rise to gift tax consequences upon formation, because the marital deduction is not available. A gift on formation can be avoided by having the grantor create a CRT for the grantor's life, followed by the life of the partner, with a retained right to terminate the survivorship interest.[231] The result will be the same from a gift tax perspective, regardless of whether the testamentary right is exercised, although if the partner survives the grantor and if the grantor did not exercise the right, then the present value of the survivorship income interest will be included in the grantor's taxable estate.[232]

Some commentators have suggested that the retained right to terminate could be further limited to situations where the relationship has terminated.[233] Alternatively, instead of a reserved testamentary power to terminate the surviving partner's interests, for the security of the named surviving partner, the grantor partner may agree to make a completed gift but build into the trust a provision that if the relationship terminates, so does the surviving partner's interest. In any event, this kind of plan can lead to some insecurity on the part of the potential surviving beneficiary. On the other hand, it can create some security for the grantor, who may not necessarily feel comfortable with the otherwise irrevocable nature of the CRT.

Whether at death or during life, creation of a CRT may have gift or estate tax consequences because the marital deduction is not available.[234] However, the charitable deduction for the

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[231] Treas. Reg. §1.664-2(a)(4) & Treas. Reg. §1.664-3(a)(4).

[232] Treas. Reg. §25.2511-2(c).

[233] Jerry Simon Chasen & Elizabeth F. Schwartz, *Estate and Gift Tax Planning for Nontraditional Families*, 15 Probate & Property 6, 10 (Jan./Feb. 2001). In a similar situation involving a heterosexual divorce, the IRS ruled that a CRT containing a termination provision if the parties divorced, as well as a provision that one spouse could terminate the interest of the survivor by will, was permissible. PLR 9511029 (March 17, 1995). *See also* PLR 200430012 (July 23, 2004) in which the I.R.S. ruled that a contingency to terminate a CRAT upon the earlier of the surviving spouse's death or remarriage was a qualified contingency.

[234] In addition, if an inter vivos CRT is established by a donor for the benefit of his or her partner, and if the donor dies before the partner and has retained the right to change charitable beneficiaries, one commentator has asserted that under certain circumstances, the overall transfer tax cost might be higher than if the right to change charitable beneficiaries had not been retained by the donor. Alan F. Rothschild, Jr., *Designing and Documenting Charitable Gifts*, posted on the Planned Giving Design Center web site, http://www.pgdc.com/usa/item/?itemID=310036 (Nov. 9, 2005).

value of the remainder passing to charity will lessen the tax due as a result of conferring a benefit on the other partner.

CRTs with unrelated grantors should generally be avoided. The IRS determined, in PLR 9547004 (August 9, 1995) that a CRT established by a husband, wife, and 6 grandchildren qualified as an association, rather than a trust, under Treas. Reg. §301.7701-2(a)(1), and thus could not qualify as a CRT. Whether the IRS would rule similarly if a CRT were formed solely by an unmarried couple using only jointly owned property has not been tested. Even though the cautious approach would be to form separate trusts, it could be that public policy considerations would cause the IRS to rule differently than in PLR 9547004.

B. Charitable Lead Trusts.

A charitable lead trust ("CLT") could be used to provide a stream of income to one or more charities for a term of years or for the life or lives of one or more individuals, and thereafter provide support for a partner.[233] At the end of the charitable lead term, the trust terminates and the trust estate can be paid to the partner, as well as to children. Like a CRT, a CLT may be structured to pay a unitrust amount or an annuity, although the payment, as a percentage of the initial value of trust assets (annuity trust) or of the value of trust assets as it may change from year to year (unitrust) can be less than 5% or more than 50%. In addition, if the trust is to last for a term of years, the period may be longer than 20 years. Finally, whereas CRTs are tax-exempt entities when administered properly, CLTs are taxable trusts.

If structured as a grantor trust (usually as a result of the donor reserving a reversionary interest, in which case nothing is distributed to a partner or to children when the trust ends), the grantor would receive an income tax deduction in the year the trust is funded, for the present value of the payments made to charity. No gift tax is due because a gift tax charitable deduction applies to the present value of the payments to charity, with the balance reverting to the donor and therefore not being treated as a gift. During the term of the grantor CLT, the donor is taxed on the income but does not receive a further charitable contribution deduction for the payments to charity.

More typically, however, *inter vivos* CLTs are structured as non-grantor trusts, in which case the grantor receives at the time of transfer a gift tax charitable deduction for the present value of the payments to charity during the trust term. This means he or she is treated as having made a taxable gift equal to the present value of the noncharitable remainder interest. Nevertheless, the trust, not the grantor, will be taxed on the income passing to charity during the term of the trust. Interestingly, if the trust lasts long enough or has a high enough payout rate, the amount subject to gift tax can be reduced to zero.

Care should be devoted to determining which scenario makes sense for a particular client, based, in part, on whether he or she would benefit from the immediate income tax charitable deduction

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[233] Rev. Proc. 2007-46, 2007-29 I.R.B. 102 (July 16, 2007) provides a ample testamentary charitable lead annuity trust for a term of years, with alternate provisions for basing the annuity on the life of an individual, leaving apportionment of the annuity amount in the trustee's discretion, defining the annuity as a specific dollar amount, and naming alternate charitable beneficiaries.

for the grantor CLT, or if the client would prefer a non-grantor CLT in order to pass wealth on to others and to avoid the annual income tax liability of the grantor CLT. Particularly if a non-grantor CLT is being contemplated, the client should give thought to funding it with assets that are likely to increase in value significantly, thereby leveraging the impact of the gift tax charitable deduction.[236]

It is important to take into consideration the rules regarding permissible measuring lives when a charitable lead trust is established for the life of one or more individuals.[237] Each remainder beneficiary must be a lineal descendant or spouse of a descendant of the individual lives used as measuring lives, which would include stepchildren and step-grandchildren. Thus, the measuring lives must be chosen carefully.

The testamentary CLT may be used as a substitute for a marital deduction type trust. In this situation, the gift to the remaindermen would be included in the donor's gross estate, subject to estate tax, but the gift to charity would qualify for the estate tax charitable deduction. The testamentary CLT is generally used when the children and/or the surviving partner do not need immediate access to the funds (perhaps because a charitable remainder trust has been established concurrently to provide a stream of income during the term of the CLT), as the non-charitable beneficiaries will not receive their interest until the CLT terminates at the end of the specified term. From a tax perspective, it is possible to transfer significant assets to the next generation while significantly reducing the estate tax liability.

Because the individual beneficiary of a non-grantor CLT or a testamentary CLT does not receive distributions until the term of the trust has expired, and then only if he or she survives the charitable term, this vehicle works best for younger individual beneficiaries, particularly children and grandchildren. Also, as with a CRT, establishing and operating a CLT involves complying with numerous requirements. Less attention is being devoted to such details here, however, because CLTs are far less common than CRTs, likely due to the relatively larger value of assets needed for a CLT to be applicable. Still, in the proper circumstances, a CLT can be quite relevant – sometimes, as mentioned above, in combination with a CRT.

C. Charitable Gift Annuities.

Couples may also consider using a charitable gift annuity ("CGA") to satisfy their charitable intentions while securing a stream of payments that benefit one or both members of the couple for life. A CGA is like a CRT in that the donor receives in the year the payments are arranged an income tax charitable deduction for part of the value of the assets contributed. Unlike a CRT, however, payments may be made to no more than two persons (whether consecutively or on a joint-and-survivor basis), and they may not be made for a term of years. In addition, a CGA is

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[236] Of course, when assets are distributed to the remainder beneficiaries, those assets retain the donor's cost basis, even if the donor has since died. In other words, there is no step-up in basis in connection with the donor's death, and a beneficiary could recognize substantial gain upon sale of an asset that had been in the trust.

[237] Treas. Reg. §1.170A-6(c)(2)(i) & (ii). There must be less than a 15% probability that persons who are not lineal descendants of the measuring individuals will receive any portion of the trust corpus.

fundamentally a contract entailing a transfer of assets directly to a single charity. By contrast, a CRT is indeed a trust arrangement and can potentially benefit many charities.

Thus, a CGA involves a gift to a specific charity, in exchange for the charity's promise to pay an annuity. The annuity could be for the life or lives of *any* two persons, although typically it would be for the life of the donor, the life of the partner, or both lives.

An unmarried couple's use of a CGA presents potential disadvantages. For example, if appreciated property is used to fund the annuity, the taxable gain, calculated under the bargain sale rules, must be fully recognized by the donor in the year the annuity is created (unless the donor is the sole or initial annuitant, in which case the gain may be prorated over the donor's life expectancy calculated as of the time payments begin).[238]

In addition, as with the charitable remainder trust, there is no marital deduction available for an arrangement between unmarried partners, so if the annuity is created by one member of the couple and payable to the other, there are very likely to be gift tax consequences upon formation. Fortunately, if the present value of the payments made to the donor's partner is less than the gift tax annual exclusion amount, then depending on the value of any other gifts the donor may make to the partner in the year the annuity is established, it is possible that the present value of the annuity will be absorbed by the annual exclusion.

Likewise, even if the present value of the annuity causes the total of taxable gifts to the partner to exceed the annual exclusion amount, the donor still may not have to pay any gift tax, provided some or all of the donor's lifetime gift tax applicable exclusion amount remains unused. Of course, if the annuity is paid first to the donor and then to the partner, or if the partner is an annuitant of a deferred payment gift annuity, then the gift tax annual exclusion – which applies only to gifts of present interests – will not be available to offset any portion of the present value of the payments. Therefore, in certain cases, the donor might do well to retain in the gift annuity contract a right to revoke the partner's annuity interest, either on a testamentary basis or during the lifetime of the donor.[239]

In lieu of establishing a CGA during life to benefit a partner, a donor could do so through his or her will.[240] Alternatively, the donor could arrange now for a CGA to be funded upon death with a distribution from his or her IRA.[241] Finally, even though technically a CGA could be funded with assets owned jointly by both members of a couple,[242] the simpler and preferable approach would separate CGAs established by each of the partners with his or her own assets.

D. Pooled Income Funds.

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[238] Treas. Reg. §1.1011-2(a)(4).

[239] Frank Minton, Edith Matulka and J. William Zook, Jr. *Charitable Gift Annuities: The Complete Resource Manual* 2:11-22 (2003).

[240] *Id.* at 20:17-19 (April 22, 2002).

[241] *Id* at 16:17-20 and PLR 200230018 (.

[242] *Charitable Gift Annuities: The Complete Resource Manual*, *supra* note 239, at 2:14.

A pooled income fund ("PIF") is a taxable trust established and administered by a public charity.[243] A donor to a PIF irrevocably transfers assets (usually cash or publicly-traded securities other than municipal bonds) to a trustee. The assets of all donors who have contributed to the PIF are commingled and invested like a mutual fund. Donors to the fund receive units of participation in the fund based on the pro rata value of their contributions relative to the total value of the fund. Each year for life, a variable share of the total income from the fund is paid to the donor and/or other beneficiaries designated by the donor. The term of the non-charitable interest may not be for a period of years. It must be for the life of the beneficiary or beneficiaries.[244] It is important to keep in mind that qualified contingencies are not specifically authorized to be used to terminate a beneficiary's interest, nor are they prohibited.[245] At the death of the beneficiary or beneficiaries of the units associated with the donor's contribution, a proportionate share of the assets of the PIF is conveyed to the charity.

For an *inter vivos* transfer of assets to a PIF, a donor is entitled to both income and gift tax charitable deductions in the year of the gift, based on the present value of the remainder interest passing to charity.[246] Likewise, a testamentary contribution to a PIF results in an estate tax charitable deduction for the present value of the remainder interest. A donor does not generally recognize gain or loss on the transfer of property to a pooled income fund.[247] Instead, the fund takes on the basis and holding period of the assets transferred. However, where the gift is to someone other than the charity and the donor, he or she makes a taxable gift of the income interest (or the applicable portion thereof) that benefits the other person or persons.

A donor can postpone a taxable transfer to another individual recipient by retaining a testamentary right to revoke that interest, which causes the gift to be incomplete.[248] However, the donor should not retain a lifetime right to revoke.[249] If a power to revoke has not been retained, then the present value of the future income payments to be received by the non-spouse/non-donor recipient is considered a present interest gift.

