

**AMERICAN
COUNCIL ON
GIFT ANNUITIES**

Promoting Responsible Philanthropy

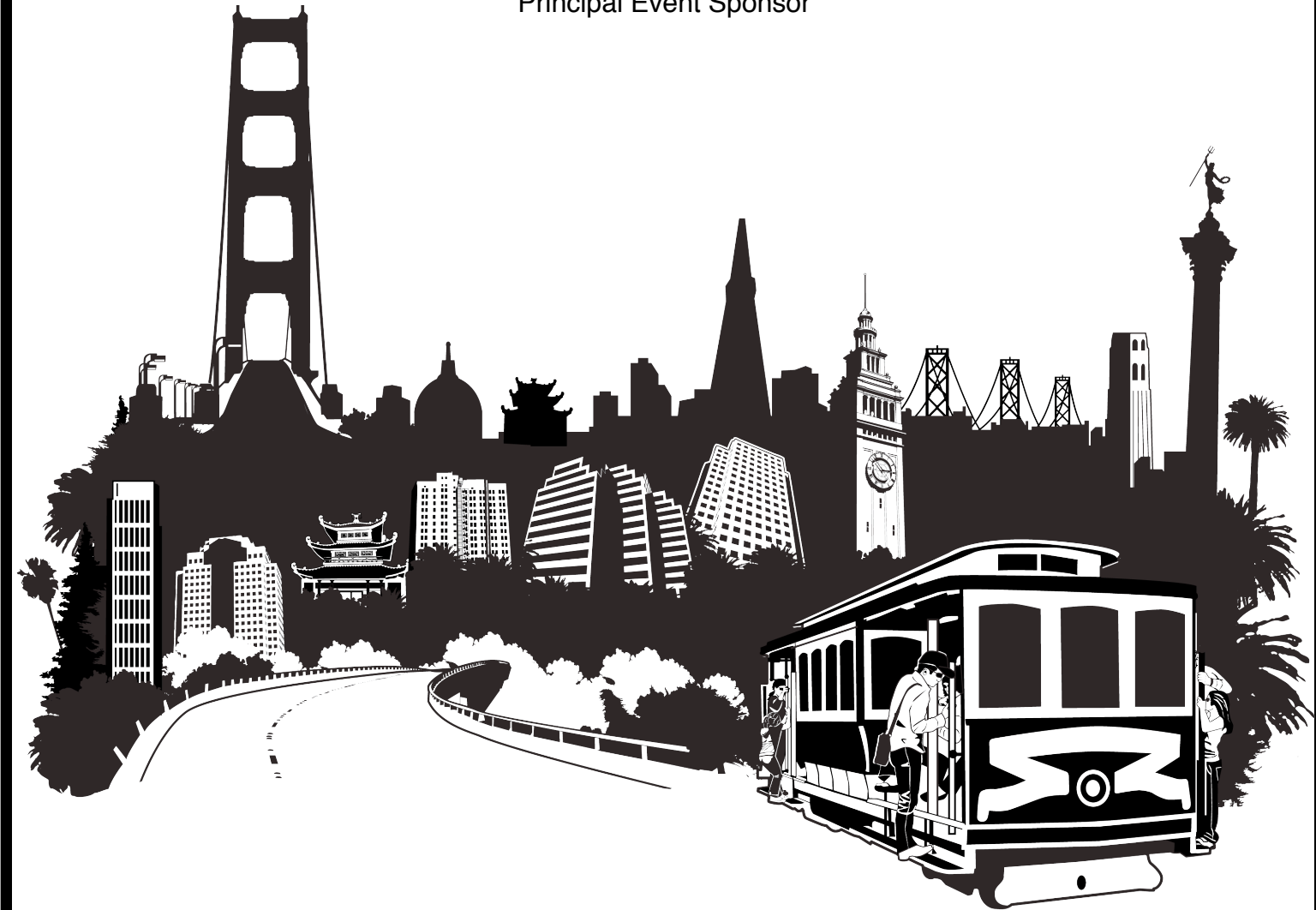
American Council on Gift Annuities
1260 Winchester Parkway SE
Suite 205
Smyrna, Georgia 30080
Phone: (770) 874-3355 . Fax (770) 433-2907
e-mail: acga@acga-web.org . Web: www.acga-web.org

30th ACGA Conference... A conference on planned giving • April 18-20, 2012 • Westin St. Francis - San Francisco

Conference Proceedings

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Conference Proceedings

The 30th ACGA Conference... A conference on planned giving
April 18-20, 2012 . Westin St. Francis, Union Square - San Francisco, CA

Presented by the American Council on Gift Annuities

The American Council on Gift Annuities
thanks...



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Convening Conference Sponsor of the
30th Conference on Gift Planning

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 and a list of exhibitors.

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Welcome to San Francisco and the 30th ACGA Conference! We're glad you're here! Since 1927, the conference has been a quality educational and networking event. Our conference allows representatives from charities and consulting organizations the opportunity to gather together, share expertise, and enjoy the camaraderie.

The 30th Conference Committee, with Edie Matulka and Kristen Schultz Jaarda as co-chairs, has been hard at work for two years to plan all the details of this conference. The Conference Committee has developed the educational program that will serve the needs of each of you, and has spent countless hours recruiting an outstanding faculty of the nation's most well-recognized speakers. They have been a hands-on, working committee from start to finish.

Our conference staff has carried out the plans of the Conference Committee with exemplary professionalism. From faculty communications and registration procedures to publications design and menu planning, the conference staff has worked with the committee, the faculty, and the hotel staff to make this the best experience possible for you, our valued attendees.

While in San Francisco, you will find the ACGA Board at work monitoring the educational sessions, taking food tickets, and greeting our guests. Please take a moment to introduce yourself to any member of the Board. We are eager to meet you and learn about your needs as ACGA moves forward.

Most importantly, each of you has contributed to the success of this conference. We know that you have sacrificed precious time and professional development dollars to be here. We appreciate your confidence in us, and thank you for attending. Please let any member of the conference team – committee members, staff, Board members, hotel staff - know how we may better serve you.

Lindsay L. Lapole

ACGA President & Chairman of the Board

2012 Board of Directors

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Karen Gallardo

Senior Director of Gift Planning & Major Gifts
AARP Foundation

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President
ACU Foundation

Charles B. Gordy

Director, Planned Giving
Harvard Law School

Cynthia Halverson

Executive Director for Advancement
Evangelical Covenant Church

Kristen Schultz Jaarda

Senior Vice President
Crescendo Interactive

Carol Kersten

Director of Planned Giving
Stanford University Medical Center

David A. Libengood

Director, Relationship Management
Kaspick & Company

Rebecca Locke

Senior Director, Gift Planning
American Red Cross

Edith E. Matulka

Senior Consultant
PG Calc

Ruby Pedingco

Director of Planned Giving
Minnesota Orchestral Association

William S. Reeser

Chief Investment Officer
ALSAC/St. Jude Children's Research Hospital

Terry L. Simmons

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President
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Laird G. Yock

Sr. Philanthropic Advisor
Colby College

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Moderator: Kristen Schultz Jaarda, JD, LLM

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(presentation not included in book, will be provided online/onsite)
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EDUCATION AGENDA

Wednesday, April 18, 2012

10:00am - 9:00pm	Registration Open
1:30pm - 3:00pm	Symposium 1: Social Media for Planned Gifts
3:30pm - 5:00pm	Symposium 2: Trends in Gift Planning
5:30pm - 6:30pm	Grand Opening Reception
6:30pm - 9:00pm	Opening Dinner/Keynote Address

Symposium 1: Social Media for Planned Gifts

1:30PM - 3:00PM - Track I, II, & III
Location: Grand Ballroom

Panelists:

David B. Moore - Director of Planned Giving - Chapman University

David J. Neff - CEO - Lights.Camera.Help.

Rebecca Scott - Director of Planned Giving - Tufts University

Dr. Carole L. Touchinski - Executive Director - Marquette County Community Foundation

Moderator:

Kristen Schultz Jaarda, JD, LLM - Senior Vice President - Crescendo Interactive

Come learn the latest strategies for planned gifts social media from a panel of successful charities. Discover how to harness the power of social media to further your charity's mission. This panel discussion features gift planners from a university, religious/healthcare foundation and community foundation. Learn from these differing perspectives how to generate responses from fans and followers. Our technology expert, David Neff, will provide guidance on integrating social media into your planned gifts marketing. With a growing number of supporters and potential donors using Facebook, Twitter, LinkedIn and other social media to stay connected, you need a strategy for how to build relationships utilizing social media. Our panel of charities and social media experts will share examples of social media best practices to help you navigate these new technologies and create an effective online presence to facilitate planned gifts.

Symposium 2: Trends in Gift Planning

3:30pm - 5:00pm - Track I, II, & III
Location: Grand Ballroom

Presented by:

Robert Sharpe - President - The Sharpe Group

This session will examine the current environment for planned gifts and ways donors and their charitable interests can best work together to make gifts that help meet both personal and philanthropic goals. Special emphasis will be placed on making gifts in light of investment market fluctuations, lower interest rates, reductions in income and capital gains tax rates, the reduction or elimination of estate taxes, political uncertainty, the aging of America's donor population and other factors.

Opening Dinner & Keynote Address: A World in Economic Transition

6:30pm - 9:00pm - Track I, II, & III
Location: Grand Ballroom

Presented by:

Ronald Florance - Senior Vice President and Managing Director of Investment Strategy - Wells Fargo Bank

In this presentation, attendees will hear an interesting and in depth discussion about the current global and domestic economic situation. Mr. Ronald Florance will explain how the global economy is at a crossroads and its consumer is in transition, changing the engines of growth for the global economy. According to Mr. Florance, the developed economies, including the United States, will be entering a decade of de-leveraging, which will have ramifications for interest rates and currencies. Mr. Florance will discuss the resulting implications for liquidity and cash flow management. The global transformation, Mr. Florance believes, will bring continued volatility to the capital markets, and investors will need to execute strategies to address the new sources of risk to the capital markets. Mr. Florance will tie these economic realities back to specific investment themes and strategies that investors can use to address the changing landscape they face with the global economy and capital markets.

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Thursday, April 19, 2012

7:30am - 4:30pm	Registration Open
7:30am - 8:30am	Continental Breakfast in Exhibit Hall
8:30am - 9:45am	Morning Breakout Sessions
9:45am - 10:15am	Refreshment Break in Exhibit Hall
10:15am - 11:30am	Morning Breakout Sessions Repeated
11:45am - 1:15pm	Rates Luncheon
1:30pm - 2:45pm	Afternoon Breakout Sessions
2:45pm - 3:15pm	Refreshment Break in Exhibit Hall
3:15pm - 4:30pm	Afternoon Breakout Sessions Repeated
4:30pm - 5:45pm	Cable Car Reception in Exhibit Hall
5:45pm	Enjoy San Francisco on your own!

Thursday, April 19, 2012 Morning Sessions

Bequests - Who? What? When? Why? How? Dealing with the "You Can Have It When I'm Done with It" Donor

8:30am - 9:45am & 10:15am - 11:30am
Track I & II
Location: Victor Room - 32nd Floor

Presented By:

Ellen G. Estes, LL.B - Estes Associates
Frank W. Estes, LL.B - Estes Associates

In this presentation we will discuss:

1. What is a "Bequest" – a gift that takes effect upon the death of the donor: bequests under wills, gifts from revocable trusts, and remainder distributions from retirement plans.
2. Who makes bequests: profiles of donors who make these types of gifts – and how to recognize them.
3. Why are bequests important to your organization and its future.
4. When should you promote bequests among your constituents.
5. How to promote – marketing and outreach.