A PIF can be an attractive charitable giving vehicle for a donor with certain highly appreciated assets because neither the donor nor the PIF is taxed on any of the gain, so long as the PIF

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[243] The technical requirements for a pooled income fund are set forth at I.R.C. §642(c)(5). *See* John H. Clymer, *Pooled Income Funds: A Good Vehicle for Smaller Charitable Gifts*, 24 Estate Planning 310 (Aug./Sept. 1997) and *Pooled Income Fund*, posted on the Planned Giving Design Center web site, http://www.pgdc.com/usa/item/?itemID=60848 (last viewed Jan. 15, 2008) for a comprehensive analysis of pooled income funds.

[244] Treas. Reg. §1.642(c)-5(b).

[245] There is no equivalent to the qualified contingency provision under I.R.C. §664(f) for charitable remainder trusts, applicable to pooled income funds.

[246] Inter vivos gifts are covered by I.R.C. §170(f)(2)(A) & I.R.C. §2522(c)(2), and testamentary gifts by I.R.C. §2055(e)(2).

[247] Treas. Reg. §1.642(c)-5(a)(3). There is an exception, however, for debt-encumbered property, the transfer of which is treated as a bargain sale. I.R.C. §1011(b).

[248] Treas. Reg. §1.642(c)-5(b)(2).

[249] *See* Mary C. Hester & Lizbeth A. Turner, *Retaining a Right to Revoke an Interest in a Charitable Plan*, 32 Estate Planning 26, 27 (June 2005) for a complete discussion of the tax consequences of a retained right to revoke.

always pays out all of its income. Nevertheless, the payments made by a PIF are fully taxable as ordinary income to whoever receives them, whereas the payments made by a CRT or a CGA are often taxed more favorably. Finally, relatively few charities maintain PIFs, and those PIFs that do exist often make payments at relatively modest rates (i.e., below 5%), so this technique will be an option only in a limited number of cases.

E. Gifts of Remainders Interests in Personal Residences.

A couple may benefit from giving a personal residence to a charity, subject to the reservation of a life estate. The home involved must be a personal residence, but need not be the primary residence.[250] Reasonable surrounding grounds, determined by the customary lot size in the area, may also be included in the charitable gift. The gift of the remainder interest could take effect at the end of one or two lives, or a term of years.[251]

While the gift itself is made by means of a simple deed, there should also be separate documentation regarding the rights and responsibilities of the charity and of the life tenant or tenants. Customarily, life tenants will be required to pay property taxes, utilities, liability and casualty insurance, maintenance expenses, and similar costs.

If the donor makes the gift during life, he or she receives income and gift tax charitable deductions for the present value of the charity's remainder interest. In addition, if the property is appreciated the donor does not recognize any capital gain. If the gift is made on a testamentary basis, the donor's estate is entitled to an estate tax charitable deduction for the present value of the charity's remainder interest.

This arrangement is most useful with a residence that is not subject to a mortgage and for couples that do not intend to pass the property on to further generations or heirs. If one partner makes the gift, it might be possible for the other partner to re-acquire the gifted property from the charity at a later date, as only the remainder interest will need to be purchased. Additional options exist if the life tenant -whether the donor or the partner – wants or needs to move out of the residence. He or she can rent the property to another tenant; contribute the remaining life interest to the charity (perhaps for a CGA) and receive a deduction for the present value of the remaining life interest; or agree with the charity to sell the property and divide the proceeds according to the respective interests of the parties.

F. Simple Wills.

Even though subject to probate, and therefore to challenge by disapproving family members, basic charitable bequests can make sense for unmarried couples with estates modest enough in size that they likely will not be subject to transfer taxes. Indeed, the so-called "I love you" will that is suitable for many married couples can also work well for people who are not married, provided they agree on the ultimate beneficiaries of their estates. Naturally, if there are children

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[250] A farm is defined as land that is used for the production of agricultural products, including crops or timber. Treas. Reg. §1.170A-7(b)(4).

[251] Treas. Reg. §1.170A-7(b).

or other descendants to be considered, one partner's will may need to differ from the other's. Yet in many cases, an "all to my partner if she survives me but otherwise all to charity" disposition will be practical.

G. Disclaimer Planning.

For a couple with excess assets and charitable intent, qualified disclaimers can be used to further that intent. A qualified disclaimer allows the disclaimed interest to be treated for federal tax purposes as if it had never been transferred to the individual disclaiming, thus avoiding gift or estate tax.[252] A disclaimer must be completed within nine months of the interest being created and it must be in writing. As a result of the disclaimer, the property must pass to an individual or organization other than the disclaimant without any direction by the disclaimant (exceptions apply with respect to disclaimers resulting in property passing to a spouse).[253]

In the unmarried couple context a will may provide that any assets disclaimed by a surviving partner are to pass to a particular charity. As a result, the asset will be treated as if it passed directly from the decedent to charity, and be eligible for an estate tax charitable deduction equal to the value of the property disclaimed. Nevertheless, because a disclaimed interest may not result in the disclaimed property passing to or for the benefit of the disclaimant, a disclaimer to a charitable vehicle where the disclaimant will have a life income interest, such as a CRT or CGA, will not be qualified, and therefore ineligible for an estate tax deduction.

VIII. PLANNING FOR PERSONAL NEEDS

Because unmarried partners do not have the benefit of a family relationship, it is important that they name agents to make financial and health care decisions while they are alive, and for burial decisions at death.[254]

A. Durable Powers of Attorney and Guardianship.

The durable power of attorney grants another person (the "attorney-in-fact" or "agent") the authority to act on the principal's behalf during the principal's life, including any periods of incapacity. Generally, the principal executing the durable power of attorney would designate his partner as primary attorney-in-fact and one or more alternate attorneys-in-fact if the partner is unable or unwilling to serve. The primary advantage of this document is that it avoids the need for expensive, cumbersome guardianship proceedings in the event of disability. As with

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[252] I.R.C. §2046 & §2518.

[253] Treas. Reg. §25.2518-2(e)(1)(ii).

[254] For a thorough discussion of this topic, *see* Horwood, *supra* note 210, at A-43. *See also* Matthew R. Dubois, *Legal Planning for Gay, Lesbian and Non-Traditional Elders*, 63 Alb. L.Rev. 263 (1999) for a discussion of the unique issues faced by the elderly in non-traditional relationships, as well as an analysis of estate planning issues for the indigent client in a non-traditional relationship, including Medicaid and other entitlement programs. *See* Diane Lourdes Dick, *The Impact of Medicaid Estate Recovery on Nontraditional Families*, 15 U.Fla. J.L. & Pub. Pol'y 525 (Summer 2004) for an analysis of the effect of Medicaid estate recovery (the federally mandated recovery of assets from estates of individuals who received Medicaid long-terms care assistance) on unmarried couples.

testamentary documents, clients should be aware that a durable power of attorney designation is not revoked by the termination of a relationship.

In Washington, certain powers must be specifically stated in the power of attorney in order for the attorney-in-fact to be authorized to perform such acts.[255] The powers that may be especially important for the unmarried couple, include the power:

1. To execute, amend or revoke any trust agreement;
2. To fund, with the principal's assets, any trust not created by the principal;
3. To make a gift from the principal;
4. To create or change survivorship interests in the principal's property or in property in which the principal may have interest;
5. To designate or change the designation of beneficiaries to receive any property, benefit or contract right on the principal's death;
6. To give consent to an autopsy or postmortem examination;
7. To make a gift of the principal's body parts under the Uniform Anatomical Gift Act;
8. To give consent to, or prohibit, any type of health care, medical care, treatment or procedure; or
9. To direct the withholding or withdrawal of artificially supplied nutrition or hydration.

A durable power of attorney may be used to nominate a guardian and alternates, in the event the appointment of one is necessary.[256] In the absence of a power of attorney (or in the absence of a durable power of attorney nominating a guardian, if one is necessary), the court may appoint any person it finds suitable as guardian, which may not be the person the principal may have considered most suitable while still competent.[257]

A "springing" durable power of attorney (one that takes effect upon the disability or incompetence of the principal) may be problematic as a result of the HIPAA regulations concerning the confidentiality and disclosure of health care information.[258] A typical springing durable power of attorney requires an opinion of a health care professional as to disability or incompetence to be effective. However, HIPAA may prevent a physician from disclosing

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[255] *See* RCW ch. 11.94 (Washington's power of attorney statute).

[256] RCW 11.88.010(4).

[257] RCW 11.88.020.

[258] 45 C.F.R. §§164.500-.534.

medical information without the authorization of the patient, who would not be able to give a valid authorization if already incompetent. To avoid this Catch-22, a durable power of attorney could be effective immediately, or the principal could either execute a separate HIPAA authorization or the durable power of attorney should contain a HIPAA authorization to allow a physician to disclose protected health information for purposes of the springing power to be effective.[259] RCW 70.02.030 sets forth the requirements for a valid authorization to disclose the health care information of the principal.

B. Medical Powers of Attorney.

The medical power of attorney may be a separate document. It appoints an agent to make decisions regarding medical care and treatment on behalf of the principal (or these powers may be included in the durable power of attorney). The same agent may be named in both documents; however, it is not necessary to do so. A medical power of attorney should specifically grant a partner visitation rights and the power to control other visitors, in order to eliminate visitation by hostile family members.

In Washington, in the absence of a medical power of attorney, RCW 7.70.065 provides that the following individuals may give informed consent on behalf of an individual unable to consent, which includes (i) the patient's spouse or registered domestic partner; (ii) children of the patient who are at least eighteen years of age; (iii) parents of the patient; and (iv) adult brothers and sisters of the patient. It provides no authority to the unmarried partner.[260]

C. Health Care Directives.

The health care directive, also known as a "living will," is a statutory document authorizing the withdrawal or withholding of life-sustaining procedures for a terminal condition if death is imminent.[261] It may include provisions regarding the withdrawal or withholding of hydration and intravenous nutrition.[262] In the absence of a directive, the wishes of the principal may not be able to be carried out.

D. Mental Health Advance Directives.

Washington authorizes the use of a mental health advance directive. The rules regarding content, operation and form of the directive are found in RCW ch. 71.32. The purpose of the directive is to allow a mentally ill person to express his or her wishes with respect to mental health treatment.[263] A validly executed mental health advance directive is binding on agents, guardians, and other surrogate decision makers, health care providers, other professionals and health care

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[259] *Id.*

[260] *See* Rebecca K. Glatzer, *Equality at the End: Amending State Surrogacy Statutes to Honor Same-Sex Couples, End-of-Life Decisions*, 13 Elder L.J. 255 (2005) for an examination of the many statutory approaches to surrogate decision making for same-sex and unmarried couples.

[261] RCW ch. 70.122.

[262] RCW 70.122.030(1).

[263] RCW 71.32.010.

facilities.[264] As with a durable power of attorney, execution of a mental health advance directive, it may be possible to avoid the necessity of a court appointed surrogate decision maker, who may not have been the individual the principal would have named under the directive.

E. Physician Orders for Life-Sustaining Treatment ("POLST").

The Physician Orders for Life-Sustaining Treatment ("POLST") form is a document developed by Washington health care professionals as a standardized method to summarize a patient's wishes regarding life-sustaining treatment.[1] The form is intended to be portable and must be on file with a particular physician in order for it to be followed. The form allows an individual to express his or her wishes with respect to resuscitation, various types of medical interventions, antibiotics and artificial nutrition. This form must be completed with the assistance of an attending physician and both the patient and the preparer must sign it. The form is printed on a bright green card stock to make it visible in a patient's file.

F. Burial, Cremation and Funeral Instructions, and Organ Donation.

Making arrangements for funerals, disposition of remains, and burial or cremation is critical for unmarried couples. Washington law provides that "[a] valid written document expressing the decedent's wishes regarding the place or method of disposition of his or her remains, signed by the decedent in the presence of a witness, is sufficient legal authorization for the procedures to be accomplished."[265] In the absence of enforceable, written instructions, state law creates a hierarchy of persons who have the authority to make these decisions, and the unmarried partner of a decedent is not found in that hierarchy. In the absence of instructions, the following individuals are authorized to make arrangements: (i) the surviving spouse; (ii) the surviving adult children of the decedent; (iii) the surviving parents of the decedent; (iv) the surviving siblings of the decedent; (v) a person acting as a representative of the decedent under the signed authorization of the decedent.[266] However, the statute does provide that prepaid arrangements are not subject to cancellation or substantial revision by survivors.

Instructions regarding disposition of remains may be in a will or in a separate document. If the instructions in a will comply with the requirements for instructions regarding the disposition of remains, they are considered valid, regardless of the will's validity. Nevertheless, instructions separate from a will are usually preferable, because of the increased likelihood that the instructions will be found prior to any alternate arrangements being made. Clients should also tell their partner or other trusted friend where to find the instructions.

The instructions should set forth the client's intentions with respect to funeral and burial arrangements, disposition of remains including disposition of anatomical parts, and any arrangements already made and paid for.

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[264] *Id.*

[265] RCW 68.50.160(1).

[266] RCW 68.50.160(3).

If an individual wishes to donate organs upon death, the best way to evidence that wish is through a Uniform Donor wallet card. The Washington Department of Licensing provides the opportunity for residents to register their intent to donate organs on the back of the their driver's license.

IX. STRATEGIES TO MINIMIZE CONFLICT

The practitioner and the testator should understand the grounds for contesting a will, such as improper execution, incompetence of the testator, duress, undue influence, and fraud. Family members, especially those unhappy or surprised about learning that a loved one was gay or lesbian, or unwilling to accept that a relationship existed between partners who never married, may challenge a will, alleging fraud, duress, undue influence, or mental incapacity of the decedent. The possibility of disgruntled family members disputing an estate plan is far greater with unmarried couples.[267]

To deter will contests, practitioners use a number of strategies discussed below:[268]

A. *In Terrorem* Clauses.

In terrorem clauses are only useful if a potential contestant is actually in danger of losing something.[269] Unless a client is willing to give a potential contestant a gift, such a clause may only create a false sense of security.[270] If a client insists on including an *in terrorem* clause, and they are willing to make a gift to the person or persons they are concerned about, below is a sample clause to consider:

> If any beneficiary contests the probate or validity of this Will or any provision herein, or institutes or join in (except as a party defendant) any proceeding to contest the validity of this Will, or to prevent any provision from being carried out in accordance with its terms (regardless whether such proceedings are instituted in good faith and with probable cause), then all benefits provided for such beneficiary are revoked. Each benefit conferred herein is made on the condition precedent that the beneficiary accepts and agrees to all of the provisions of this Will.

B. Include a Statement That the Omission of a Family Member Is Intentional.

It is generally not recommended to make statements in a will as to why certain individuals have not been provided for. Such statements may incite an individual to contest a plan where, in the

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[267] Kathleen Ford Bay, *Estate Planning for Unmarried Couples: What's Different and What's the Same?*, 2004 American College of Trust and Estate Counsel Annual Meeting at 3.

[268] For additional drafting recommendations to avoid conflict over an estate plan, *see* Bruce Stone and Bruce S. Ross, *Bombproofing the Estate Plan to Anticipate and Avoid Litigation*, 2001 American College of Trust and Estate Counsel Annual Meeting at 4.

[269] Bay, *supra* note 267, at 7.

[270] *Id.*

absence of such a statement, that person might not have.[271] Worse, it might be grounds for a testamentary libel claim.[272] Alternatively, a client might consider making positive statements about why the client has chosen to benefit his or her partner over others.[273] For example:

> I am aware that I may disappoint certain members of my immediate family by omitting them from my will, and some may believe that they have been omitted due to undue influence by a beneficiary of my estate. However, that is not the case. My estate plan is a product of careful consideration and reflection, with the advice of my attorney, who prepared the dispositive documents at my direction. I request that the members of my family honor and respect my wishes and allow my plan to be carried out. To that end, it is my wish that the validity of my estate planning documents not be challenged on any grounds, including but not limited to, fraud, duress, mistake, lack of capacity, or undue influence.

C. Videotaping of Document Execution

Videotaping should only be used with extreme caution. "Many people do not come across well on videotape and if you rehearse the ceremony on film, the other side will undoubtedly want to see the entire video, not just the polished product."[274] Similarly, tape recording should be avoided. In *Discipline of Miller*,[275] the drafting attorney recorded the signing ceremony in a failed attempt to demonstrate his client's testamentary intent. At the drafting attorney's malpractice trial, the Court relied on the tape recording as evidence that the testator did not understand the scope of the gift that she made (to the drafting attorney in violation of Washington's RPC 1.8(c)).

D. Obtain Evidence of the Client's Capacity at the Time of Execution.

It is also strongly recommended that the attorney extensively interview the client, in the presence of the witnesses, regarding his or her intent, his or her assets, and the objects of his or her bounty.[276] The attorney should keep detailed notes of this meeting, signed and dated by the witnesses.[277] Witnesses should be articulate, and likely to make a good impression if asked to testify.[278] The attorney may also obtain a statement from the client's physician as to the client's capacity. Some attorneys videotape the execution. However, as discussed above, this might well be used as evidence supporting a lack of competency.

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[271] *Id.* at 8.

[272] *Id.*

[273] *Id.*

[274] *Id.* at 9, *citing* Gerry W. Beyer, *Videotaping the Will Execution Ceremony – Preventing Frustration of the Testator's Final Wishes*, 15 St. Mary's L.J. 1 (1983).

[275] 149 Wn. 2d 262, 269, 66 P.3d 1069 (2003).

[276] Elaine DuCharme, *Estate Planning for Non-Traditional Families*, 28 Real Property Probate and Trust Newsletter (Wash. St. Bar Assoc.) Summer 2000, at 1, 5.

[277] *Id.*

[278] Bay, *supra* note 267, at 6.

E. Periodic Re-Execution of Estate Planning Documents.

When competency is likely to be an issue, and even when it is not, it is recommended that the client re-sign the same estate planning documents periodically, without destroying prior versions, even if the content changes little from one version to the next, so that a contestant would need to set aside a series of documents rather than just one to bring a successful contest.[279] Repetition also provides evidence of a client's intent.

F. Maintain Standardized Procedures.

It is important to have standardized procedures for execution of any documents. If irregularities in the execution of a particular document are later alleged, the fact that all documents are executed according to the same procedure may be sufficient to overcome the allegation, even if the witnesses are unable to recall the details of the event. Execution of documents outside of the presence of the drafting attorney should be strongly discouraged. But when this is not possible, a standardized memorandum of instructions should be delivered to the client along with the documents to be signed. If possible, it is recommended that the attorney request that after the execution, the client sign and return the instructions to indicate that they were complied with. The signed instructions should be retained in the client file.

G. Confirm Intent With Respect to Nonprobate Transfers.

Unhappy family members may also challenge nonprobate transfers. Accordingly, attorneys may want to consider placing a statement in a will that any nonprobate transfers were intended by the decedent, and were not for mere convenience while the decedent was living.

X. CONCLUSION

Even in states where same-gender marriage and civil quasi-marital relationships are permitted, the DOMA makes it unclear how federal law will apply. As states are persuaded to adopt same-gender marriage or some form of quasi-marital relationship, it will be necessary to develop a new body of law to define the rights and responsibilities that come with it. In the mean time, the bias in favor of married couples that is inherent in the transfer tax laws means that unmarried couples will often bear a heavier estate and gift tax burden.

The estate plans of unmarried partners, and partners in marriages not legally recognized, needs special attention to insure that their objectives are met with a minimum of income, gift, and estate tax, as well as a minimum of conflict. Unmarried partners need to understand that no default legal structure exists in the absence of an estate plan, as there is for married couples. Their advisors need to understand the disparities in the law relative to unmarried couples, and need to be able to recommend steps, if any, to mitigate the lack of parity with married couples. Furthermore, family dynamics and hostile family members often play a large role in shaping the plan of an unmarried couple. It is critical to consider this when recommending a plan, and to take steps to reduce the risks.

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[279] *Id.*

EXHIBIT A

The Status of Same-Gender Marriage, Domestic Partnership and Civil Union Legislation in the U.S. and Abroad (last updated December 2007)

Jurisdictions Permitting Same-Gender Marriage:

1. Massachusetts

Jurisdictions Permitting Domestic Partnership:

1. California
2. Hawaii
4. New Jersey
5. Maine
6. New Hampshire
7. Oregon
8. Washington
9. Washington, D.C.

Foreign Jurisdictions Recognizing Same-Gender Marriage and/or Civil Union:

1. Andorra
2. Argentina (legal recognition of same-gender couples in some regions)
3. Aruba
4. Australia (legal recognition of same-gender couples in some regions)
5. Belgium (marriage)
6. Brazil (legal recognition of same-gender couples in some regions)
7. Canada (marriage)
8. Croatia
9. Czech Republic
10. Denmark (registered partnership)
11. Finland (registered partnership)
12. France (civil solidarity pact)
13. Germany (registered partnership)
14. Great Britain (civil partnership)
15. Greenland
16. Hungary
17. Iceland (registered partnership)
18. Israel
19. Luxembourg
20. Mexico (legal recognition of same-gender couples in some regions)
21. Namibia
22. The Netherlands (marriage and registered partnership)
23. Netherland Antilles
24. New Zealand
25. Norway (registered partnership)
26. Portugal
27. Slovenia
28. South Africa (marriage)
29. Spain (marriage)
30. Sweden (registered partnership)
31. Switzerland
32. United Kingdom (marriage)

EXHIBIT B

Bibliography of Internet Resources

1. LAMBDA Legal -- Gay Rights By State: http://www.lambdalegal.org/our-work/states/ (last visited Dec. 16, 2007)

2. Legal Marriage Court Cases – A Timeline. U.S. Constitutional cases from 1971 – Present: http://www.buddybuddy.com/t-line-1.html (Dec. 10, 2007)

3. Same-gender Marriage a Selective Bibliography of Legal Literature: http://law-library.rutgers.edu/resources/SSM.php (last updated Dec. 12, 2007)

4. Transgender Law & Policy Institute – Transgender Legal Resource Site: http://www.transgenderlaw.org/

5. Immigration Equality: An organization seeking equal application of U.S. Immigration laws and for those facing discrimination due to sexual orientation: http://www.immigrationequality.org/ (last visited Jan. 16, 2008)

6. ABA AIDS Coordination Project – a Committee of the ABA to Educate the Bench, Bar and Public about Legal Issues Concerning AIDS: http://www.abanet.org/AIDS/home.html (last visited Jan. 16, 2008)

7. Project Inform's AIDS Advocacy Resource List: http://www.projectinform.org/advo/resources.shtml/ (last visited Jan. 16, 2008)

8. Human Rights Campaign – A comprehensive web site dealing with a wide range of legal issues, including marriage, for the gay, lesbian and transgender community, and a section providing information concerning state adoption laws: http://www.hrc.org/ (last visited Jan. 16, 2008)

9. Legal Marriage Alliance of Washington -- Provides extensive information on the status of same-gender marriage by state and by country: http://www.lmaw.org (last visited Jan. 16, 2008)

10. Wikipedia contains entries on several topics including same-gender marriage, the history of legislation and the status of legislation worldwide: http://en.wikipedia.org/wiki/Same-sex_marriage (last viewed Jan. 16, 2007)

Philanthropy: Going the Magnificent Mile
28th Conference on Gift Annuities • April 2-4, 2008

Gift Acceptance Policies and Procedures

Presented by:

Philip M. Purcell
Vice President for Planned Giving & Endowment Stewardship
Ball State University Foundation
Muncie, IN

28th Conference on Gift Annuities
Friday, April 4, 2008

How to Draft and Implement Effective Gift AcceptancePolicies and Procedures

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Ball State University Foundation

I. Introduction.

A. Evolution of Gift Planning.

1. A gift planning policies and procedures manual must be a dynamic document, allowing for change over time.
2. Many factors can cause a policies or procedures manual to be amended over time, such as:
   a. New laws.
   b. New gift planning techniques deemed appropriate for a particular charity.
   c. Enhanced ability of a charity to consider new or different gift planning techniques.
   d. Changing donor demographics.

B. What are Policies and Procedures?

1. *Policies* may be defined as:
   a. Broad statements.
   b. Guides general course of action.
   c. Approved by governing Board.
2. *Procedures* may be defined as:
   a. Implements policies.
   b. Specific statements detailing action.
   c. Defines course of action or conduct.
   d. May be Board approved.
3. The policies/procedures manual should *not* be a legal treatise, though it may cite and reference specific laws.
4. The policies/procedures manual should *not* be a "cook book" detailing each administrative step by all staff. Rather, such procedural routing sheets are important and can be included in an appendix.