Best Practices in Charitable Gift Annuity Programs

8:30am - 9:45am & 10:15am - 11:30am
Track I, II, & III
Location: Tower Salon A - First Floor

Presented by:

Charles B. Gordy - Director, Planned Giving, Harvard Law School

Many charities run successful charitable gift annuity programs that are invested appropriately, administered smoothly, and in compliance with Federal and State regulations. They may differ in how they get there and this paper presents what ACGA considers to be best practices in those programs. Additionally, 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.

Focusing on the Donor by Asking the Right Questions

8:30am - 9:45am & 10:15am - 11:30am
Track I & II
Location: Colonial Room - Mezzanine Floor

Presented By:

Roger Ellison - Senior Advisor for Philanthropy - West Texas Rehabilitation Center Foundation

This session will focus on a very deliberate process of focusing on the donors and discovering their goals and needs through the asking of the right questions and carefully listening to answers. We'll discuss preparing for meetings, setting the stage for success, finding the passion, exploring options, arriving at a solution, committing to a gift and sharing the passion. The result of this session will be practical ideas for using a very natural approach to successfully get gifts. Chock full of stories.

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Gift Administration - Harmony or Discord?

8:30am - 9:45am & 10:15am - 11:30am
Track II & III
Location: St. Francis Suite - 12th Floor

Presented By:

J. Michael Sutton - Director of Investment Operations -
The Salvation Army

Administration of CGAs and CRTs has unique and intricate challenges. Run smoothly and efficiently, the program can assist the fundraisers and help with donor loyalty. Run inefficiently, the program can cause harm and conflict. This session will explore the methods, processes, and functions of administering these charitable gifts. How does your Finance/Business office interact with Development? Do you buy software to run the program or attempt an in-house system? Payments, taxes, address changes, deferred tracking, these are just a few of the details that must be considered in administering a CGA/CRT program. Whether your organization is new to gift annuities or an established program, the administrative functions of the program are there and require your attention.

Gift Planning Marketing - Who, What, and When

8:30am - 9:45am & 10:15am - 11:30am
Track I & II
Location: Elizabethan A-B - 2nd Floor

Presented By:

Rebecca Scott - Director of Gift Planning, - Tufts
University

This presentation will look at the who, what, and when of gift planning marketing. Who is your best audience for marketing planned gifts? We'll look at both simple and more complicated ways to create a donor model of your best prospects. What should you send? We'll look at the relative merits of postcards, emails, video, newsletters, and social media as ways to encourage people to establish gift annuities, bequests, and other planned gifts. As two examples, we will look at Tufts University's Charles Tufts Society video and Facebook page. We will also consider when to market gift planning in order to create urgency and keep your message at the top of your donors' minds.

Gifts of Complex Assets

8:30am - 9:45am & 10:15am - 11:30am
Track I & II
Location: Elizabethan C & D - 2nd Floor

Presented By:

Lawrence Katzenstein - Partner - Thompson Coburn
LLP

This session will discuss gifts of complex assets, including unique issues involved in charitable gifts of tangible personal property, patents and copyrights, encumbered property, oil and gas interests and issues in sales of property subject to possible sale. The application of the split interest rule even to outright gifts will be explored along with sale of unique assets using flip unitrusts to sell unique assets.

Recent Developments of Interest in Charitable Planning

8:30am - 9:45am & 10:15am - 11:30am
Track I & II
Location: Georgian Room - Mezzanine Floor

Presented By:

Turney P. Berry - Partner - Wyatt Tarrant & Combs, LLP

This session will discuss Treasury and IRS rulings that are of interest to those engaged in charitable planning, as well as recent Federal and state cases that suggest opportunities and highlight pitfalls for the charitable practice. We will also spend some time reviewing planning ideas and interesting, effective strategies in view of the current planning environment.

State Regulations Panel

8:30am - 9:45am & 10:15am - 11:30am
Track: I & II
Location: Alexandra Room - 32nd Floor

Panelists:

Steven Drutz, CPA, CFE - Senior Financial Analyst -
Washington State Office of Insurance Commissioner

Carol Harmon - Senior Staff Counsel - California
Department of Insurance

Bene' Kyles - Securities Analyst - Alabama Securities
Commission

Moderator:

Edie Matulka - Sr. Consultant - PG Calc

This year's state regulations session is aimed at educating charities on the ongoing compliance requirements relating to state gift annuity regulations. Representatives from state agencies will speak on a panel regarding regulatory issues relevant to their states. The goal is to educate charities on

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ways to comply with state law in issuing and administering gift annuities, with emphasis on meeting both initial and annual reporting requirements. The panel will be moderated and there will be time for Q & A from the audience.

Rates Luncheon

11:45am - 1:15am

Track I, II & III

Location: Grand Ballroom

Presented By:

Cam Kelly - ACGA Rates Committee Co-Chair

David A. Libengood - ACGA Rates Committee Co-Chair

Join us as the ACGA Rates Committee Co-Chairs discuss developments regarding ACGA's suggested gift annuity rates.

Thursday, April 19, 2012 Afternoon Sessions

Accounting 101 for Charitable Gifts

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track III

Location: Georgian Room - Mezzanine Floor

Presented By:

Vera Bennett - Chief Financial and Administrative Officer
- Silicon Valley Community Foundation

Kristine L. Caratan, CPA - Partner - Retired - Moss Adams, LLP

This session will provide an overview of the accounting and reporting requirements for split interest gifts and recent updates to some of the regulations governing these and other charitable gifts. It will focus on the elements and best practices for sound operations, and is designed to assist nonprofit staff, volunteers, advisors to nonprofit organizations, and advisors to prospective donors to understand the financial health and governance of an organization.

Charitable Remainder Trust Basics

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track I & II

Location: Alexandra Room - 32nd Floor

Presented By:

Pamela J. Davidson, J.D. - Charitable Gift Planner and Consultant - Davidson Gift Design, - Thompson & Associates

Charitable remainder trusts are optimal for taking assets in without capital gains on the front end, providing income to donors or children and grandchildren for life or a term of

years. The rules of these irrevocable statutory instruments must be complied with if optimal advantage is to be obtained, with the timing of the asset funding also important to achieve maximum effect. We will discuss the charity's role, generally not as trustee, and how to encourage a prospect's consideration of such a plan. Also covered will be testamentary funding of such plans, such as with highly taxed retirement plan assets for the next generation. Actual donor stories will be used to illustrate the concepts and possible uses.

Diving Into Endowments: UPMIFA and More

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track II & III

Location: Tower Salon A - Main Floor

Presented By:

Erik Dryburgh - Principal - Adler & Colvin

The law of endowments changed dramatically with the introduction of UPMIFA. This session will review the law of endowments and the related accounting rules, and then focus on some of the "implementation" issues I have seen over the past few years: how to determine and document a endowment spending rate, how a charity may (or may not) access its endowment in times of need, and how a charity should design an endowment going forward. We will also review a few "new" ideas for donors reluctant to give to the traditional endowment.

The Impact of "Philanthropic Planning" on Your Career

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track I, II, & III

Location: Victor - 32nd Floor

Presented By:

Brian M. Sagrestano, J.D., CFRE - President & CEO - Gift Planning Development, LLC

The emergence of the Baby Boomers, Generation X and Millennials as donors has changed the face of philanthropy. Charities and professional advisors are quickly discovering that the old rules of demonstrating a need and asking for a gift are being replaced with a philanthropic planning strategy that requires collaboration among non-profits, advisors and donors. At the same time, more and more charities are abandoning the gift planning specialist, in favor of general gift planning training for the entire development staff. Citing findings from his new book with Robert E. Wahlers, CFRE, the *Philanthropic Planning Companion, A Charitable Giving Guide for Fundraisers and Advisors*, (Wiley 2012), Brian M. Sagrestano, JD, CFRE, will explore what these changes mean for the job prospects and careers of gift planners,

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development officers and professional advisors going forward.

Joining the Campaign Mainstream: Gift Planning as an Integral Function

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track I & II

Location: Elizabethan C-D - 2nd Floor

Presented By:

Ilisa Hurowitz - Principal - West Cambridge Consulting

Planning for Comprehensive Campaigns often neglects Gift Planning and the role that it can play to maximize overall Campaign achievement. As a result, Gift Planning can operate in isolation from the Campaign with missed opportunities to leverage overall Campaign and post-Campaign Gift Planning results. This session will address practical ways to integrate Gift Planning as an important and strategic component of Campaign Planning, including the benefits of doing so.

Overview of Gift Annuities

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track I

Location: Elizabethan A-B - 2nd Floor

Presented By:

Frank Minton - Frank Minton Consulting, LLC

Whether you are thinking about starting a gift annuity program, making an existing one more effective, or expanding your own knowledge, this session will give you the information you need. This session will cover tax aspects, recommended policies, marketing techniques, as well as some creative applications for making a program more productive.

Retirement Accounts - Charitable Giving Implications of the 2012-2013 Income and Estate Tax Environment

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track II & III

Location: Colonial Room - Mezzanine Floor

Presented By:

Christopher Hoyt - Professor - University of Missouri (Kansas City) Law School

Taxpayers face a large tax increase in 2013 when the Bush Tax cuts expire and the new healthcare taxes take effect. What steps should charitable gift planners and estate planners take in 2012 to plan for the future tax world? Topics will include:

- Charitable IRA Rollover – When to Use It. When to Avoid It. What to do if legislation isn't extended.
 - Funding Charitable Bequests with Retirement Assets – the tax traps and the easy solutions.
-

Working Productively with your Finance Office and Actually Enjoying It

1:30pm - 2:45pm & 3:15pm - 4:30pm

Track III

Location: St. Francis Suite - 12th Floor

Presented By:

Andrew M. Coddington - Associate Vice President of Institutional Advancement & Director of Planned Giving - Colgate University

David B. Hale - Vice President for Finance & Administration - Colgate University

A strong partnership between the Gift Planning Office and your colleagues in the Finance Office is a key ingredient in your institution's advancement success. Donors rarely see distinctions between internal division, far less their respective goals and objectives; they only see the entire institution. As gifts become more complex, a relationship built on trust, expertise, institutional responsibility and a donor-centered approach, will yield positive outcomes for both the donor and institution.

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Friday, April 20, 2012

7:30am - 12:00pm Registration Open
7:30am - 8:55am Closing Breakfast
9:00am - 10:15am Morning Breakout Sessions
10:15am - 10:30am Refreshment Break in Exhibit Hall
10:30am - 12:00pm Morning Breakout Sessions Repeated

Can Beneficiary Happiness and Trusts Co-exist?

9:00am - 10:15am & 10:30am - 12:00pm
Track III
Location: St. Francis Suite - 12th Floor

Presented By:
Chris Cline - Regional Fiduciary Manager - Wells Fargo Bank

The new "science of happiness" has much to say about the impact of finances on our lives. Some of these conclusions, however, conflict with traditional views of trust drafting and administration. This presentation will reconcile the two.

Charitable Gift Annuities: When Things Don't Go As Expected

9:00am - 10:15am & 10:30am - 12:00pm
Track II & III
Location: Colonial Room - Mezzanine Floor

Presented By:
David A. Libengood - Director, Relationship Management - Kaspick & Company

Things don't always go according to plan with the funding, administration and investment of charitable gift annuities. This session will use a series of actual case studies to explore the types of problems that can arise for both donors and the charities they wish to benefit, how those problems can be resolved or ameliorated, and what policies and practices can help to eliminate surprises in the future.

Growing a Planned Giving Program

9:00am - 10:15am & 10:30am - 12:00pm
Track I & II
Location: Victor Room - 32nd Floor

Presented By:
Winton C. Smith, Jr. - Attorney at Law - Law Offices of Winton C. Smith, Jr.

This is the plan that provides results and helps people give more than they ever dreamed possible. The focus is on specific actions that provide major planned gifts. Practical tips are provided to help you increase results. Planned

Giving Policies that both provide safeguards and also expand results are included.

Investing Planned Giving Assets

9:00am - 10:15am & 10:30am - 12:00pm
Track II & III
Location: Georgian Room - Mezzanine Floor

Presented By:
William Reeser - Chief Investment Officer - ALSAC/St. Jude Children's Research Hospital

In this session, the investment considerations for CGA assets in the current economic environment are reviewed. What is the potential impact of how fixed income yields, muted equity returns, and volatility on a CGA pool?

The Power of the Pyramid: How to Integrate Annual Planned and Major Giving

9:00am - 10:15am & 10:30am - 12:00pm
Track I & II
Location: Tower Salon A - Main Floor

Presented By:
Phil Purcell - Vice President Planned Giving & Endowment Stewardship - Ball State University Foundation

This presentation will explain effective strategies for integrating annual, major and planned giving. Specific topics will include goal setting, case for support, donor proposals, gift integration, prospecting donor cultivation, stewardship and recognition. The role of the board will be highlighted.

Real Estate Gifts in the Wake of the Great Recession

9:00am - 10:15am & 10:30am - 12:00pm
Track I, II, & III
Location: Elizabethan A-B - 2nd Floor

Presented By:
Harry Estroff - Real Estate Gift Manager - The Nature Conservancy

The Great Recession has produced a tough environment for charitable giving and real estate alike.

- Real Estate gifts have always had a well deserved reputation for being challenging, risky and time-consuming.
- Real Estate gifts compromise somewhere between 2% and 5% of total charitable giving.

Looked at from this perspective, what is the prospect of real estate donations in the current environment? Is this a good

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or bad time for them? Should we accept them, and if so, which gifts and property types work best? How can we limit our risks and improve our odds for success?

These are a few of the questions that this presentation will address, using examples drawn from a number of actual gifts, mostly positive, but a few cautionary. The emphasis will be on how to manage the very real risk inherent in real estate gifts so as to be able to mine this rich, underutilized vein of support regardless of the current state of the economy.

Update on Elder Law - Medicaid

9:00am - 10:15am & 10:30am - 12:00pm

Track II & III

Location: Elizabethan C-D-2nd Floor

Presented By:

Lisa Newfield - Partner - McCarthy Fingar, LLP

This session will cover current changes to medicaid laws, medicaid planning for single individuals and married couples, protecting the family home, use of trusts in elder law planning, retirement accounts and long-term planning.

What Every Donor Would Like You to Know

9:00am - 10:15am & 10:30am - 12:00pm

Track I & II

Location: Alexandra Room - 32nd Floor

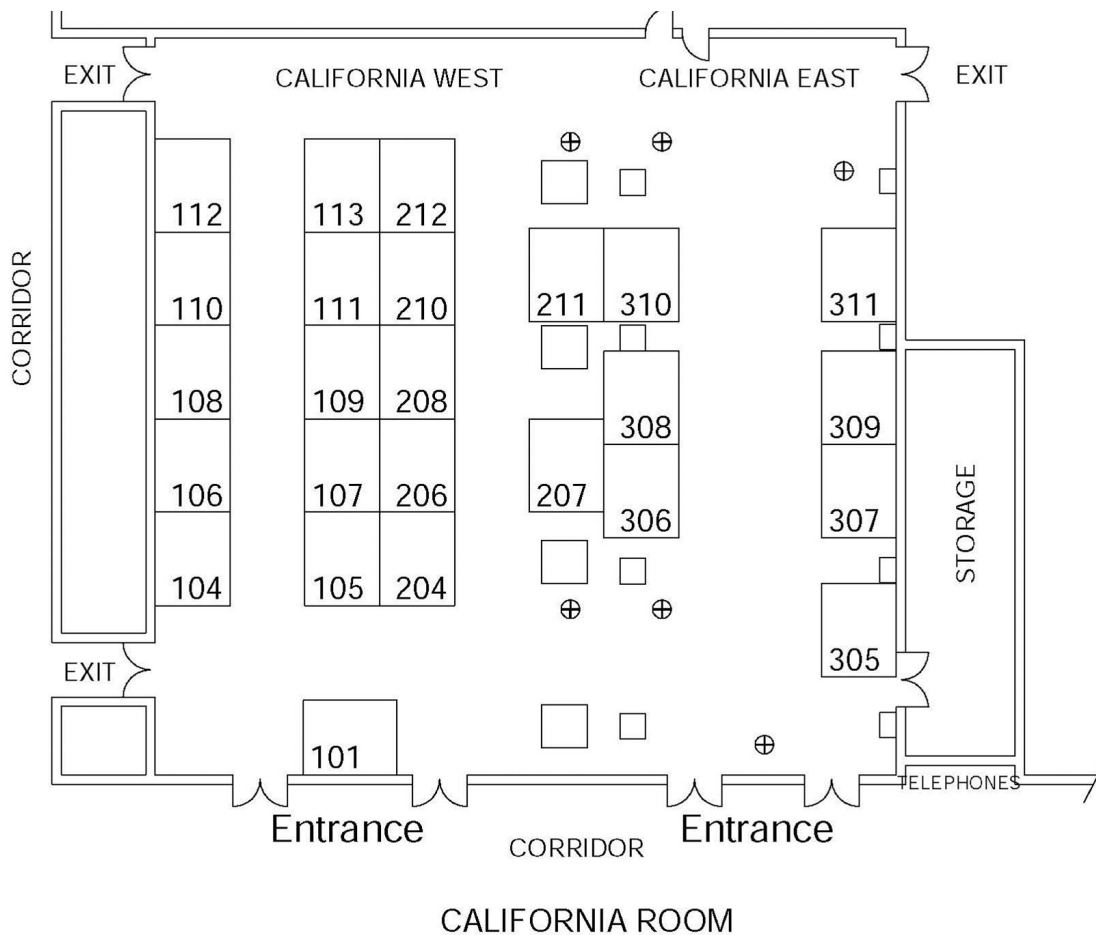
Presented By:

Dan Garrett - Vice Chancellor & President - The ACU Foundation

This session will be a discussion on donor cultivation, motivation, and appropriate recognition. Securing current and ongoing gifts for any organization will ultimately depend on how well you treat your donors. We will use case studies and 38 years of fund development experience to illustrate the “care and feeding” of donors including the annual gift, the capital gift and the ultimate gift.

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Exhibitor Listing by Company:

BNY Mellon Wealth Management.....	305
Crescendo Interactive, Inc.	204 & 206
CTAC.....	113
Delta Trust Philanthropic Solutions	101
Endowment Development Service, Inc.	104
Fifth Third Institutional Services.....	110
Gabriel Group	106
Kaspick & Company	306
MetLife	310
Mutual of Omaha.....	109
Northern Trust.....	112
Pentera.....	309 & 311
PG Calc.....	107
PNC Bank N.A.....	105
R & R Newkirk.....	108
Renaissance Administration.....	211
Ruffalo CODY, LLC	207
State Street Global Advisors.....	210
The Orchard Foundation.....	208
The Sharpe Group	212
The Stelter Company	111
US Bank Charitable Services Group	307
Wells Fargo Bank.....	308

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MetLife	310

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Edie Matulka - Co-Chair

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Ruby S. Pediangco

Laurie W. Valentine

30th Conference Staff

Jennifer Westmoreland, ACGA Account Executive

Kathy Rhodes, President, The Association Group

Tami Brodie, The Association Group

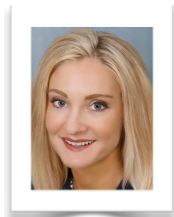
Alicia Gilbert, The Association Group

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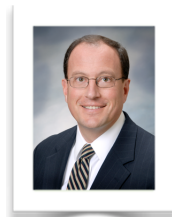


Kristen Schultz Jaarda, JD, LLM - As Crescendo's Senior Vice President, Kristen specializes in online marketing and social media for planned gifts. She is responsible for client education, and consultation for Crescendo's web services. She is a nationally recognized speaker, conducts seminars nationwide and is a principal faculty member of GiftCollege. Kristen serves as a board member for the American Council on Gift Annuities (ACGA) and as a member of the ACGA Rates and State Regulations Committees, Editorial Advisory Board member for Planned Giving Today, Committee Member for the ABA Charitable Planning and Organization's Group, Legislative Chair and a board member for the Partnership for Philanthropic Planning of Greater Los Angeles (PPP-LA), a member of the Ventura County Planned Giving Council and a committee member and volunteer for several local charities. She writes daily for CrescendoTweet and her planned giving blog <http://www.kristenschultz.blogspot.com>. Previously, Kristen served as Counsel to the Assistant Secretary of Education in Washington, D.C. and was Oversight Counsel to the U.S. House Committee on the Judiciary. Prior to that, she worked in a public affairs law practice. Kristen graduated from UCLA School of Law where she was Law Review Editor. She completed her Tax LL.M. with honors at Loyola School of Law. Kristen is a member of the California State Bar, D.C. Bar and the Maryland State Bar.



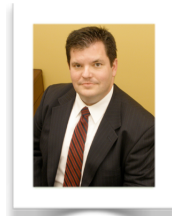
Edie Matulka is a senior consultant in the Seattle, Washington office of PG Calc. She has assisted charities in complying with state regulations for issuance of gift annuities since 1997. In addition to the practice of law, Edie's background includes work in government, public, and nonprofit settings. She is the primary author of certain chapters of Charitable Gift Annuities: The Complete Resource Manual, and has spoken on gift annuities and state regulation at a number of conferences. She currently serves on ACGA's State Regulations Committee.

Keynote Address



Ronald Florance is a Senior Vice President and Managing Director of Investment Strategy at Wells Fargo. His responsibilities include providing comprehensive strategic and tactical asset allocation, financial planning, and investment management solutions for high net-worth individuals, families and philanthropic entities. Mr. Florance has more than 20 years' experience in financial services, with 15 of them in investment management. Mr. Florance has experience managing private client assets and mutual fund portfolios as well as developing strategic and tactical asset allocation policies. Earlier in his career, Mr. Florance worked for Wells Fargo/Nikko Investment Advisors as the lead portfolio manager; he later managed the quantitative equity strategies at The Vanguard Group. Mr. Florance earned his Bachelor of Science degree in Applied Mathematics and Economics from Brown University. He was awarded a Chartered Financial Analyst® designation in 1995. Mr. Florance chairs the Wealth Management Asset Allocation committee, is a voting member of the Due Diligence Committee, and works closely with the Chief Investment Office on the Investment Policy Committee. Mr. Florance is quoted often by print and broadcast media throughout the country.