C. Why are Policies and Procedures Important?

1. Document philosophy or mission of program.
2. Informed approval of gift planning program.
3. Education of staff, Board, donors and other key internal and external constituents.
4. Clarify staff duties.
5. Legal compliance: Federal laws, state laws and other applicable rules and regulations.
6. Risk management. Limitation of liability.
7. Privacy pursuant to state public records acts for governmental units (public universities, libraries, etc.).
8. Compliance with applicable privacy laws (HIPPA, FERPA, etc.)
9. Coordination of all forms of giving: annual, major, planned.
10. Equitable treatment of donors with regard to recognition.
11. Uniform treatment of exceptions.
12. Use of National Committee on Planned Giving (NCPG) Valuation Standards. See at www.ncpg.org.
13. Use of NCPG, CASE or other campaign reporting standards. See at www.ncpg.org or www.case.org.
14. Implementation of FASB accounting standards.
15. Adherence to NCPG Model Standards of Practice and other applicable ethical standards. See www.ncpg.org for a printable version of the Model Standards. Other nonprofit organizations offer ethical standards such as Association of Fundraising Professionals, Independent Sector, Council on Foundations, CASE, Association of Healthcare Philanthropy and others. The Donor Bill of Rights is endorsed by several organizations and is available at www.case.org.

16. Prevent conflicts of interest.
17. Disclosure of laws, endowment policies and other essential matters to donors, Board and others.
18. Consistent explanation of tax benefits.
19. Endowment management: investment, spending and fee policies.
20. Efficient and effective gift management.
21. Enhances teamwork.
22. Documentation for historic record.
23. Dealing with restrictions.
24. Spectacular stewardship!
25. Allows for the graceful "no" to gifts that may be inappropriate.

II. Drafting Effective Gift Planning Policies and Procedures.

A. When Should Policies and Procedures be Prepared?

1. Inception of fundraising program.
2. Inception of planned giving or endowment giving program.
3. Preparation for capital campaign.
4. After a "problem gift" raises concerns.
5. Anytime! Once created: a "working" and dynamic document.

B. How Should Policies and Procedures be Prepared?

Consider a *personal* process, unique to your organization . . .

1. Who is Involved?

a. Development staff.
b. Business / Finance office.
c. Legal counsel.
d. Investment advisors.
e. Consultants.
f. Planned gift administrators.
g. Accountants.
h. Auditor.
i. Chief Executive Officer, Chief Financial Officer, Chief Development Officer.
j. Board Committee(s) and full Board of Directors/Trustees.
k. Donors.

2. What is a Successful Process?

a. Preparation:
   - Review samples from colleagues, peers, consultants or other resources.
   - Collect existing policies or procedures: minutes, legal counsel, business office, memos, letters.
   - Solicit input, ideas, complaints and other comments from internal and external constituents.
   - Prepare an initial outline or checklist - share with others for input and comment.

b. Consider Best Practices:
   - Proactive contact person.
   - Organized committees re: investment strategies, accounting issues, gift acceptance, etc.
   - Regular meetings of Development, Finance, Business, Investment and other offices.
   - Integrated structure for recognition, accounting, investment, administration, reporting and other functions.
   - Graphs, charts, software illustrations, gift acknowledgement letter with tax information, brochures and other high quality materials for donor education and stewardship.
   - Tough, but fair and consistent, gift negotiations.
   - Personal touch!

e. Possible successful process:
   - Gift planning staff prepares an initial draft.
   - Share with others for input, comments and revisions.
   - Edit and share revised versions.
   - Final draft for staff approval.
   - Share staff's final draft with appropriate Board committee(s) for review and possible revisions.
   - Final approval by governing Board.
   - Amend as appropriate to reflect best practices, new laws, new programs, changing donor demographics and other significant factors.

III. What to Include?

A. Policies to Consider.

1. Mission statement.
2. Encourage independent counsel for donors.
3. Authorization of staff who may negotiate on behalf of organization.
4. Procedure for final approval by authorized staff or Board.
5. Legal counsel approval of policies and procedures.
6. Ethical standards to be followed.
7. Campaign reporting standards to implement.
8. Donor recognition of planned gifts and integration with comprehensive recognition system.
9. Protection of donor confidentiality.
10. Honor all requests for anonymity
11. Avoid inappropriate conflicts of interest.
12. Financial accounting standards to be followed.
13. Authorization for gift annuities.
14. Local, state and federal law compliance in all respects.
15. Authorization for charity to serve as trustee, executor and/or other fiduciary capacities.
16. Requesting copies of legal documents from donors.
17. Allowance of exceptions pursuant to approved protocol.

B. Procedures to Consider: Types of Planned Gifts.

1. Charitable Gift Annuities.

a. Definition: Contractual obligation. Immediate and/or Deferred (commutation and/or optional beginning payment options).

b. American Council on Gift Annuities (ACGA) recommended rates. Be careful with negotiating exceptions! Some considerations:
   - Equity among donors.
   - Costs of asset (real estate especially) disposition (environmental review, title insurance, etc.) may justify a lower rate.
   - Giving decisions should be based on charitable mission, not rates of return!

c. State laws: certification, investment, reserves, fees, agreement language and other requirements. See website of ACGA for details: www.acga-web.org.

d. Minimum gift amount (initial and subsequent gifts).

e. Compliance with federal rules: Minimum charitable deduction of 10%.

f. Compliance with federal rules: Two beneficiaries per contract.

g. Minimum age.

h. Assets acceptable for gifts. Special considerations for marketability.

i. Disclosure pursuant to Philanthropy Protection Act. See www.acga-web.org.

j. Contract format approved by legal counsel.

k. Administration. In-house or outsource?
    - Payments. Encourage direct deposit.
    - Consider recommended payment schedule such as quarterly for ease of administration.
    - 1099-R to donors and IRS.

l. Stewardship.
    - Summary of accounting and tax information at time of gift with 8283 form, etc.
    - Recognition.
    - Confirmation of payments.
    - News from your charity.
    - Birthday cards.
    - Invitations to events.

2. Charitable Remainder Trusts.

a. Definition of types of charitable remainder trusts:
    a. Unitrusts (regular, net income, net income with make-up, flip provision) and annuity trust.
    b. Lifetime or term of years payments (not to exceed 20).
    c. *Inter vivos* or testamentary.

b. May charitable organization serve as trustee? Consider potential conflicts of interest, time, expense, expertise, and whether allowed under state law. Approval by Board.

c. Approval of trust document.

d. Authority to share IRS model templates with donor and his/her legal counsel.

e. Minimum gift amount (initial and/or subsequent additions if allowed). No additional payments for charitable remainder annuity trusts.

f. Compliance with federal laws: 10% minimum charitable deduction.

g. Compliance with federal laws: 5% minimum/50% maximum payout percentages. Fixed payment for charitable remainder annuity trusts.

h. Compliance with federal laws: 5% probability test for charitable remainder annuity trusts.

i. Minimum age for lifetime payments.

j. Assets acceptable for gifts. Special considerations:
    - Marketability considerations for payment of income
    - Unrelated Business Income Tax.
    - Avoid debt encumbered property.
    - Comply with Private Foundation Rules (e.g., prohibition on self-dealing). For example, donor or other disqualified persons cannot live in or use personal residence or real estate donated to a charitable remainder trust.
    - No pre-arranged sales.

k. Administration. In-house or outsource?
    - Payments. Encourage direct deposit.
    - Consider recommended payment schedule such as quarterly for ease of administration.
    - 1041/K-1 to donors and IRS. Tiered taxation system.
    - 5227 IRS information return.

l. Annual Investment Policy Statement.
    - Evidence of due diligence.
    - Executed by charity, donor and income beneficiaries.
    - Summarizes investment policy and current portfolio asset allocation with annual return.
    - Resource: Center for Fiduciary Studies: www.fi360.com

m. Stewardship.
    - Summary of accounting and tax information at time of gift with 8283 form, etc.
    - Recognition.
    - Confirmation of payments.
    - News from your charity.
    - Birthday cards.

- Invitations to events.

3. Charitable Lead Trusts.

a. Definition of types of charitable lead trusts:
   - Grantor (income tax charitable deduction) or non-grantor (gift tax paid now leveraging long-run gift/estate tax savings).
   - Unitrust or annuity trust.
   - *Inter vivos* or testamentary.
   - Lifetime or term of years payments (no maximum).

b. May charitable organization serve as trustee? Consider potential conflicts of interest, time, expense, expertise, and whether allowed under state law. Approval by Board.

c. Approval of trust document.

d. Authority to share templates with donor and his/her legal counsel.

e. Minimum gift amount (initial and/or subsequent additions if allowed)

f. Compliance with federal laws: no minimum or maximum payout percentages.

g. Compliance with federal laws: avoid retention of powers by donor that would disqualify trust:
   a. Power to revoke the trust.
   b. Power to divert trust income to non-charitable persons.
   c. Power to purchase or borrow trust assets for less than adequate price.
   d. Power to control investments.
   e. Power to pre-pay charitable interest.

h. Assets acceptable for gifts. Special considerations:
   - Marketability or ability of donated assets to generate income for payments to charity.
   - Private Foundation Rules (prohibitions on self-dealing, jeopardizing investments, excess business holdings, taxable expenditures).
   - No pre-arranged sales.

i. Administration. In-house or outsource?
   - Payments. Encourage direct deposit to charity. Donor can change purpose each year if agreed to.
   - Consider recommended payment schedule such as quarterly for ease of administration.
   - 5227 IRS information return. Taxable complex trust.
   - Payments qualify for charitable deduction for trust.

j. Annual Investment Policy Statement.
   - Evidence of due diligence.
   - Executed by charity, donor and income beneficiaries.
   - Summarizes investment policy and current portfolio asset allocation with annual return.
   - Resource: Center for Fiduciary Studies: www.fi360.com

k. Stewardship.
   - Summary of accounting and tax information at time of gift with 8283 form, etc.
   - Recognition.
   - Confirmation and thank you note for payments.
   - News from your charity.
   - Birthday cards.
   - Invitations to events.

4. Pooled Income Fund.

a. Definition of pooled income fund.

b. Charitable organization must serve as trustee.

c. Implement IRS model templates: governing trust document and individual donation agreements.

d. Minimum gift amount (initial and/or subsequent additions).

e. Minimum age of income beneficiaries.

f. Compliance with federal laws: Must use highest payout rate from past three years to calculate income tax charitable deduction.

g. Compliance with federal laws: All annual net income is paid on a per unit/pro rata basis.

h. Compliance with federal laws: Disclosure statement to prospective donors pursuant to Securities and Exchange Commission regulation.

i. Assets acceptable for gifts. Special considerations:
   - Marketability considerations for payment of income.
   - Depreciation reserve for real estate.
   - No tax-free asset investments or gifts.
   - Unrelated Business Income Tax.
   - Avoid debt encumbered property.
   - Comply with Private Foundation Rules (e.g., prohibition on self-dealing).
   - No pre-arranged sales.

i. Administration. In-house or outsource?
   - Payments. Encourage direct deposit.
   - Consider recommended payment schedule such as quarterly for ease of administration.
   - 1041/K-1 to donors and IRS.
   - 5227 IRS information return.

l. Annual Investment Policy Statement.
   - Evidence of due diligence.
   - Executed by charity, donor and income beneficiaries.
   - Summarizes investment policy and current portfolio asset allocation with annual return.
   - Consider separate pooled income funds with different investment strategies: long-term growth, current income orientation, etc.

m. Stewardship.
   - Summary of accounting and tax information at time of gift with 8283 form, etc.
   - Recognition.
   - Confirmation of payments.
   - News from your charity.
   - Birthday cards.
   - Invitations to events.

5. Life Insurance.

a. Definition. Charity may be beneficiary only or owner/beneficiary.
b. Compliance with state insurable interest laws.
c. IRS form 712(*Life Insurance Statement*) required for donor to claim charitable deduction of gift of existing policy.
d. Annual premium payments supported by gifts from donors. Charity assures payment of premium.
e. Annual due diligence review of all policies owned by charity to determine if policies should be kept in force, cashed in, viability of use of policy loans, etc.
f. Avoid potentially abusive life insurance products.
   - Avoid illegal charitable reverse split dollar.
   - Due diligence review of other proposals: premium financing, FOLI, CHOLI, group insured policies, annuity arbitrage, viatical or life settlements, etc.
   - See www.ncpg.org for life insurance valuation guidelines.
   - New reporting requirements for certain life insurance contracts are required by the Pension Protection Act of 2006. See www.ncpg.org.