Symposium I



David B. Moore serves as the director of Planned Giving at Chapman University in Orange, California. In his 17 years of progressive responsibility in the fields of advancement, David has also worked in alumni and parent relations, annual giving and major gifts. Additionally, he has completed a master's degree in organizational leadership and a graduate certificate in organizational development. Always interested in e-marketing, David launched one of the first alumni e-newsletters in the nation at Texas State University- San Marcos in 1994. At the University of Maryland Baltimore County, David launched an alumni and a parent e-newsletter. Under his direction, the planned giving office at Chapman University is believed to have been the first non-profit organization in the nation to have a Facebook page dedicated to planned gift marketing.

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David J. Neff has been doing things that have never been done in nonprofits for the last 10 years. He is currently the creator and CEO of the nonprofit Lights. Camera. Help., a nonprofit organization dedicated to encouraging cause-driven organizations to use film and video to tell their stories. He is the current President of the Social Media Club Austin, as well as a Senior Digital Strategist consultant for a variety of startups and nonprofits and a co-founder of internet start up HelpAttack! He was the American Marketing Association Nonprofit Social Media Marketer of the year for 2009 as well as being named one of the top 20 Social Media people in the state of Texas for 2009 by the Austin American Statesman.



Rebecca Scott has more than 10 years of experience in gift planning, and has been Tufts University's director of gift planning since 2005. Prior to joining Tufts, Rebecca was the associate director of gift planning at the Unitarian Universalist Association of Congregations. She currently serves as the vice president for programming for the Planned Giving Group of New England (PGGNE), and she has presented on gift planning topics at a number of conferences, including the PGGNE All-Day Conference (2010) and the CASE District I Conference (2008). The Facebook page for Tufts' legacy society (The Charles Tufts Society) was just awarded an honorable mention in the 2012 CASE District I Communications Awards in the Social Media category. A graduate of McGill University, she was the general manager of Playwright's Workshop Montreal. Rebecca completed residency in new media design at the Canadian Film Centre and is a co-founder of the interactive marketing company, Trapeze Media (www.trapeze.com). Rebecca has presented on interactive storytelling at a variety of conferences including the National Association of Broadcasters and the Narrative and Interactive Learning Environments conference in Scotland.



Dr. Carole L. Touchinski, CFRM is the CEO of the Marquette County Community Foundation; with key responsibilities for implementing the annual and planned giving campaigns, enterprise accountability, research and development, marketing and donor services. Carole also leads the Foundation's community investment initiatives and is heavily involved in community planning and strategic development. She also serves as an adjunct faculty for Northern Michigan University in the Health Education/Health and Fitness Management Department. Prior to joining the Marquette County Community Foundation she served as the President and CEO of Strategic Solutions. In this position she provides strategic planning, grant writing and fund development services including annual campaigns,

planned giving and capital campaigns for nonprofit organizations in the Midwest. Dr. Touchinski, holds a bachelors degree in Health and Fitness Management, a Masters of Public Administration and a Doctorate in Education. She is also holds a Certificate of Fund Raising Management from Indiana School of Philanthropy. In her free time she bikes, kayaks, reads and spends time with her two children.

Symposium 2



Robert F. Sharpe, Jr. is President of The Sharpe Group. He has over 30 years of gift planning experience. He is an honors graduate of Vanderbilt University and Cornell Law School. In past years, he practiced law with a major law firm specializing in income, estate, and gift taxation and corporate planning. Prior to his legal experience, he served as a development officer for a liberal arts college. He has authored many articles and other publications covering numerous gift planning topics. His remarks on this subject have been featured in the Wall Street Journal, The New York Times, Newsweek, Forbes, Smart Money, CBS Market Watch, The Chronicle of Higher Education, Trusts & Estates, Kiplinger's and other national publications. Mr. Sharpe is chairman of the philanthropy editorial board of Trusts & Estates magazine. He is a co-author of the Model Standards of Gift Valuation adopted by the National Committee on Planned Giving (NCPG). He is a recipient of the CASE Crystal Apple Teaching Award and the Donaldson Distinguished Service Award from the Planned Giving Group of New England. The Sharpe Group consults nationwide with a number of leading educational, health, social service, and religious organizations and institutions in implementing their major and planned gift development efforts. With offices in Memphis and Washington, DC, The Sharpe Group has worked with over 10,000 nonprofits nationwide during its 45-year history. Mr. Sharpe is a frequent speaker for gatherings including Planned Giving Groups in New York, Los Angeles and other cities, the National Committee on Planned Giving National Conference, the American Bankers Association Trust Asset Management Conference, the Association of Fundraising Professionals (AFP) National Conference, the International Fundraising Congress, the Association for Healthcare Philanthropy Advanced Planned Giving Institute, Council for Advancement and Support of Education (CASE) National Conference, CASE Advanced Planned Giving Conference, the O.M.I. Non-Profit Tax Conference, and others.

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Breakout Sessions



Vera Bennett: As chief financial and administrative officer, Vera is responsible for fiscal oversight, regulatory compliance and operational effectiveness of Silicon Valley Community Foundation's \$1.8 billion in assets. She oversees six departments:

grants, gifts and compliance, accounting, investments, information systems, human resources, and facilities. Her responsibilities include managing a \$13 million operating budget and a projected \$250 million in annual grant disbursements through the unrestricted endowment, 13 supporting foundations and more than 1,500 philanthropic funds. Vera served as the longtime CFO and interim CEO in 2006 for Peninsula Community Foundation, where she oversaw the investment and management of the foundation's assets.

Vera graduated summa cum laude from Notre Dame de Namur University in Belmont, California where she received her bachelor's of science degree in business administration with an emphasis in accounting.



Turney P. Berry concentrates his practice in the areas of estate planning, fiduciary matters, and charitable planning. Mr. Berry is a Regent of the American College of Trust and Estate Counsel (ACTEC), a Fellow of the American College of Tax Counsel, a member of the Joint

Editorial Board for Trusts and Estates, a Uniform Law Commissioner representing Kentucky, a Member of the Advisory Board of Trusts and Estates Monthly, and a Trustee of the Southern Federal Tax Conference. He has been certified as an Accredited Estate Planner® (AEP®) by the National Association of Estate Planners & Councils. He is listed in Woodward/White's The Best Lawyers in America® and in the Kentucky Super Lawyer Magazine in the area of Trusts and Estates. Mr. Berry has been an Articles Editor of The Tax Lawyer, a past chair of the Louisville Bar Association Probate and Estate Planning Section, Adjunct Professor at Vanderbilt University, the University of Missouri, and the University of Louisville and regularly speaks at the nation's leading estate planning conferences. He is a member of the Louisville Estate Planning Council, Kentuckiana Planned Giving Council, an adjunct member of the American Association of Life Underwriters, and is a member of the Legal Advisory Committee of the Council on Foundations. Mr. Berry is the author or co-author of three Tax Management Portfolios: Estate Tax Deductions - Sections 2053 and 2054; Private Foundations - Self Dealing - Section 4941; and Taxable Expenditures - Section 4945. In addition he is co-author of Tax Planning for S Corporations and Trust Law in Kentucky (both in progress) and his frequent articles have appeared in numerous journals and magazines. Mr. Berry is Chair of the Center for Interfaith Relations, a

Director of Actors Theatre of Louisville, the Kentucky Opera, and the Louisville Science Center, and a Member of the Honorable Order of Kentucky Colonels. He is a member of Louisville Downtown Rotary, and is a past President of the Daily Bread Sunday School Class at Christ Church United Methodist.



Kristine L. Caratan, CPA, retired from public accounting after nearly 37 years to pursue a full time career in the NFP arena. She currently provides consulting for a variety of NFPs in the greater San Francisco Bay area, including the San Francisco Symphony, the Exploratorium, Street Smart

for Kids, Aknadi, Diocese of Orange California, and ADWF-USA. Kristine served as longtime Audit Partner for Moss Adams, LLP. During her stint at Moss Adams, Kristine assisted in creating a practice for the firm that required developing a brand name for the firm in the not-for-profit community, identifying and training staff in NFP accounting and auditing, and building a coalition within the entire firm. Kristine received her Bachelors of Science in Commerce from Santa Clara University, and is currently enrolled in Masters of Nonprofit Administration at the University of San Francisco.



Christopher P. Cline is Wells Fargo Bank's Regional Wealth Management Director for Oregon and SW Washington. His career includes over 15 years of experience in the estate planning field with Holland & Knight LLP and Lane Powell LLP in Portland, and Pillsbury, Madison, & Sutro

LLP in San Francisco. Chris is a fellow of the American College of Trust and Estate Counsel and a Past President of both the Portland Estate Planning Council and the Oregon State Bar's Estate Planning and Administration Section. He is the author of "Trustee Investments" and an upcoming book on disclaimers, both published by the American Bar Association, and six Tax Management Portfolios, published by the Bureau of National Affairs, on Disclaimers, Dynasty Trusts, Powers of Appointment, Trustee Investments and Spousal Elections.



Andrew Coddington is the Associate Vice President of Institutional Advancement and Director of Gift Planning at Colgate University. He started at Colgate in 2004 as a regional advancement director in Colgate's Major Gifts office. His work involves integrating philanthropy from

alumni and friends with financial, retirement, and estate planning, as well as oversight of Colgate's Corporate, Foundation and Government Relations program.

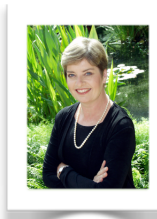
Prior to Colgate, he was Director of Development for Bennington College, in Bennington Vermont, where he was

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in charge of the fundraising operations and had major gift responsibilities. From 1995 through 2001, he held several fundraising positions at Syracuse University, including director of development for the Maxwell School of Citizenship and Public Affairs. Andrew has a Bachelor of Science degree from the State University of New York College at Geneseo, and a Master of Arts degree in public administration from the Maxwell School at Syracuse University.

In Hamilton, NY, he is the president of the Hamilton Emerald Foundation, which supports the education of the children attending the local Hamilton Central School. He is also a youth soccer coach with the AYSO chapter in Hamilton. Andrew is the father of two boys, ages 14 and 8. His wife teaches kindergarten at their local school.



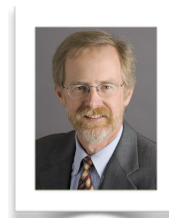
Pamela Jones Davidson, J.D., is President of DAVIDSON GIFT DESIGN, Bloomington, Indiana, a consulting firm specializing in gift planning, planned giving program design and implementation, and training. She is also a Senior Vice President for THOMPSON & ASSOCIATES, offering estate planning services to nonprofits. Before forming Davidson Gift Design in 1999, she was a charitable gift planner and consultant for three years with Laura Hansen Dean and Associates, Indianapolis, Indiana. From 1985 through 1996, she was with Indiana University Foundation, most recently as its Executive Director of Planned Giving and Associate Counsel. Ms. Davidson received her undergraduate degree from Indiana University in 1975, and graduated magna cum laude from the Indiana University School of Law at Indianapolis in 1979. She has previously been an examiner in the Estate and Gift Tax Division of the Internal Revenue Service, and later practiced business, corporate and probate law with the Indianapolis law firm of Bingham, Summers, Welsh & Spilman (now Bingham McHale) before joining the nonprofit sector in 1985. Ms. Davidson was the 1999 President (now Chair) of the National Committee on Planned Giving (now Partnership for Philanthropic Planning, PPP), and served NCPG in various capacities during her six years on the Board, in 1995 as Education Chair, in 1996 as Secretary, and as President Elect in 1998. She served as NCPG's 2000 Nominating Committee Chair and is a past member and chair of its Ethics Committee.

Ms. Davidson is on the Editorial Board of the Planned Giving Design Center, and past faculty of The College of William and Mary's National Planned Giving Institute. She is a past board member and past treasurer of the Indiana Chapter of the National Society of Fund Raising Executives (now Association of Fundraising Professionals, AFP), and a past board member and president of the Planned Giving Group of Indiana. She is a past president of the Network of Career Women, and a Leadership Bloomington alumna. She is on

the Boards of her local Edgewood Choral Foundation and Buskirk-Chumley Theater, and on the Board and past President of Middle Way House, her community's nationally recognized women's shelter, now in a capital campaign with an endowment component. She serves on the Community Advisory Boards of both her local public radio and television stations. In her almost twenty six years in the gift planning profession, Ms. Davidson has made countless presentations throughout the state of Indiana and nationally to development professionals, planned giving councils, estate and tax attorneys, accountants and financial planners, and to prospects and donors about planned giving and charitable giving techniques. She is known for her pragmatic and practical presentations, designed to empower and motivate many individuals to understand that there is an understandable gift plan that will work in their circumstances that can further both personal planning goals and philanthropy.



Steven Drutz is a Senior Financial Analyst with the Washington State Office of Insurance Commissioner. For over 10 years Steve has been working with the Financial Analysis section of the Company Supervision division. His primary responsibilities include monitoring the financial solvency of many of Washington State's domestic insurance companies and their compliance with that state's insurance code. Since 2010 Steve has been the lead analyst overseeing the financial analysis of the over 300 Charitable Gift Annuity Issuers holding a Certificate of Exemption in Washington State. Steve received a Bachelor of Science degree at the University of Colorado at Boulder in Architectural Engineering in 1987 and another from The Evergreen State College in Environmental Studies in 1989. He is a Certified Public Accountant and Certified Financial Examiner. He was a recipient of the National Association of Insurance Commissioner's Paul De Angelo Development Scholarship in 2004.



Erik Dryburgh is a principal in the law firm of Adler & Colvin, a law firm specializing in representing nonprofit organizations and their donors. He has an undergraduate business degree from the University of Wisconsin at Madison, and earned his J.D. at the University of California at Berkeley, Boalt Hall. He is also a Certified Public Accountant. Erik's areas of expertise include charitable gift planning, endowments, and not-for-profit organizations.

Erik has authored the chapter "Charitable Remainder Trusts," in California Estate Planning, Continuing Education of the Bar (2002) and published numerous articles on charitable gift planning. Erik is a co-editor of The Charitable Gift Planning News.

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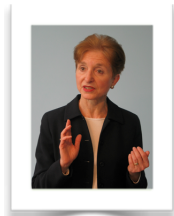
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Erik is a past Board member of the Partnership for Philanthropic Planning (formerly NCPG), the San Francisco Estate Planning Council, and the Northern California Planned Giving Council. He is a Co-Chair of the Charitable Planning Committee of the American Bar Association's Real Property, Trust and Estate Section. Erik received the 2005 Phil Hoffmire Service Award from the Northern California Planned Giving Council, and is a fellow of the American College of Trust and Estate Counsel (ACTEC).



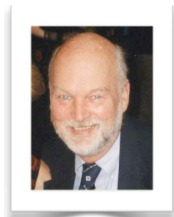
Roger Ellison is Senior Advisor for Philanthropy at the West Texas Rehabilitation Center Foundation. He graduated from the University of Texas at El Paso with undergraduate and graduate focus on political science, rhetoric and politics. Ignoring that preparation, he spent twenty-three years in the resident camping program of the Dallas YMCA and four years directing a boys ranch near San Angelo, Texas before those experiences inexorably lead him in 1993 to planned giving and his current responsibilities. Roger is a Certified Financial Planner®.

A member of the Dallas area North Texas Chapter, Partnership for Philanthropic Planning, he drives 250 miles each way for regular meetings. Additionally, Roger is a planned giving consultant whose work focuses on relationship building and is a furniture maker who builds fine furniture, especially of mesquite. He enjoys cooking over a campfire and with his Dutch ovens.



Ellen G. Estes, LL.B., 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.

Ellen founded Estes Associates to provide consulting services on major and planned gift matters to non-profit organizations nationwide. Ellen is a regular speaker at professional conferences around the country. In 2008 she was awarded the prestigious David M. Donaldson Distinguished Service Award by the Planned Giving Group of New England. Ellen is also widely recognized for her no-nonsense, basic seminars, "Planned Giving – Plain and Simple™".



Frank Estes, LL.B., a graduate of Stanford Law School, 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. Frank formerly served on the Boards of the Connecticut Chapter of AFP and the Planned Giving Group of Connecticut.



Harry Estroff was born in Pittsburgh, PA and raised in Birmingham, AL. He has a BA from Yale University. He has been the Real Estate Gift Manager for The Nature Conservancy for over 10 years. At The Conservancy, he is responsible for all phases of "trade land" gifts (i.e. those donated with permission from the donor to sell them and use the proceeds for TNC's work) up to the point that the property is deeded to the Conservancy. His duties include promotion, solicitation, working with donors and gift planners to structure gifts, due diligence, approval and closing. Prior to joining the Conservancy, he was involved in commercial real estate-acquisition, syndication, renovation, leasing and sales in downtown Washington for 20 years.



Dan Garrett has served as President of The ACU Foundation and Vice Chancellor of Abilene Christian University since 1995. In this capacity he is responsible for leadership and direction of planned giving activities designed to sustain endowment, capital and operating needs of the university. During his tenure, endowment has grown from approximately \$50 million to almost \$300 million. The Foundation also manages more than \$70 million in split-interest agreements for the benefit of donors/beneficiaries and the university. He also serves a president of The Garrett Group, providing consultation and services for planned giving, capital campaigns and general fund raising. He has thirty-five years of successful practice in the planned giving arena. In recent years, he has more intentionally incorporated values-based elements into deferred gift and estate planning by successfully completing the Certified Wealth Counselor's program and routinely incorporating heritage planning into all donor/client relationships. Mr. Garrett has conducted several hundred training seminars for fund raising executives, planned giving officers and allied professionals. In addition, he has provided training for non-profit executives and board members, and educational seminars for donors and clients. Most recently, he presented at the Crescendo 2010 Practical Planned Giving Conference and to the governing board of Christus Healthcare in Beaumont, Texas.

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Charles B. Gordy is the director of Planned Giving at Harvard Law School. Prior to joining Harvard Law School, he managed planned giving services for The Bank of New York, and was the Director of Planned Giving at Yale University and at Tufts University. He is on the Board of the

American Council on Gift Annuities and the Planned Giving Group of New England. He served on the Boards of the Partnership of Philanthropic Planning and the Planned Giving Group of Greater New York. He is a frequent speaker nationally and regionally on topics related to planned giving.



David Hale is Vice President for Finance and Administration and Treasurer of Colgate University. A 1984 graduate of the university, David returned to Colgate in 1993 to take a position in the Development Office as Associate Director of Planned Giving. In 1996 he moved to the financial

side of the institution, assuming the role of Director of Financial Analysis and Investments. He was promoted to Assistant Treasurer in 2000 and was named Financial Vice President & Treasurer in 2001. In late 2007, President Chopp announced the formation of the Division of Finance and Administration, and Dave was promoted to Vice President of this newly formed division. Prior to his return to Colgate, David worked in public accounting and then in the financial divisions of Paramount Pictures and Sony Pictures in NYC, Amsterdam and Los Angeles. He holds a Masters in Accounting from New York State Stern School for Business.



Carol Harmon has practiced law in California since 1978. An Illinois native, she practiced civil litigation in San Francisco for 12 years before joining, in 1992, the California Department of Insurance at the San Francisco headquarters of its Legal Division. While she deals with virtually all

matters filed by insurance companies with the Corporate Affairs Bureau, including Certificate of Authority applications, mergers and acquisitions, and stock permits, she has a special affinity for non-profit licensees of charitable gift annuities. In the past several years, she has licensed hundreds of additional "Grants and Annuities Societies" in California, and has recently revised the Application Forms and Instructions packet for prospective licensees and seen it added to the Department's award winning website.



Christopher Hoyt is a Professor of Law at the University of Missouri Kansas City School of Law where he teaches courses in the area of federal income taxation and business organizations. Previously, he was with the law firm of Spencer, Fane, Britt & Browne in Kansas City, Missouri. He

received an undergraduate degree in economics from

Northwestern University and he received dual law and accounting degrees from the University of Wisconsin. Professor Hoyt is currently the Co-Chair of the American Bar Association's Committee on Charitable Organizations (Section of Trusts and Estates). He is an ACTEC fellow and he serves on the editorial boards of Trusts and Estate magazine and the Planned Giving Design Center. He is a frequent speaker at legal and educational programs and has been quoted in numerous publications, including The Wall Street Journal, Forbes, MONEY Magazine, The New York Times and The Washington Post.



Ilisa Hurowitz brings to her diverse client work more than 25 years of experience as a development professional, consultant and gift planning specialist. An independent consultant, Ilisa is also affiliated with Marts & Lundy, where she had been a senior consultant and planned giving

practice group leader for 10 years. Campaign consulting experiences with a range of institutions have included Boston College, Boston University and Boston University School of Law, MIT, John F. Kennedy Library Foundation, Children's Hospital Boston, Preservation Society of Newport County, Northwestern University, and the Boston Symphony Orchestra. Prior to joining Marts & Lundy, Ilisa served as endowment development vice president with Combined Jewish Philanthropies of Greater Boston. She served as associate director, major gifts for Harvard University's Faculty of Arts and Sciences, and as director of planned giving at Wellesley College. Ilisa is a member of the Development Committee of Belmont Day School. She is past president of Women in Development of Greater Boston, a past president of the Planned Giving Group of New England, a former member of the Board of Jose Mateo's Ballet Theater, and a past president of the Cornell Club of Boston. Ilisa is an alumna of Cornell University and Boston University School of Law.



Lawrence P. Katzenstein is a nationally known authority on estate planning and planned giving, and a frequent speaker around the country to professional groups. He divides his practice between representation of wealthy individuals in estate planning matters and serving as

outside counsel to planned giving programs at charitable organizations nationwide. He has provided continuing legal education programs to Internal Revenue Service estate and gift tax attorneys. He appears annually on several American Bar Association-American Law Institute estate planning programs, and has spoken at many other national tax institutes, including the Notre Dame Tax Institute, the University of Miami Heckerling Estate Planning Institute and the Southern Federal Tax Institute. Mr. Katzenstein has served as an adjunct professor at the Washington University School of Law where he has taught both estate and gift

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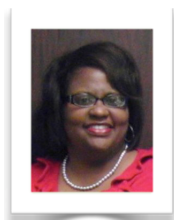
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taxation and fiduciary income taxation. A former chair of the American Bar Association Tax Section Fiduciary Income Tax Committee, he is current chair of several Tax Section charitable planning subcommittees. He is listed in Best Lawyers in America® 2011 (Copyright 2010 by Woodward/White, Inc., of Aiken, S.C.) in the field of Trusts and Estates and was named Best Lawyers' 2011 St. Louis Non-Profit/Charities Lawyer of the Year. He was selected in the 2009 edition of Chambers USA in Wealth Management: Eastern Region - National. He has served as a member of the advisory board of the National Center on Philanthropy and the Law at New York University. Mr. Katzenstein is also the creator of Tiger Tables actuarial software, which is widely used around the country by tax lawyers and accountants as well as the Internal Revenue Service. He received his undergraduate degree from Washington University in St. Louis and his law degree from Harvard.