6. Bequests.

a. Definition. Bequests in wills, trusts or payment on death (e.g., bank accounts, stock funds, etc.) should be a priority for any planned giving program.
b. Available sample bequest language with correct legal name and location of organization.
   - Sample format for unrestricted bequest: percentage, specific dollar amount, specific asset.
   - Sample format for a restricted purpose. Encourage consultation for approved purposes.

- Sample format for an endowment fund. Encourage creation of an endowment fund agreement to be incorporated into the bequest language by reference in order to assure compliance with organization's endowment policies.
- Sample formats approved by legal counsel.

c. Request copies of bequest language.
d. Will organization serve as executor? Consider potential conflicts of interest, time, expense, expertise, and whether allowed under state law. Approval by Board.
e. Consider procedures to be followed for open estates:
   - One contact person for executor/estate attorney.
   - Extend appreciation to surviving family and friends.
   - Copies of estate filings: inventory, pleadings, contests, etc.
   - Will organization need counsel to represent its interests during estate proceedings? May be necessary with size of estate, complexity of issues, jurisdiction (out-of-state), etc.
   - Resource: BIPSTER at www.bipster.com

7. Gift of Remainder Interest with Retained Life Estate.

a. Definition. Applies only to personal residences or farms.
b. Required due diligence as with any real estate gift. See discussion below for outright gifts of real estate. Define who has authority to negotiate and sign gift agreement.
c. Remainder Interest Agreement must be signed with donor to stipulate responsibility for essential terms of the shared property:
   - Property tax payment.
   - Insurance coverage.
   - Maintenance costs.
   - Approval of major improvements.
   - Conditions for leasing or other use.
   - Other.

d. If donor wishes to move or donate life estate, the charity may negotiate a subsequent agreement or gift.

8. Bargain Sale.

a. Definition. Purchase by charity for less than fair market value as determined by a qualified independent appraisal.
b. Due diligence as with an outright gift of the asset should be followed. See discussion below relative to outright gifts of real estate. Define who has authority to negotiate and sign gift agreement.
c. In certain cases, installment bargain sales may be considered whereby the purchase price is paid in installments at times and in amounts as negotiated.

9. Retirement Plan Beneficiary Designation.

a. Definition. Assets classified as "income in respect of a decedent" (IRD) are subject tom potential income and estate tax. IRD includes other assets such as U.S. Savings Bonds in addition to qualified retirement plans.
b. Priority for any planned giving program. Limited charitable IRA rollover allowed through 2007. Per the Pension Protection Act of 2006. See www.ncpg.org.
c. Donors must designate charity or testamentary charitable remainder trust, gift annuity, etc. as beneficiary on the beneficiary designation form provided by plan administrator.
d. Donors should include designation of gift with IRD assets in bequest language of will or trust as with a "savings clause".
e. Charity may request copies of bequest designations and retirement plan beneficiary forms to assure correct legal name, tax identification number, appropriate gift designation or restriction, etc.

10. Qualified Conservation Easement.

a. Perpetual restrictions the qualified use of land or structures. Strictly defined and regulated by federal and state law (e.g., Uniform Conservation Easement Act). Available income tax deduction, estate tax deduction and estate tax exclusion. See www.lta.org for helpful information from the Land Trust Alliance. Subject to enhanced tax deduction limits per the Pension Protection Act of 2006. Also façade easements are subject to new rules per the Act. See www.ncpg.org.

b. Only governmental units or charities with conservation missions are qualified to hold conservation easement interests. Assure staff expertise.
c. Due diligence as with an outright gift of the asset should be followed. See discussion below relative to outright gifts of real estate. Define who has authority to negotiate and sign gift conservation easement agreement.
d. Conservation easement agreement must be reviewed by legal counsel.
e. Perpetual interest may need renewal pursuant to applicable state Marketable Title Act.
f. Consider permanent endowment gift of cash, stock or other assets to provide perpetual funds for maintenance of the conservation easement interest.
g. Promote possible gift of entire real estate in fee outright or by testamentary plan (bequest, remainder interest with life estate, etc.) in which case the easement merges with the fee ownership interest.

11. Endowment and Fund Gifts.

a. Definition. Endowments are permanent pursuant to applicable state law (Uniform Management of Institutional Funds Act - UMIFA). "Funds" are wholly expendable at any time by the charity. Accounting standards (FASB) also define endowments and quasi-endowments (i.e., otherwise unrestricted gifts that are treated as endowments by action of the governing Board). For UMIFA state laws and current status see www.nccusl.org and for FASB statements see www.fasb.org.
b. Required endowment and fund agreement, templates approved by legal counsel, to be signed by donor and charity representative, including essential terms such as:
   - Name of the fund or endowment.
   - Preferences for use of the gift. Avoid legally binding criteria.
   - History or biographical information about the donor.
   - Outright and /or planned gifts to create the endowment or fund.
   - Definitions of unique terms.
   - Reference to use of an Investment Policy subject to annual Board approval.
   - Reference to use of a Spending Policy subject to annual Board approval.
   - Reference to use of a Fee Policy subject to annual Board approval.
   - Gift not in trust.
   - Amendment or variance power of the charity.
c. The charity's governing Board must annually review and approve key policies that should be disclosed to donors prior to their gifts:
   - Investment Policy, e.g.: asset allocations, benchmarks, due diligence oversight, etc.
   - Spending Policy, e.g.: percentage of annual or rolling average.
   - Fee Policy, e.g.: tiered percentages based on values of endowments or funds.
   - Amendment or variance power authority.
d. ***Donor Advised Funds and Supporting Organizations*** require special considerations:
   - If grants are to be paid to other charitable organizations, be certain that the host charity's mission and purpose as defined in the applicable state incorporation documents, bylaws and IRS determination letter permits such payments for other charitable missions.
   - Some charities require a minimum percentage to the host charity each year from the spendable amount.
   - In addition to annual spendable advised awards, determine use of residual upon the death of the final donor/advisor. Some charities require all the residual for the host charity.
   - Requirements or limitations for multi-generational advising.
   - Detailed procedures to determine qualified charitable uses of grant awards. For example:
     a. *Guidestar* to check 990 forms. See www.guidestar.com.
     b. IRS Publication 78 to check tax exempt status. See www.irs.gov.
     c. Applicable state records (e.g., filed with Secretary of State) for nonprofit incorporation status.
     d. Signed letters or agreements with recipient entities assuring qualified use.

e. Site visits, phone calls or other communication.

- No private inurement or benefit to the donors. For example, no pledge payments, payment for dinners, grants to private foundations, or other return benefit transactions.
- Prevent stock-piling of donor advised funds without current grant-making.
- Note: Donor advised funds and supporting organizations are under study by the Treasury Department, IRS and Congress pursuant to the Pension Protection Act of 2006. See www.ncpg.org.

B. Procedures to Consider: Assets for Gifts.

1. Real Estate.

a. Definition. Real property and that which is affixed to the property. Many types of real estate interests: fee simple, bargain sale, real estate investment trusts, family limited partnerships, LLC interests, remainder interests, easements, residences, farmland, commercial, vacant land, natural resource interests, etc. Outright gifts or planned gifts (gift annuity, charitable remainder trust, lead trust, etc.) may be considered if appropriate.

b. Procedure for acceptance is essential. Approved parties to negotiate and accept on a case-by-case basis. Board approval for each case may be required.

c. Due diligence protocol is required. Components of due diligence may include:

- Qualified and independent appraisal to be secured and paid for by donor to substantiate his/her claim of a charitable tax deduction. Encourage donors to consult IRS Publication 561, *Determining the Value of Donated Property*. The Pension Protection Act of 2006 includes reform of the penalties for failure to use accurate appraisals as well as definitions of qualified appraisers and appraisals. See www.ncpg.org.
- Title review and insurance to be secured from qualified attorneys and paid for by recipient charity to protect its title interest.
- Qualified environmental review by expert to be secured and paid for by recipient charity to protect against strict liability per CERCLA law. Phase 1, or higher (2 or 3) environmental audits contingent on discovered indicators of contamination.
- Assessment of marketability by qualified expert if real estate is intended to be sold for reinvestment. Resale may be essential if real estate is donated to a charitable remainder trust or for a gift annuity. Beware legally binding pre-arranged sales.
- Debts, liens, mortgages and other encumbrances or restrictions must be revealed and resolved. Possible resolution includes payment or removal by donor, debt shifted to other property, or perhaps payment or acceptance by charity if considered appropriate under the circumstances. Approval by required officers or the governing Board.
- Insurance coverage must be assured to protect against liability or loss.
- Zoning review to assure intended use or sale is possible.
- Note: Donors may be subject to unique rules when claiming tax benefits. For example:
    1. Real estate owned by a land developer may be deemed ordinary income property (inventory) and the tax deduction limited to cost basis rather than fair market value.
    2. Gift of the free use of property (not the property itself) is not a tax deductible gift since it is an improper partial interest gift. See IRS Publication 526, *Charitable Contributions* at www.irs.gov.

d. Real estate for planned gifts carry unique considerations. For example, mortgaged property is unacceptable for a charitable remainder trust. Slow to sell property is often unacceptable for a regular fixed percentage payment unitrust, annuity trust or gift annuity. A "flip" trust can be a good alternative.

e. Share IRS 8283 form and instructions with donors in order to claim a tax deduction for a non-cash gift. Charity must be careful not to fill out the form for the donor. Signature on a blank 8283 form is problematic if the donor claims an inflated tax benefit. Some charities require donors to complete the form before signature by the charity representative. If the real estate is sold within two years of gift, then the charity is required to file IRS form 8282. See www.irs.gov. Inform donor of subsequent sale value as courtesy.

2. Intangible Personal Property.

a. Definition. Value represented in ownership interest. Examples: publicly traded stock, closely held stock, S stock, stock options, mutual funds, bonds (corporate, government, U.S. Savings), intellectual property (patents, copyrights, royalties, trademarks), partnership or LLC interests, natural resources, etc. May be donated outright or with a planned giving technique if appropriate.

b. Procedure for acceptance is essential. Approved parties to negotiate and accept on a case-by-case basis with some exceptions such as publicly traded stock, bonds, etc. Board approval for most cases may be required with some exceptions such as publicly traded stock, bonds, etc.

c. Share IRS 8283 form and instructions with donors in order to claim a tax deduction for a non-cash gift. Charity must be careful not to fill out the form for the donor. Signature on a blank 8283 form is problematic if the donor claims an inflated tax benefit. Some charities require donors to complete the form before signature by the charity representative. If the property is sold within two years of gift, then the charity is required to file IRS form 8282 with some exceptions as with certain publicly traded stock. Inform donor of subsequent sale value as courtesy.

d. Note: Donors may be subject to unique tax rules depending on the type of intangible personal property being donated. A few examples:
   - Gifts of S stock are subject to new basis adjustment and other rules pursuant to the Pension Protection Act of 2006. See www.ncpg.org.
   - Gifts of U.S. Savings bonds (IRD assets) and stock options may incur immediate income tax liability to the owner/donor.
   - Intellectual property gifts are subject to relatively new tax deduction limits and rules as of January 1, 2005 per P.L. 2004-357.
   - Gifts of partnership interests such as family limited partnerships may be subject to enhanced IRS scrutiny on audit to assure proper valuation of the tax benefit for gifts to charity. See White Paper discussion at www.ncpg.org.

e. Due diligence protocol is required. Components of due diligence may include:
   - Qualified and independent appraisal to be secured and paid for by donor to substantiate his/her claim of a charitable tax deduction. Encourage donors to consult IRS Publication 561, *Determining the Value of Donated Property*. The Pension Protection Act of 2006 includes reform of the penalties for failure to use accurate appraisals as well as definitions of qualified appraisers and appraisals. See www.ncpg.org.
   - Assessment of marketability by qualified expert if property is intended to be sold for reinvestment.
   - Legal counsel review on behalf of the charity may be required in certain cases to assess potential debts, liabilities as well as to assure appropriate transfer in the name of the charity. Legal review may be essential for gifts of closely held stock, S stock, partnership or LLC interests, intellectual property and natural resources.
   - Delivery by the most efficient means possible, understanding that the tax benefit value is generally determined by the date of irrevocable receipt by charity. Options include:
     1. Hand delivery. Valuation is fixed on date of hand delivery.
     2. Mailing, if appropriate. Valuation is fixed by postmark rule, unless check or other instrument is dated later for purpose of negotiation of the gift instrument such as the date on a personal check. If a stock certificate or bond is mailed, it should be unsigned with a signed stock/bond power form mailed separately for purposes of security.
     3. Wire delivery for certain types of intangible property such as publicly traded stock. Depository Trust Company (DTC) procedure is possible with the use of qualified fiduciary agents for the charity, such as a bank or brokerage firm.
     4. Delivery may be effectuated by a signed deed or other legal instrument of transfer in some cases. Certain property transfers such as for stock options, S stock, intellectual property, partnership or LLC interests and closely held stock may require specific procedures or forms pursuant to legal counsel review and assistance on a case-by-case basis to comply with governing legal instruments for the gift entity in question.