Cam Kelly joined the University Development Office at Duke as assistant vice president for principal gifts programs in October 2008. She held advancement positions at her alma mater, Smith College, for seventeen years before coming to Duke; her most recent position was director of campaign & gift planning. She also served as special assistant to the president for strategic plan implementation in 2007 and 2008. Kelly held the position of director of planned gifts & bequests at Smith beginning in 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 an investment management firm in Boston. She earned an A.B. degree from Smith College in mathematics, and she is a Chartered Financial Analyst (CFA).

Kelly has served on the board of the American Council on Gift Annuities since 1994. She currently co-chairs its Rates Committee and serves as Vice Chair for the organization. She is a member of the Editorial Advisory Board of Planned Giving Today.

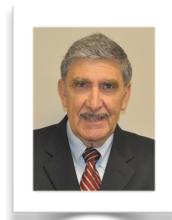


Bene' Kyles As a Securities Analyst of the Alabama Securities Commission since July 2000, Ms. Kyles performed Investment Adviser/Broker Dealer audits and reviewed and analyzed Investment Adviser/Broker Dealer applications. Currently, she reviews and analyzes registration/exemptions of church bonds, church extension funds, charitable gift annuities, restricted agents and the licensing of money transmitters. Ms. Kyles has participated in numerous North American Securities Administration Association (NASAA) Training; Broker Dealer/Investment Advisers, WEB CRD/IARD, Corporate Finance, Attorney/Investigator Training Seminar, Investor Education Training Seminar and served as a 2002 Southeastern Zone Representative.

Ms. Kyles was recently a presenter for community outreach to young men and women in Career and Technical Education Student Organizations on behalf of the Education & Public Affairs Division of the Alabama Securities Commission. Ms. Kyles received her Bachelor of Science degree in Accounting from Alabama State University in 1986 and Master of Business Administration degree from Troy State University, Montgomery in 1994.



David A. Libengood is Director, Relationship Management at Kaspick & Company. He has 25 years of experience in planned giving and is a frequent speaker at regional and national conferences. Libengood serves as a member of the Board of Directors, and Co-Chair of the Rates Committee, of the American Council on Gift Annuities (ACGA). He is also a Past President of the Planned Giving Group of New England. Prior to joining Kaspick & Company in 2001, Libengood was responsible for gift planning, trust and bequest administration, and the investment of life income gifts at The First Church of Christ, Scientist in Boston. He graduated with high honors from the American Bankers Association's National Graduate Trust School and is a Certified Trust and Financial Advisor (CTFA). He holds a Bachelors of Music Performance degree and an MBA with distinction from The University of Michigan.

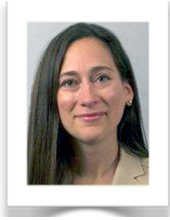


Frank Minton founded Planned Giving Services, a consulting firm that built an exceptional national reputation and was acquired by PC Calc in August 2005. Before entering consulting in January 1991, he spent 1 1/2 years with the University of Washington, where he served as Director of Planned Giving and Executive Director of Development. Minton has played a critical role in shaping the planned giving industry as we know it today. He has served both as Conference Chair and Board Chair of the Partnership for Philanthropic Planning. In 1992 he received its Distinguished Service Award. He is an extensively recognized expert on gift annuities and has served as Chair of the American Council on Gift Annuities. He has also received a CASE (Council for the Advancement and Support of Education) Distinguished Service Award, the David Donaldson Distinguished Service Award from the Planned Giving Group of New England, and was the first recipient of the Outstanding Development Officer Award from the Northwest Development Officers Association. He is the principal author of Charitable Gift Annuities: The Complete Resource Manual and is co-author of Planned Giving for Canadians (Second Edition, 1997). A number of his presentations have been to Canadian audiences, and in 1997, he received the "Friend of the Canadian Association of Gift Planners" award. He is on the advisory board of Planned Giving Today, and is a member of the Seattle Estate

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Planning Council and the Washington Planned Giving Council.



Lisa Newfield co-chairs McCartny Fingar, LLP Charitable Gift Planning, Exempt Organizations, and Trusts & Estates groups and is a member of the Taxation group. Lisa is also a noted lecturer on charitable giving, exempt organization and various tax topics and has spoken to bar associations and

exempt organizations on numerous topics in those areas. Lisa has lectured before Pace University School of Law, Center for Continuing Legal Education, Elder Law Section of the Westchester County Bar Association, The Westchester Women's Bar Association and several national non-profit institutions. She has contributed to Tax Planning Tips for Professional Advisors, the newsletter of the United Jewish Appeal-Federation of Jewish Philanthropies of New York. Lisa has also appeared on the Westchester Women's Bar Association's local cable show "Financial Planning with Legal Ease."



Phil Purcell currently serves as Vice-President for Planned Giving and Endowment Stewardship at the Ball State University Foundation where he assisted with the successful completion of a \$200 million campaign, of which \$65 million in planned gifts was raised. Formerly, he

served as Director of Gift Planning for the Central Indiana Community Foundation (Indianapolis, IN), Director of Development for St. Vincent Hospital Foundation and Director of Planned Giving and Development Counsel for Rose-Hulman Institute of Technology. Phil is an attorney and member of the American and Indiana State Bar Associations. Phil 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). Phil has served as a member of the board of directors for the Partnership for Philanthropic Planning, Planned Giving Group of Indiana (past president), Association of Fundraising Professionals Indiana Chapter (president-elect), and the Central Indiana Land Trust. He has written articles on charitable gift and estate planning that have appeared in The Journal of Gift Planning, Planned Giving Today, CASE Currents, Planned Giving Design Center and other publications. Phil serves on the Editorial Advisory Board for Planned Giving Today.

He has consulted on behalf of all types of charitable organizations, including the Lilly Endowment's GIFT program serving community foundations throughout Indiana. His consulting has focused on philanthropy (e.g., fundraising,

planned giving) and nonprofit governance (e.g., strategic planning, nonprofit governance, legal issues). Phil received his B.A. degree from Wabash College in 1981 (magna cum laude) and his J.D. and M.P.A. degrees (with honors) from Indiana University in 1985.



Brian M. Sagrestano, JD, CFRE, is the President and founder of Gift Planning Development, a full-service gift planning consulting firm. Brian provides gift planning services to a wide range of charitable clients from national organizations focused on high end gift plans to local charities seeking to

start new gift planning programs. Some of his clients include the University of Notre Dame, Temple University, Create a Jewish Legacy, Children's Hospital of Philadelphia, and Delaware Art Museum. Prior to starting GPD, he spent twelve years as a charitable gift planner, directing the gift planning programs for the University of Pennsylvania, Middlebury College and Meridian Health Affiliated Foundations. Brian is a nationally sought after speaker on gift planning topics and serves on the editorial board of the Journal of Gift Planning. He is a past board member of the Partnership for Philanthropic Planning (PPP), the Gift Planning Council of New Jersey and PPP of Greater Philadelphia. Brian has been a contributor to Planned Giving Today, Planned Giving Mentor, Plannedgiving.com and Planned Giving Tomorrow. He just released his first book, with co-author Robert E. Wahlers, CFRE, The Philanthropic Planning Companion: A Charitable Giving Guide for Fundraisers and Advisors, (Wiley 2012). An honors graduate of Cornell University and Notre Dame Law School, Brian lives with his wife and children in New Hartford, New York, the scenic gateway to the Adirondack Mountains.



Bill Reeser is the Chief Investment Officer of ALSAC / St. Jude Children's Research Hospital. Bill joined ALSAC / St. Jude Children's Research Hospital in December 2000 to establish the organization's internal investment department. Bill developed the structure,

process, controls and best practices necessary for the management and administration of multiple institutional portfolios within the organization. He currently has investment responsibility for over \$2.5 billion in assets in the endowment, operating, pension, charitable trust and charitable gift annuity investment pools of the organization. Additionally Bill serves on the executive management team of the fundraising organization and is involved in the strategic and long range planning of the institution. Prior to joining ALSAC / St. Jude Children's Research Hospital Mr. Reeser served as President of an investment advisory and consulting firm and as a Registered Principal for a national pension plan third party administrator. He currently serves on the board of directors of the American Council of Gift

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Annuities and has previously served on the board of a national youth services organization.



Rebecca Scott - With more than 10 years of experience in gift planning, Rebecca Scott has been Tufts University's director of gift planning since 2005. Prior to joining Tufts, Rebecca was the associate director of gift planning at the Unitarian Universalist Association of Congregations. She currently serves as the vice president for programming for the Planned Giving Group of New England (PGGNE), and she has presented on gift planning topics at a number of conferences, including the PGGNE All-Day Conference (2010) and the CASE District I Conference (2008).

A graduate of McGill University, she was the general manager of Playwrights' Workshop Montreal. Rebecca completed a residency in new media design at the Canadian Film Centre and is a co-founder of the interactive marketing company, Trapeze Media (www.trapeze.com). Rebecca has presented on interactive storytelling at a variety of conferences including the National Association of Broadcasters and the Narrative and Interactive Learning Environments conference in Scotland.



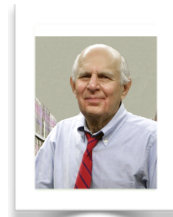
Winton Smith, J.D., is a nationally recognized estate and charitable gift planning attorney whose clients include both philanthropists and also charitable organizations. He works with charitable organizations and helps them build and conduct planned giving programs that

encourage their donors to learn how they can both make the smartest gift and also give more than they ever dreamed possible to their charitable interests.



Mike Sutton is the Director of Investment Operations for The Salvation Army, Southern Territory. Mike has been with The Salvation Army in various capacities for over 20 years. Most of his years with the Army have been in positions in the areas of Finance, Investments, and

Planned Giving. Mr. Sutton oversees the day to day operation of the Army's investment portfolio through the Army's Office of Investments. Some of his duties include ongoing relationships with investment managers, liaison with the custody bank and the investment consultant, and secretary to the Investment Advisory Board. Additionally, Mr. Sutton is responsible for oversight of the Planned Giving accounting and administrative operations including investments of trusts, gift annuities and pooled income funds. Mike received a BA in Business Management from Asbury University in Wilmore, KY.



Conrad Teitell is a partner in the Connecticut and Florida law firm of Cummings & Lockwood, based in the Stamford, Conn. office, and is chairman of the firm's National 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, estate planning and public speaking. Teitell writes the monthly newsletter, Taxwise Giving, and is the author of the five-volume treatise, Philanthropy and Taxation. His column, Estate Planning and Philanthropy, appears in the New York Law Journal. He is a contributing editor of Trusts & Estates magazine and is listed in The Best Lawyers in America. He is the recipient of the American Council on Gift Annuities's Lifetime Achievement Award and the American Law Institute/American Bar Association's Harrison Tweed Award for Special Merit in Continuing Legal Education. As a volunteer, on behalf of charities nationwide, he has testified at hearings held by the Treasury, the Internal Revenue Service, the Senate Finance Committee, the House Ways and Means Committee and the House Judiciary Committee. He was one of four invited witnesses to testify at the Senate Finance Committee on estate tax revision.

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MODEL STANDARDS OF PRACTICE FOR THE CHARITABLE GIFT PLANNER

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 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 finder's fees, commissions or other fees by a donee organization to an independent Gift Planner as a condition for the delivery of a gift is 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 Advisers**

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 advisers 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 Planner, 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 Planner 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.

*Adopted and subscribed to by the National Committee on Planned Giving and the American Council on Gift Annuities, May 7, 1991
Revised April 1999.*

Investing in a better tomorrow.

Our Charitable Gift Services group offers comprehensive administrative and investment management services to planned giving programs across the country.

We are proud to serve clients who support our communities and strive to make them a better place, now and in the future.

George Rio

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Keynote Presentation:

A World in Economic Transition

Presented by:

Ronald Florance
Managing Director of Investment Strategy
Wells Fargo
8601 N. Scottsdale Road
Suite 150
Scottsdale, AZ 85253
P: 480-348-4007
E: ronald.m.florance@wellsfargo.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

Focus 2012 – The Global Economy At a Crossroads


Wells Fargo Wealth Management
Ronald Florance, EVP
CFA, WBR Chief Investment Strategist

A Note about Disclosures:
Please be sure to read the important disclosures at the end of this presentation.

Investment and Business Related:
 • We will receive the bulk of any other related compensation only
 • We will receive an equity award from the bank in any form of
 • We will receive

Wells Fargo Private Bank provides financial services and products through Wells Fargo Bank, N.A. and its affiliates. Wells Fargo & Company does not provide tax advice. Please consult your professional tax advisor to determine how this information may apply to your own situation.

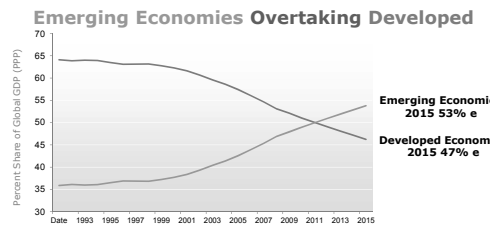
Together we'll go far



The World's Economic Face is Changing

By some measures, emerging economies are set to surpass the developed economies in terms of total GDP.

Emerging Economies Overtaking Developed



Emerging Economies 2015 53% e
Developed Economies 2015 47% e

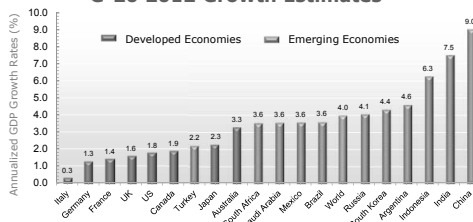
The Purchasing Power Parity (PPP) exchange rate is defined as the amount of currency that would be needed to purchase the same basket of goods and services as one unit of the reference currency, usually the US dollar.

Source: IMF, 9/2011

Global Growth is Decoupling

Resource-rich countries with low debt burdens are expected to grow more rapidly.

G-20 2012 Growth Estimates



Source: IMF World Economic Outlook, 9/2011

Seven of Largest Twenty Economies “Emerging”

Per-capita GDP is far lower in emerging economies, however.

GDP Rank	Country	Current GDP (US\$ Billions)	Per Capita GDP
1	USA	\$ 14,582	\$ 47,302
2	China	5,372	4,220
3	Japan	5,498	43,093
4	Germany	3,310	40,538
5	France	2,560	39,526
6	United Kingdom	2,246	36,025
7	Brazil	2,038	10,332
8	Italy	2,051	33,769
9	India	1,729	1,474
10	Canada	1,574	46,625
11	Russia	1,430	10,516
12	Spain	1,407	20,263
13	Mexico	1,040	9,244
14	South Korea	1,014	20,859
15	Australia	925	42,984
16	Netherlands	783	47,268
17	Turkey	735	2,450
18	Indonesia	707	2,908
19	Switzerland	524	68,709
20	Poland	469	12,182

Source: Bloomberg Financial, LLP, US Census International Database, 11/2011

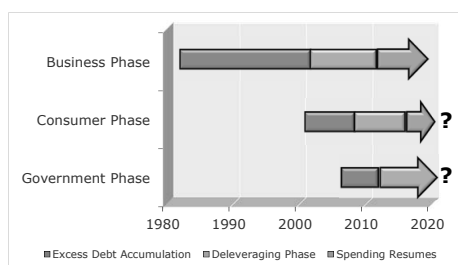
The Global Economic Evolution

Five Investment Themes for 2012:

- 1) Deleveraging in the Developed Economies
- 2) The Global Consumer in Transition
- 3) The New Growth Engines of the Global Economy
- 4) Cash Flow/Liquidity for New Economic Realities
- 5) Managing Through Uncertain Times

Developed Markets are Deleveraging

Businesses cut debt first, followed by consumers. Governments are just starting to address debt levels.

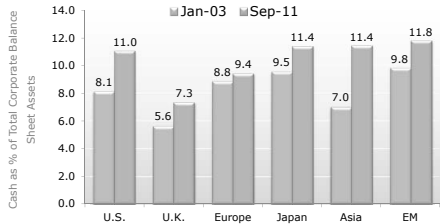


Source: Wells Fargo Wealth Management, 2011

Phases of Deleveraging - Business

Corporate balance sheets around the world reflect significantly higher levels of liquidity.

Corporations' Cash Holdings Have Risen

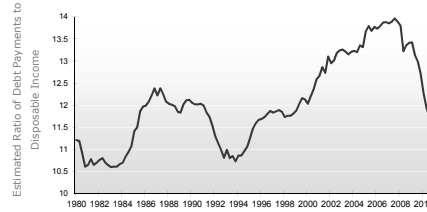


Source: Empirical Research Partners, 2011. U.S. not including utilities, financials, or autos. All others not including financials.

Phases of Deleveraging - Consumer

Lower debt levels and interest rates have helped bring U.S. household debt service costs down to 1994 levels.

U.S. Household Debt Service Ratio

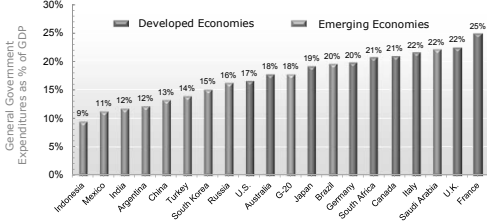


Source: Wells Fargo Wealth Management, U.S. Federal Reserve 11/11

Phases of Deleveraging - Government

Government spending has been a significant factor in European economies.

Government Expenditures as % of GDP¹

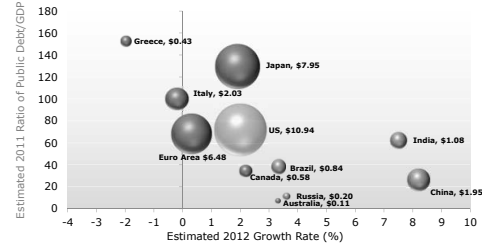


¹ Based on constant 2000 USD, 2009
Source: United Nations Statistical Division

Emerging Economies Have Low Debt/GDP

Emerging economies have more fiscal flexibility than most developed economies.

Emerging Economies Debt/GDP Lower



Bubble size = 2011 Net (Public) Debt Estimates in US\$ (Brazil, China and Russia = Gross Debt in US\$)
Source: 2012 Growth Estimates, Wells Fargo Wealth Management, 12/11; IMF, WEO Database, 9/2011

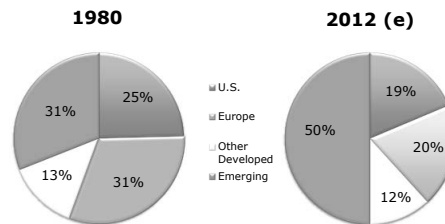
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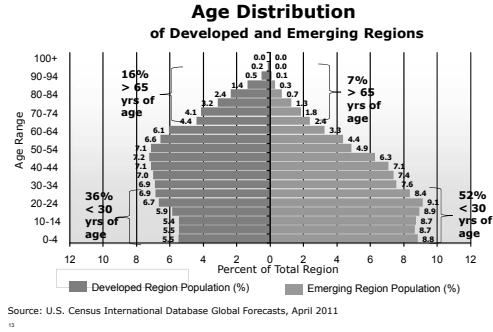
Consumers Becoming More Global

Emerging economies have greatly increased their share of GDP in the past 30 years.



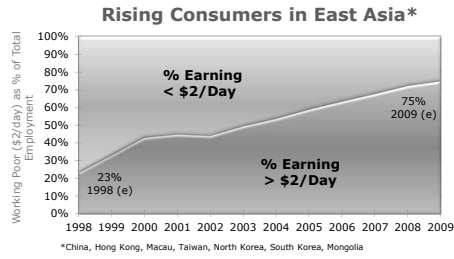
Based on purchasing power parity (e) estimated
Source: IMF, World Economic Outlook Database, 9/2011

Emerging Economies Are Younger



The Rise of the Global Consumer

In East Asia alone, nearly three hundred million workers have risen above "working poor" (\$2/day) conditions.

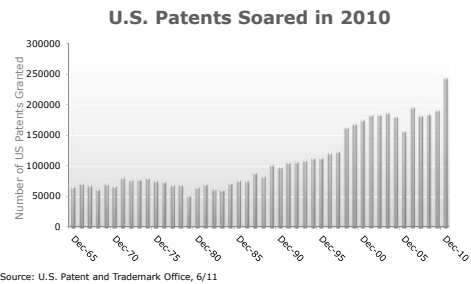


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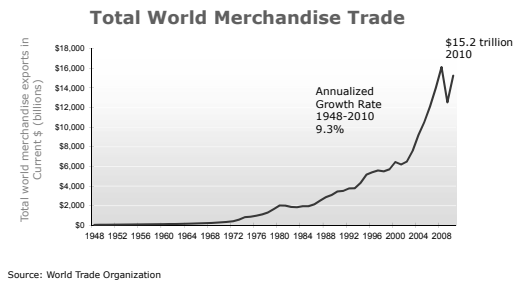
Will Innovation Be an Engine for U.S. Growth?

America's strong entrepreneurial spirit may lead to higher U.S. growth rates than we are forecasting.



Trade as a Growth Engine

The world economy continues to see rising global trade in goods and services.



Global Investment Opportunities

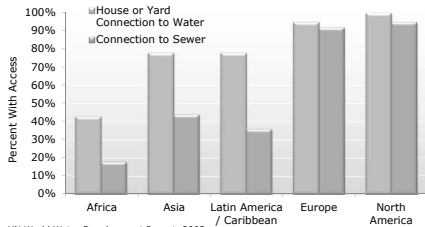
Two-thirds of the world's largest corporations, by market capitalization, are domiciled outside the U.S.



Infrastructure Needs are Great in EM

Many urban citizens of developing countries lack basic infrastructure (not to mention rural citizens).