3. Tangible Personal Property.

a. Definition. Value inherent in the tangible item but tax benefits are subject to unique and specific rules. Examples: Artwork, antiques, automobiles, boats, jewelry, coins, stamps, clothing, food, books, crops, animals, equipment, etc. May be donated outright or with a planned giving technique if appropriate.

b. Procedure for acceptance is essential. Approved parties to negotiate and accept on a case-by-case basis with exceptions for charities that accept tangible personal property on a regular basis. Board approval for some gifts may be required if the property is uniquely valuable (concern for insurance, special handling, etc.) or carries unique liabilities.

c. Share IRS 8283 form and instructions with donors in order to claim a tax deduction for a non-cash gift. Charity must be careful not to fill out the form for the donor. Signature on a blank 8283 form is problematic if the donor claims an inflated tax benefit. Some charities require donors to complete the form before signature by the charity representative. If the property is sold within two years of gift, then the charity is required to file IRS form 8282 with some exceptions as with certain tangible personal property that is used or consumed by the charity (e.g., food by a soup kitchen, medical equipment by healthcare mission, etc.). Inform donor of subsequent sale value as courtesy.

d. Note: Donors may be subject to unique tax rules depending on the type of tangible personal property being donated. A few examples:
   - If tangible personal property is used for the exempt mission of the charity, then a fair market value deduction is available. Otherwise, the deduction is limited to cost basis. Therefore, the charity may provide the donor with a letter evidencing the related use of the donated item for the donor's tax file in the event of an audit.
   - Artwork donated by the original artist (i.e., ordinary income inventory) is limited to a cost basis deduction.
   - Books and food inventory are subject to enhanced (above cost basis) deductions pursuant to the Pension Protection Act of 2006. New rules are also stated for valuation of taxidermy gifts, clothing or household items.
   - The Pension Protection Act of 2006 provides new rules for gifts of a partial or fractional interest in donated tangible personal property. For example, the charity must take complete ownership within ten years or by the date of death of the donor whichever occurs first. See www.ncpg.org.
   - Gifts of automobiles, boats and airplanes are subject to new tax deduction rules as of January 1, 2005 per P.L. 2004-357. In general, the deduction is limited to the sale price in cases where the gift is immediately sold. A fair market value or cost basis (whichever is less) deduction is available in cases where the property item is actually used by the charity.

e. Due diligence protocol is required. Components of due diligence may include:
   - Qualified and independent appraisal to be secured and paid for by donor to substantiate his/her claim of a charitable tax deduction. Encourage donors to consult IRS Publication 561, *Determining the Value of Donated Property*. The Pension Protection Act of 2006 includes reform of the penalties for failure to use accurate appraisals as well as definitions of qualified appraisers and appraisals. See www.ncpg.org.
   - Assessment of marketability by qualified expert if property is intended to be sold for reinvestment.
   - Insurance coverage must be assured to protect against liability or loss.
   - Legal counsel review on behalf of the charity may be required in certain cases to assess potential debts, liabilities as well as to assure appropriate transfer in the name of the charity.
   - Delivery by the most efficient means possible, understanding that the tax benefit value is generally determined by the date of irrevocable receipt by charity. Options include:
     1. Hand delivery. Valuation is fixed on date of hand delivery.
     2. Mailing or other secured delivery system, if appropriate. Valuation is fixed by U.S. postmark rule.
     3. Delivery may be accompanied by a signed deed of gift or other legal instrument of transfer in some cases. However, actual delivery of the property is required for the gift to be complete in most cases. Retained control or possession by the donor is suspect by the IRS upon audit.

C. **Procedures to Consider: Documentation.**

1. **Receipting (written acknowledgement and substantiation) protocol for outright and planned gifts.**
   a. Pledges may be documented by letter or other written form as required by auditors. FASB statements require display of pledge obligations. See www.fasb.org. Consider ultimate fulfillment of a pledge by a planned gift commitment should donor pass before lifetime payments are completed. This planned gift commitment should be stated in the original pledge letter and appropriate planned gift (will, trust, etc.).
   b. Outright cash and non-cash gifts must comply with rules as defined in Reg. Sec. 1.170A-1 and 13 and described in IRS Publication 1771. See www.irs.gov.
   c. Examples of specific receipting rules for outright gifts:
      - Required for any cash gift over $250. Required for any cash gift over $75 when a return benefit is provided to the donor.
      - A good faith estimate of the value of any return benefit above a *de minimis* amount (annually indexed for inflation) must be disclosed by the charity. Exceptions include member benefits and insubstantial religious benefits. If no benefit is received, then the receipt must affirmatively state that no goods or services were received in exchange for the gift.
      - The Pension Protection Act of 2006 imposes new requirements relative to a receipt, check or bank record including the name of donee, date of gift and amount of contribution (cash gifts). See www.ncpg.org.
      - Non-cash gifts do not need to state a value but the property must be described.
      - The receipt must be contemporaneous, i.e., received by the donor on or before the earlier of the filing of his/her tax return for the year of the gift or the due date of the return, including extensions.
      - For gifts of cars, boats and airplanes over $500 in value, see IRS Publications 4302 and 4303 for applicable receipting rules. See www.irs.gov.
   c. Irrevocable planned gifts may be acknowledged by a letter of appreciation accompanied by:
      - Summary of accounting and tax information.
      - Tax benefits review.
      - Tax reporting review (e.g., 1099, K-1, 5227).
      - Software illustration.
      - IRS 8283 form and instructions if appropriate.
      - Disclosures as appropriate: Philanthropy Protection Act requirements for gift annuities (financial viability) and charitable remainder trusts (if investments are co-mingled with endowment); applicable AFR rate election; secure independent counsel review.

2. **Copies of Planned Gift Documents.**
   a. Respectfully request copies with rationale:
      - Confirm that correct legal name and location of charity is stated.
      - Review of any designations or restrictions for appropriateness and potential problems.
      - Requirement for donor recognition.
      - Provisions for endowments may call for a separate agreement.
      - Assists charity to ultimately steward gift when the time comes.
      - Internal planning and reporting. Dollar values are helpful.
      - Always honoring confidentiality and requests for anonymity.
   b. Examples:
      - Will or trust bequest.
      - Retirement plan beneficiary form.
      - Life insurance beneficiary form.

- Copies of charitable remainder or lead trust if charity is not trust.
- Copies of deeds of remainder interests.

3. Documentation of Gift Preferences.

a. Avoid legally binding gift restrictions.
b. State as preferences.
c. Include variance or amendment power in gift agreements.
d. Include statement that gift is not "in trust".
e. Disclose to donors the long-term necessity of charity's flexibility always, ethically honoring donor intent in good faith as closely as possible, but being able to deal with changing conditions that may render preferences illegal, impossible or impractical.

4. Endowment and Fund Agreements. See discussion above in III. B. 11.

D. Procedures to Consider: Reporting Gifts, Donors and Prospects.

1. Consider different standards depending on the purpose involved:

a. ***Valuation*** of gifts for long-range planning and other purposes. Consider NCPG Valuation Standards which allow for institution-specific considerations at www.ncpg.org.
b. ***Financial accounting and auditing*** purposes. Follow appropriate FASB or GASB Accounting Standards at www.fasb.org and as required by auditor.
c. ***IRS approved tax benefits***. Follow appropriate laws, regulations and other rules. See www.irs.gov and consult legal counsel.
d. ***Campaign reporting*** for fair and accurate disclosure. See recommended standards promulgated by NCPG at www.ncpg.org and CASE at www.case.org.
e. ***Work performance goals and achievement*** reports are institution-specific.
   - Consider reasonable goals that reflect the sophistication and historic track record of planned giving and the total development program.
   - Regular (monthly, quarterly, annual) reports to CEO, CDO, President, governing Board displaying data (using graphs, pie charts, spreadsheets, etc.) such as:
     1. New planned gift expectancies and matured planned gifts since the last report organized by donor name, type, use designation, actual or estimated dollar value.
     2. Total number of planned gift expectancies by type, use designation and estimated expectancy period.
     3. Total number of matured planned gifts by type and use designation.
     4. Total dollar value of planned gift expectancies by type, use designation and estimated expectancy period.
     5. Total dollar value of matured planned gifts by type and use designation.
     6. Special notations for deleted expectancies due to revocation or changed plans.
     7. Growth over time of number and dollar value of expectancies and matured gifts.

2. Donor Recognition. Unique to each charitable organization.

a. Outright Gifts:
   - Annual giving. Consider categories to prompt renewal and upgrades.
   - Major gifts. Consider categories to prompt renewal and upgrades.
   - Naming opportunities on or in buildings. Consider minimum levels as appropriate. Outright and/or planned gifts.
   - Naming opportunities with endowments and other funds. Outright and/or planned gifts.

b. Cumulative Lifetime Giving categories, accounting for:
   - Outright gifts.
   - Endowment gifts.
   - Planned gifts:
     1. Irrevocable gifts: Full original gift amount value or discounted present value.

2. Revocable gifts: Full original gift amount above a certain age (e.g., age 60) and discounted present value for donors under a certain age.

c. Planned Gift Recognition. Select a creative and inspirational name.

- Recognition society. Membership requirements may include signed verification of planned gift. Copy of gift documentation and/or dollar value may be divulged later if donor wishes.
- Annual event for recognition society.
- Unique gift for recognition society.
- Publish list of names on plaque, in annual report, etc. Honor all requests for anonymity. Respect confidentiality of individual gift plans.
- System for sending thank you letters of appreciation to donors for new planned gifts as well as to surviving family or loved ones (if appropriate) for matured gifts. Letters of appreciation may be sent by appropriate staff, including the CEO or President.

3. **Prospect Contact Reports.** Regular reporting to assure effective donor coordination and planned gift integration in the total development program. Reports may include:

a. Name spelling.
b. Contact information.
c. Linkage to charity.
d. Personal (spouse, children).
e. Career information.
f. Success stories.
g. Asset issues and ownership (stock, bonds, insurance, real estate, retirement plan, business).
h. Tax issues (income, estate, capital gains)
i. Giving history.
j. Interest in planned giving options.

4. **Protecting Donor Privacy.** Applicable laws for legal counsel review and consideration:

a. Health Insurance Portability and Accounting Act of 1996 (HIPPA). See www.ahp.org
b. Gramm-Leach-Bliley Act. See www.ncpg.org
c. Family Educational Rights and Privacy Act. See www.case.org
d. Applicable state public records act and open door law for public (tax-supported organizations). For status of donor record privacy and public university foundations, see www.case.org.

IV. Appendix. See Sample Attached.

- Real Estate Checklist.
- Asset Transfer Procedures.
- Trustee Agent Procedures.
- Model Standards of Practice.
- Routing Sheets.
- Sample Forms and Documents.
- Sample Reports.

6/23/06 **DRAFT**

BALL STATE UNIVERSITY FOUNDATION

Planned Giving and Endowment Stewardship Program

Policies and Procedures

Approved by Ball State University Foundation Board of Directors

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Ball State University Foundation

Planned Giving and Endowment Stewardship Program

Policies and Procedures

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    2. Endowed Scholarship Template
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4. Internal Endowed Scholarship Template
5. Internal Expendable Scholarship Template
6. Internal University Scholars Template
7. University Scholars Template

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BALL STATE UNIVERSITY FOUNDATION

Ball State University Foundation

Planned Giving and Endowment Stewardship Program

Policies and Procedures

EXECUTIVE SUMMARY

POLICIES OF THE FOUNDATION FOR PLANNED GIVING AND ENDOWMENT STEWARDSHIP

1. **Mission.** The mission of the Ball State University Foundation (hereinafter "Foundation") and its Planned Giving and Endowment Stewardship Program is to support the mission of Ball State University (hereinafter "University").

2. **Independent counsel encouraged.** Persons acting on behalf of the Foundation shall not provide legal and/or tax advice and shall in all cases encourage the donor to discuss the proposed gift with independent legal and/or tax advisors of the donor's choice so as to ensure that the donor receives a full and accurate explanation of all legal and/or tax implications of the proposed charitable gift.

3. **Confidentiality.** The Foundation staff shall adhere to strict confidentiality with regard to any information, records, letters and personal documents pertaining to donors and gifts. Breaches of confidentiality by staff may result in disciplinary action.

4. **Charitable gift annuities authorized.** The Foundation is authorized to issue charitable gift annuities, immediate and deferred.

5. **Foundation as trustee.** The Foundation may serve as trustee of charitable remainder trusts, charitable lead trusts and pooled income funds where the Foundation is the sole named charitable beneficiary.

TYPES OF PLANNED GIFT ARRANGEMENTS: PROCEDURES

1. **Charitable Gift Annuity (Immediate and Deferred).** The minimum initial amount for an annuity agreement is $5,000. Additional gift annuities from the same donor may be issued for $2,500 per annuity. Rates offered for immediate and deferred gift annuities will be as currently recommended by the American Council on Gift Annuities.

2. **Charitable Remainder Trust.** The minimum amount for a charitable remainder trust for which the Foundation is trustee will be $100,000 (i.e., the initial amount donated to the trust).

3. **Pooled Income Fund.** The minimum initial contribution to the pooled income fund is $5,000. Additional contributions may be made at any time, and they shall be at least $2,500.

4. **Charitable Lead Trust.** The minimum amount for a charitable lead trust with the Foundation as trustee is $100,000.

5. **Life Insurance.** A donor may irrevocably assign a paid up policy to the Foundation. A donor may irrevocably assign to the Foundation a life insurance policy on which premiums remain to be paid. A donor may name the Foundation as primary or successor beneficiary (but not owner) of a life insurance policy.

6. **Gift of Remainder Interest with Retained Life Estate.** The Foundation and the donor shall execute an agreement or contract that will stipulate that the donor shall continue to be responsible for all real estate taxes, property insurance, utilities, and maintenance.

7. **Bargain Sale.** The Foundation may purchase real estate, stock, personal property, or other property for less than fair market value. The price paid for the property should generally not exceed 60 percent of its appraised value.

8. **Bequest.** Sample bequest language for unrestricted and restricted gifts, including endowments, will be available to donors and their attorneys to ensure that the bequest is properly designated.

9. **Retirement Plan Designation.** Donors will be encouraged to designate the Foundation as primary or contingent beneficiary of a retirement plan pursuant to the plan's appropriate designation procedure, such as a specific form.

10. **Qualified Conservation Easement.** As a general matter, the Foundation will consider gifts of qualified conservation easements only on real estate ultimately donated to the Foundation in fee such as by bequest or remainder interest.

11. **Endowment and Fund Gifts.** The Foundation accepts gifts for expendable, annually funded and permanent endowment funds. All endowments and funds, whether established by outright and/or planned gifts, will be documented with a written agreement signed by the donor and Foundation President.

12. **Donor Advised Fund.** The Foundation has established a supporting organization ("Cardinal Funds, Inc.") that will be used to accept and manage donor advised funds. A minimum gift of $50,000 is required to establish a donor advised fund. No more than 45% of the annual spendable amount of a donor advised fund may be spent on behalf of qualified charities or purposes other than the University. At least 55% of the annual spendable amount of a donor advised fund must be spent on the qualified programs of the University. All (100%) of the residual of a donor advised fund at the death or resignation of the advisor(s) shall be spent on qualified University programs as a permanent endowment.

ASSETS FOR GIFTS: PROCEDURES

1. **Gifts of Non-Cash Assets: Real Estate.** The Foundation has established a supporting organization ("Cardinal Properties, Inc.") that may be used to accept real estate gifts of all types.

2. **Gifts of Non-Cash Assets: Tangible Personal Property.** Donors may make gifts of tangible personal property such as automobiles, art, books, manuscripts, scientific or computer equipment, computer software, antiques, rugs, collections of all types, boats, jewelry, cut crops/timber, animals, clothing and other property. Non-cash assets can be accepted by the Foundation so long as the Foundation or University assumes no unwanted liability, management or fiduciary duties, or unrelated business taxable income unless otherwise approved.

3. **Gifts of Non-Cash Assets: Intangible Personal Property.** Donors may make gifts of intangible personal property such as cash, publicly traded stock, closely held stock, corporate or municipal

bonds, U.S. Savings Bonds, mutual fund shares, Federal Reserve items, partnership interests, mineral rights, and intellectual property.

4. **Transfer of Assets for Planned Gifts.** Mellon Bank serves as fiduciary agent for the Foundation's pooled income funds, charitable gift annuities, charitable remainder trusts and charitable lead trusts.

DOCUMENTATION: PROCEDURES

1. **Receipts for Gifts.** The Foundation shall comply with all state and federal laws, regulations, rules and rulings with regard to providing donors a receipt for gifts.

2. **Documentation of Gifts.** The Foundation shall request appropriate documentation for all gifts.

3. **Documentation of Gift Restrictions.** With regard to the acceptance and documentation of gifts with restrictions requested by the donor, the Foundation shall comply with all applicable federal and state laws, rulings, rules and regulations.

RECOGNITION AND CREDITING: PROCEDURES

1. **Crediting of Gifts.** The University seeks to give credit to all donors for purposes of donor recognition and for achievement of development goals in an equitable manner for the appropriate amount of planned and outright gifts.

2. **Recognition of Gifts.** The *Beneficence Society* recognition will be awarded to all donors who confirm a revocable or irrevocable planned gift in any amount. Planned gift amounts shall be provided to the University for the purpose of its cumulative lifetime giving recognition of donors.

State Regulations

Presented by:

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28th Conference on Gift Annuities
Friday, April 4, 2008

State Regulations Panel

I. Introduction to the Session

This year, the ACGA State Regulations Subcommittee invited regulators from key states to speak on a panel regarding regulatory issues relevant to their states, with commentary to be provided on unrepresented states as applicable. The goal of this session is to educate charities on ways to comply with state law in issuing and administering gift annuities, with emphasis placed on meeting annual reporting requirements.

The panelists are Zane Chrisman from the Arkansas State Insurance Department, Kristofer Graap from the Washington State Office of the Insurance Commissioner and Edie Matulka, Vice President of the Planned Giving Services division of PG Calc Incorporated. Ms. Chrisman and Mr. Graap will answer questions regarding regulation of gift annuities in their respective states and Ms. Matulka will answer questions as they apply to other applicable state regulations. The panel will be moderated by Kristen Schultz, Senior Vice President of Crescendo Interactive, Inc.

II. Panel Questions

The moderator will begin the discussion with general questions regarding the state registration process, annual filings, reserve requirements, penalties and changes in future law. Time will be allotted for specific questions directed to the state regulators. This handout has been designed with space for attendees to take notes after each question below.

A. General Questions:

1. Registration: What are your state reviewers specifically looking for when reviewing a charity's application to issue gift annuities in your state? What issues prompt the most concern? What steps can a charity take to ensure a successful review process?

2. Annual Filing: What information are you looking for in the annual report, and for what purpose is it requested? How can charities improve their annual filings? What advice do you have for making the annual filing process less burdensome for charities?

3. Reserves: What are the reserve requirements in your state? Can you provide some background into the purpose of certain requirements (calculation methodology, surplus requirements, need for an actuary)?

4. Penalties: What are the penalties for issuance of gift annuities in your state without a license? How are these enforced?

5. Do you envision a Uniform Law being possible for regulation of gift annuities? What would be the pros and cons to such a law from your perspective?

B. State Specific Questions:

Washington

Minimum asset requirement: How does the OIC look to determine compliance with the minimum asset requirement? How can a charity with consolidated financial statements address this issue?

Arkansas

Application and Annual Reporting Process: Can you explain how the new Rule 90 is a change to the previous requirements?

III. Audience Questions

If you wish to ask a question of one or more of the panelists, please fill out the Panel Question Form available at your seat and pass it to the aisle during the session. Following the panelists' responses to the prepared questions, the moderator will read questions from the audience as time permits.

IV. Conclusion

We hope this panel discussion provides you with an opportunity to learn more about the gift annuity state regulatory process and ask the questions you may have regarding compliance. If you have further questions about gift annuity regulation, the ACGA web site contains detailed information on the regulatory requirements of each state. Please consult the gift annuity state regulation pages at www.acga-web.org.

V. Notes

UBTI in Charitable Gift Planning: A Primer

Presented by:

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28th Conference on Gift Annuities
Friday, April 4, 2008

UBTI in Charitable Gift Planning

David Wheeler Newman

Charitable organizations which are generally exempt from federal income tax under Internal Revenue Code section 501 are nevertheless subject to tax on their unrelated business taxable income (UBTI). Charitable remainder trusts, generally exempt from tax under Code section 664, are also subject to tax on their UBTI. This presentation provides an overview of the UBTI rules, and typical charitable gift planning situations in which UBTI issues may arise.

1. **Unrelated Business Taxable Income Defined.** Code Section 511 imposes a tax on the UBTI of a tax exempt entity. The definition of UBTI is found in Code Section 512: gross income derived from an *unrelated trade or business* that is *regularly carried on*, less deductions directly connected with that business.

a. **Unrelated Trade or Business.** For purposes of the UBTI rules, a trade or business is "any activity which is carried on for the production of income from the sale of goods or the performance of services." It is a very broad definition. The activity will only generate UBTI if it is not substantially related (other than through the production of funds) to the purposes for which tax exemption has been granted to the organization. The relationship between the organization's business activities and its exempt purposes must be carefully examined. Reg. §1.513-1(d).

b. **Real Estate**. Sales of real estate by charitable organizations have generated a long series of cases and rulings on the issue of whether the charity is liquidating an investment in an attempt to maximize value (i.e., passive) or selling property to customers in the ordinary course of business (i.e., a dealer in property engaged in a trade or business). The overarching theme of these cases and rulings is that there is no fixed formula or criteria for determining whether property that has been sold was held primarily for sale to customers or for investment. The IRS does, however, apply the following factors in making this determination:

i. the purpose for which the property was acquired;

ii. the length of time the property was held;

iii. the owner's activities in improving and disposing of the property;

iv. improvements made to the property;

v. proximity of the sale to the acquisition of the property;

vi. prevailing market conditions; and

vii. the frequency, continuity and size of the sales.

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Of these factors, the most important are the frequency of sales and the level of development and selling activities undertaken by the charitable organization.

c. **Related Business.** Income is not included in UBTI if it is generated from a trade or business which is substantially related to the tax exempt purposes of an exempt organization. Income derived from charges for a tax exempt function, such as the sale of tickets to a museum exhibit, are clearly related to the exempt purpose of the charity. Similarly, the sale of books and other educational materials relating to training provided by a charitable organization are directly related to its exempt purpose. Note, however, that a charitable remainder trust can never have business income related to a tax exempt purpose since a CRT does not undertake any of its own charitable programs: all business income of a CRT will, by definition, go into the UBTI calculation since it cannot be related to any exempt purpose.

d. **Regularly Carried On.** Business activities are considered to be regularly carried on if they demonstrate *frequency and continuity* and are pursued in a manner similar to other commercial activities. Reg. §1.513-1(c)(1).

i. In the *NCAA* case, the court held that advertising in programs for an annual three week basketball tournament was not an activity that was regularly carried on for purposes of UBTI. The IRS disagrees with this result.

ii. On the other hand, the IRS has ruled that when an organization contracted with a commercial firm to solicit advertising for its annual yearbook, it was "engaging in an extensive campaign of advertising solicitation" and thus, the activity was regularly carried on for UBTI purposes. Rev. Rul. 73-424.

2. **Exceptions.** As with other areas of tax law, the exceptions to the general rule are as important as the rule itself. Several types of activity unrelated to exempt purpose, regularly carried on by the tax exempt entity, are nevertheless exempt from the UBTI rules.

a. **Passive Investment Income.** UBTI does not include dividends, interest, payment with respect to securities loans, loan fees, annuities, capital gain, rents from real estate or royalties. Code §512(b).

b. **Rental vs. Service Income.** Note that while real estate rental income is exempt from UBTI, income from performance of services is not. Payments attributable to services that are not routinely provided by a landlord, such as maid service for tenants, are not within the general exception for rental income and therefore go into the calculation of UBTI.

c. **Volunteers.** Income from activities in which substantially all the work is performed by volunteers is exempt from UBTI. Code §513(a)(1).

d. **Convenience Exception.** Income from a business conducted for the convenience of members, students, patients, officers or employees is also excluded from UBTI. Code §513(a)(2). A dormitory laundry facility or a faculty cafeteria would be within this exception.

e. **Donated Goods.** Income from the sale of donated goods (for example at a fundraising auction) is exempt from UBTI. Code §513(a)(3).

f. **Corporate Sponsorship.** Qualified sponsorship payments which provide no benefit to the corporate sponsor beyond acknowledgement of the company's name or logo in connection with the organization's activities, are excluded from UBTI. Reg §1.514-4(a).

3. **Royalties.** UBTI generally does not include royalty income (subject to the rules for royalties received from controlled entities discussed below and royalties that are debt financed income). A royalty is a payment for the use of (or the right to use) a valuable intangible right, such as a logo, copyright or trademark. Like rental income, the exemption is not broad enough to include income attributable to services that benefit the licensee. This distinction between royalty income, for the right to use intangible property, and income for services performed by the charity has generated a considerable amount of litigation in addition to (and sometimes at odds with) IRS guidance.

4. **Controlled Entities.** A charity might plan to conduct a business activity through a taxable subsidiary. This might be done for a variety of reasons, including the protection of the parent subsidiary. There is an important UBTI rule that applies in this case. Payments of interest, annuity, royalty or rent received from a controlled entity will be included in UBTI of the charity, to the extent the payments reduce the business income of the controlled entity. Code §512(b)(13).

a. **Control.** For purposes of this special rule, control means ownership of more than 50% (by vote or value) of the corporation, limited liability company or other business entity. Typical constructive ownership rules apply for interests in the entity which are held indirectly.

b. **Example.** The College campus has a lovely courtyard that is a popular spot for alumni weddings. The College organizes a wholly owned corporation as a subsidiary to provide all wedding related services, including photography, catering and wedding planning, and rents the courtyard area to the new wedding subsidiary. Even though rents are generally exempt from UBTI, the rents received by the College from the wedding subsidiary are included in the UBTI of the College.

5. **S Corporation Income.** A charity (but not a charitable remainder trust) may be a shareholder of an S corporation. Code §1361(c)(6). However, all S corporation income that flows through to the charity – even items like interest and dividends that would otherwise be exempt – are automatically included in UBTI. Code §512(e)(1). Gain from the sale of the S corporation shares by the charity is also included in UBTI.

a. **Example.** The Donor is planning to sell his businesses, which is an S corporation. Since he has been told that one of the most tax efficient ways to benefit his alma mater is through a contribution of a highly appreciated asset, he transfers a portion of his company stock, with a basis of 100 and an anticipated sales price of 1,000, to the college. He sells the company quickly so that no S corporation income (and therefore UBTI) passes through to the college. However, the entire gain of 900 is included in the UBTI calculation of the college. As a nonprofit corporation, the college is subject to a maximum federal corporate tax rate of 35% on capital gain, while the donor would have been subject to a maximum rate of 15%.

6. **Computation of UBTI.** The charity or CRT may offset items of gross income from an unrelated business with deductions (including depreciation) directly connected with that business. If the same expenses support both an exempt function and an unrelated purpose, they must be allocated between the two uses. Reg. §1.512(a)-1.

a. **Example.** The college bookstore sells both textbooks for classes at the college (exempt function) and general merchandise such as greeting cards, magazines and video games (unrelated). Expenses of operating the bookstore must be allocated between the exempt function receipts from textbooks and the unrelated receipts from general merchandise.

b. **Specific Deduction.** In addition to other deductions allocable to unrelated business income, the charity may claim a specific deduction of $1,000. Code §512(b)(12).

c. **Tax Rate.** UBTI of nonprofit corporations is taxed at the same rate as regular taxable corporations. UBTI of charitable trusts (but not CRTs – see below) is taxed at the same rate as taxable trusts (essentially the same rate as individuals).

7. **Analytical Framework.** Bruce Hopkins, in his excellent treatise on the subject cited below, suggests that unrelated business income may be approached using the following series of inquiries:

a. Does the activity in question constitute a *business*?

b. Is the business *regularly carried on*?

c. Is he regularly carried on business *related* to the exempt purpose of the organization?

d. Does a modification or exception based on the *type of income* apply?

e. Does a modification or exception based on the *type of activity* apply?

f. Apply all allocable deductions to *calculate unrelated business taxable income*.

8. **Unrelated Debt Financed Income.** An important category of UBTI is unrelated debt financed income, which can result in tax on income such as rent or capital gain that would otherwise be exempt. This category arises from *debt financed property* if the production of income from that property is *unrelated to the organization's exempt purpose*.

a. **Debt Financed Property.** Property (e.g. stocks, bonds or real estate) held to produce income with respect to which there is *acquisition indebtedness* at any time during the preceding 12 months.

b. **Acquisition Indebtedness.** Defined in Code §514(c) as the unpaid principal amount of indebtedness incurred before, during or after the acquisition of improvement of the property. (Indebtedness incurred after the acquisition of the property is included only if it is reasonably foreseeable at the time of the acquisition).

c. **Gift of Mortgaged Property.** The general rule is that if a charity acquires mortgaged property by purchase, gift or bequest, there will be acquisition indebtedness in the principal amount of the mortgage. There are important exceptions to this general rule:

i. Property acquired by the charity by bequest is not treated as having acquisition indebtedness for a period of 10 years following receipt by the charity.

ii. Mortgaged property acquired by gift is not treated as having acquisition indebtedness for a period of 10 years, *provided* the mortgage was on the property for at least 5 years before the gift and the donor owned the property for at least 5 years before the gift. For purposes of this exclusion for "old and cold" debt, a re-financing is considered a continuation of the old debt to the extent that the principal balance of the old debt is not increased as a result of the refinancing. Reg. §1.514(c)-1(c).

d. **Calculation.** A slightly different formula is used to calculate debt financed income from sale of property as opposed to the operation of the property. In both cases, the income is multiplied by a fraction, the denominator of which is the average basis of the property over the time it was held by the charity. To calculate gain from sale of the property, the numerator is the *highest* amount of debt on the property at any point during the 12 month period preceding the sale. To calculate the taxable portion of operating income, the numerator is the *monthly average* of debt on the property over the entire period it is owned by the charity.

i. **Example.** Charity received a gift of undeveloped land subject to a mortgage debt that does not qualify for the "old and cold" exception described above. The average debt over the 12 month period preceding sale is 300. The average (and current) basis of the property is 400. The debt/basis percentage of 300/400 means that 75% of the gain from sale will be unrelated debt financed income to the charity. When the property is sold for 1000, the total gain of 600 (1000 – 400) is multiplied by this percentage to derive 400 (75% of 600) which will be UBTI of the charity.

9. **Reporting and Computation of Tax Liability.** Unrelated business income and associated deductions are reported on Form 990-T filed by the charity. Nonprofit corporations are taxed on their UBTI at the same tax rates as regular for-profit corporations. Note that charitable trusts are subject to tax at the rates applicable to regular trusts, generally the same rates that apply to individuals. The taxpayer may offset unrelated business income with all deductions allocable to that income in addition to a specific deduction of $1,000.

10. **Charitable Remainder Trusts.** A special rule applies to the UBTI of a charitable remainder trust (CRT) effective January 1, 2007. This rule provides that any UBTI of a CRT is subject to an excise tax equal to the UBTI – in other words, UBTI of a CRT is taxed at a rate of 100%.

a. **Good News or Bad News?** The old rule was that income of a CRT for a given year was exempt from tax unless it had UBTI for that year. That meant that even a little bit of UBTI in a year would make all of the income of the CRT taxable – including income like capital gain that would otherwise be exempt.

i. **Example One.** A CRT is funded with an apartment building. Although the building is free and clear of any mortgage, the property includes a coin-operated laundry that generates $10,000 per year in net income after taking into account expenses including depreciation of the washing machines. The CRT is able to sell the property after only 3 months (during which the net income from the laundry is $2500) for a capital gain of $1,000,000. Under the old rules, this small amount of UBTI would cause the CRT to be taxable on all its income, including the capital gain from sale of the property, a tax of over $150,000 – a truly painful result.

ii. Under the new rules, the bad news is that the UBTI from the laundry is subject to an excise tax at the confiscatory rate of 100%. However, the good news is that the CRT retains its tax exemption with respect to other income – in this case reducing the tax payable by the CRT to $1500 or less.

iii. **Example Two.** The CRT is funded with an apartment building that needs work. The trustee of the CRT borrows $100,000 to put on a new roof and make some cosmetic improvements to the property to prepare it for sale, and sells the property for a gain of $500,000. Assume that the $100,000 mortgage increased the property's basis from $300,000 to $400,000. The result is that the CRT has 100,000/400,000 x 500,000, or $125,000 of debt financed income. Under the old rules, the CRT would lose its exemption for the year of sale, resulting in tax (at 15%) on the gain of approximately $75,000. (Even assuming that some of the gain was so-called unrecaptured Section 1250 gain taxable at 25%, a blended rate of 20% would result in total tax of $100,000).

iv. Under the new rules, the CRT would retain its tax exemption, but the debt financed income would result in tax of $125,000.

11. **Charitable Gift Annuities.** When a charity receives property in exchange for a gift annuity, the annuity is treated as debt for tax purposes, much the same as if the charity gave the donor an installment note for the property in a bargain sale transaction. Does this mean that a charitable gift annuity is acquisition indebtedness that can cause unrelated debt financed income when the charity sells the property it received in exchange for the annuity?

a. **Special Rule for CGAs.** Code §514(c)(5) contains an important exception which will prevent a CGA from being treated as acquisition indebtedness incurred by the charity issuing the annuity, but only if the annuity meets all of the following tests:

i. **Sole Consideration.** The annuity must be the sole consideration given by the charity to the donor in exchange for the property, other than an "old and cold" mortgage of the type described above.

(A) **Example:** Donor transfers real property with a tax basis of 10 and a value of 100 to Charity, subject to an old and cold mortgage of 20 and in exchange for an annuity with a present value of 40. So far so good. The Charity also agrees to pay the Donor an additional 10 in cash as part of the bargain sale transaction. Even though the old and cold mortgage will continue to qualify for the exclusion from acquisition indebtedness under the 5 year rule of Code §514(c)(2), the annuity will no longer qualify for exclusion under Code §514(c)(5) since it is not the sole consideration paid by the Charity. The Charity will have acquisition indebtedness of 40, giving rise to unrelated debt financed income when it sells the property at a gain.

What percentage of the gain will be taxable? The total consideration paid by the Charity is mortgage 20 + present value of annuity 40 + cash 10 = 70, meaning that 30% of the Donor's basis of 10, or 3, carries over to Charity as the basis from the gift part of the bargain sale transaction, which when added to the cost basis of 70 from the sale part of the transaction, gives the Charity a basis of 73 in the property. The ratio of its acquisition indebtedness, 40, to this basis results in a percentage of 54.8%.

If the Charity sells the property for 100, its total gain will be 100 – 73 = 27, 54.8% of which, or 14.79 will be unrelated debt financed income.

ii. **Limitation on Value of Annuity.** The value of the annuity must be less than 90% of the value of the property received in exchange. This requirement will typically not pose a problem for charities using the recommended rates of the American Council on Gift Annuities.

iii. **Measuring Life or Lives.** The annuity must be payable over the life of one individual (who is alive at the time the annuity is issued) or over the lives of two individuals.

iv. **No Guarantees.** The annuity contract may not guarantee a minimum amount of payments or specify a maximum amount.

v. **No Adjustments.** The annuity contract may not provide for adjustment in the amount of the annuity based on income received by the charity from the property.

12. **Other UBTI Issues.** Much has been written and discussed recently about UBTI issues that are not specifically related to charitable gift planning, including:

a. **UBTI Issues Arising from Investments.**

b. **Internet Activities.**

c. **Joint Ventures with For-Profit Participants.**

13. **Further Reading.** Readers looking for an in-depth coverage of UBTI should consult *The Tax Law of Unrelated Business for Nonprofit Organizations* by Bruce R. Hopkins, published by John Wiley & Sons, Inc. in 2005.