Households in Major Cities Connected to Water and Sewers

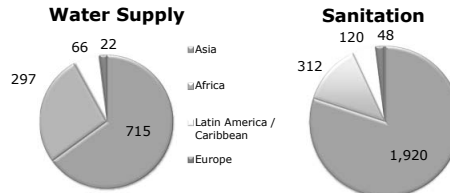


Source: UN World Water Development Report, 2003
Information provided by 116 cities.

Infrastructure Needs are Great in EM

Over a billion people lack adequate water, and nearly 2.5 billion lack basic sanitation.

Millions of People Without Improved:

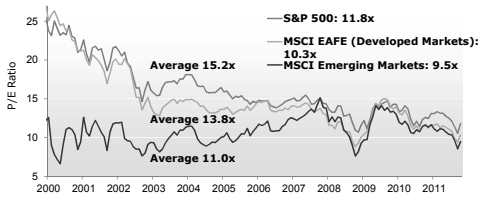


Based on purchasing power parity (€) estimated
Source: WHO/UNICEF Joint Monitoring Programme, (2002, extracted from WWDR1, "Water for People, Water for Life" (UNESCO_WWAP, 2003)

Valuations Remain Attractive

Global equity price to earnings ratios remain low by historical standards.

Global Forward P/E Ratios



Past Performance is no guarantee of future results. P/E represent current price relative to earnings expected over the next twelve months.
The S&P 500, MSCI EAFE and MSCI EM are unmanaged indexes and are unavailable for direct investment.
Source: FactSet, as of 10/31/11

The Global Economic Evolution

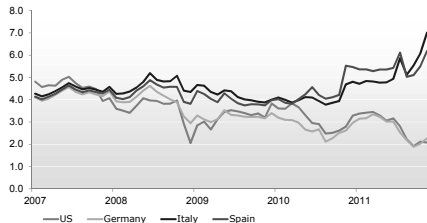
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Global Interest Rates

The European debt crisis has caused major-government bond yields to diverge.

Global 10-Year Government Yields

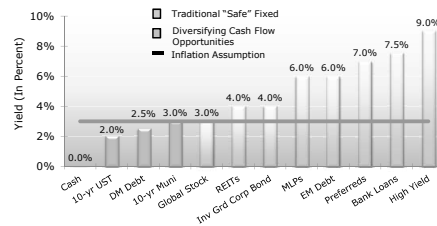


Past Performance is no guarantee of future results.
Source: FactSet, as of 11/30/11

Yields Across the Capital Markets

Consider income-generating investment opportunities across the global credit spectrum.

Yields Vary Greatly

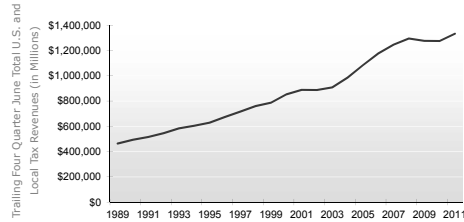


Past Performance is no guarantee of future results.
Source: FactSet, as of 11/11

Municipal Outlook Improving

U.S. state and local government revenues have recovered to all-time highs.

Total U.S. State and Local Tax Revenue

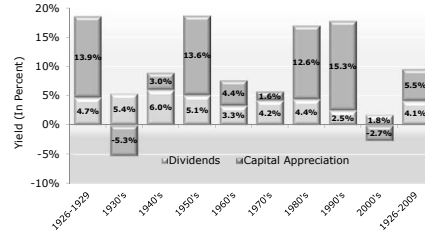


Source: Bloomberg, U.S. Census Bureau, 6/30/2011

Consider Dividend-Paying Stocks

Dividends have accounted for 45 percent of S&P 500 returns.

S&P 500 Total Return



Past Performance is no guarantee of future results. Source: Bloomberg Finance L.P., as of 11/11

The Global Economic Evolution

Five Investment Themes for 2012:

- 1) Deleveraging in the Developed Economies
- 2) The Global Consumer in Transition
- 3) The New Growth Engines of the Global Economy
- 4) Cash Flow/Liquidity for New Economic Realities
- 5) Managing Through Uncertain Times

Uncertain Times are "Normal"

From wars to market crashes, history has presented us with a series of challenging events.

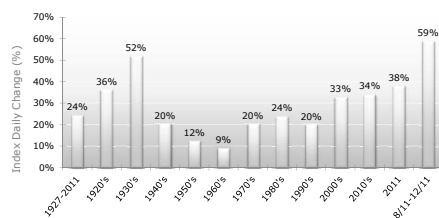


Source: Bloomberg, 2011

U.S. Market Volatility is High

There has been a jump in the number of days the S&P 500 has moved up or down one percent or more.

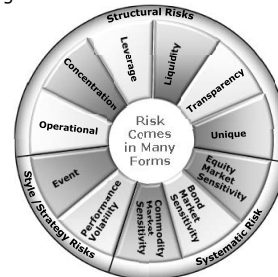
Daily Volatility Has Recently Spiked



Source: Bloomberg 11/11

Manage Risk with Wells Fargo's RiskOptics® Approach

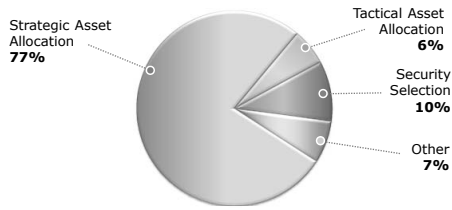
Investors should be mindful of the **types** of risk they are taking.



Source: Wells Fargo Wealth Management, 12/2011

Strategic Asset Allocation is Important

Strategic Asset Allocation is the Key Driver of Return Variability

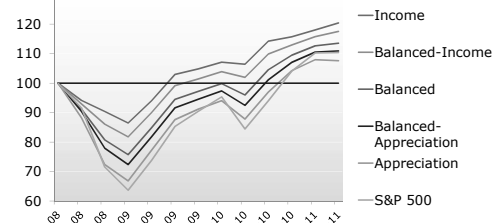


Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Source: Wells Fargo; The Journal of Wealth Management, Vol. 8, No. 3, "Strategic Asset Allocation and Other Determinants of Portfolio Returns," 08/05, data updated August 2009

Four-Asset-Group Portfolio Performance

Diversified portfolios have recovered from the market downturn.

Recovery From the Financial Crisis



Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Source: Wells Fargo Wealth Management, 6/30/2011

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- The S&P/Case-Shiller® U.S. National Home Price Index is a broad, market value-weighted composite of single-family home price indices for the nine U.S. Census divisions and is calculated quarterly.
- S&P 500 Index is a capitalization-weighted index calculated on a total-return basis with dividends reinvested. The index includes 500 widely held U.S. market industrial, utility, transportation and financial companies.

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- MSCI Europe, Australasia, Far East & Canada Gross Return Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S.
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Your focus:

Securing support
for your mission

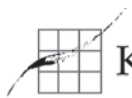
Our focus:

Providing high quality
planned giving services

Together:

Achieving your program goals

Our comprehensive services are designed to address the full range of challenges encountered by gift planning programs. We provide sophisticated asset management, high quality gift administration, expert program and policy consulting, and informative client and beneficiary reporting. Please contact us to learn more about how our services can make a difference.



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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

***Bequests - Who? What? When? Why? How?
Dealing with the "You Can Have It When
I'm Done with It" Donor***

Presented by:

Ellen G. Estes, LL.B
Frank W. Estes, LL.B
Estes Associates
41 Spoke Drive
Woodbridge, CT 06525
P: 203-393-3159
E: ellen.estes@sbcglobal.net
E: estesfw@hotmail.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

Bequests – Who? What? When? Why? How?
Dealing With the “You can have it when I’m done with it” Donor

Presented by Ellen G. Estes and Frank W. Estes
Outline

- I. **What** are “Bequests”?
 - A. Technically, gifts made pursuant to a Will or Living Trust
 - B. Broader definition includes all gifts that become effective at death and are revocable until that time. Primarily: beneficiary designations on retirement accounts, insurance policies, and payable on death accounts (POD’s)
- II. **Who** makes Bequests?
 - A. Technically – EVERYONE! Sooner or later every one of us will leave a bequest to someone. Our job as fund raisers is to identify and cultivate those who will make *charitable* bequests – hopefully to our organizations.
 - B. Who are these charitable bequest donors likely to be? People who are both charitably inclined and who are most closely related to your organization and its mission.
 1. Rich? – Doesn’t hurt, but remember -
 - a. You may not know who has wealth. There are a lot of good prospects who, for a variety of reasons, do not give lavishly during life, but have the means to make significant charitable bequests.
 - b. Not all bequests are of the multi-million dollar variety
 2. Older? Well, sure – but not necessarily ancient!
 - a. People in their 40’s and 50’s start making their estate plans. Charitable bequests put in their wills and trusts in these early years tend to stay there, unless.....
 - b. Primary concerns of older people have been shown to be –
 - (1) **Maintaining control** (over all aspects of life)
 - (2) **Leaving a legacy** – making a lasting difference
 3. Study after study has shown that the most likely person to make a bequest – is the long-term, consistent donor – even of small amounts.
 4. All of these people are *most likely to make bequests if*

III. **Where** do you find your best bequest prospects?

- A. Current and past donors
- B. Members of your Board and Administration (current and past)
- C. Development and other committee members
- D. Volunteers
- E. People who have benefitted from your services and their families (e.g. alumni, subscribers, grateful patients, people in special affinity groups (e.g. Yale Alumni Chorus members)
- F. Employees and former employees
- G. WOMEN – in all of the foregoing categories

IV. **Why** are Bequests Important to your Organization?

A. Benefits:

- 1. They are often the largest gifts you will ever receive
- 2. With few exceptions – they are likely to be the largest gift individual donors will ever make
- 3. They are highly cost effective and efficient form of fundraising
- 4. They are simple to explain and market
- 5. Donors love them
- 6. Bequest programs support and enhance, rather than inhibit other institutional fundraising

B. Challenges:

- 1. They are future gifts – and you have to wait for them
- 2. They are revocable and therefore subject to the donor's decisions, whims, and circumstances
- 3. You often do not necessarily know of their existence – leading to possible issues of accurate designation of your organization and also of appropriate gift restrictions

V. **When** to promote Bequests among your constituents? Just like voting: early and often! Promoting bequests has to be an ongoing process. You never know when a donor may be in his or her “estate planning mode” and be “ready, willing and able” to include your organization in his or her plans.

VI. **How** to promote Bequests? Marketing and outreach

A. What to talk about?

- 1. Talk about how they can really make a lasting difference – leave a legacy for the future
- 2. Promote bequests as the gift that costs nothing during lifetime – an especially important consideration in difficult economic times.
- 3. Remind them that bequest intentions are easy to arrange and revocable
- 4. Share donor success stories and testimonials
- 5. Point out the importance of their gift - to preserve and protect the mission that is important to both of you

B. Practical Tips

1. Start a Legacy Society
2. Involve your Board and Administration
 - i. Champions
 - ii. Personal bequest challenges
3. Search organizational history for prior bequests
4. Create bequest language examples – including accurate organization name

C. How to get the word out?

1. Personal visits
2. Existing written materials and publications
3. Targeted mailings
4. Seminars and other live presentations
5. Your web site
6. E-mail
7. Social media

VII. Beyond Wills and Trusts – other revocable gifts that take effect upon death

- A. Retirement Plans – a critically important gift
How to create these gifts – and why
- B. Life insurance policies
A simple and easy way to make a gift
- C. Payable on Death (POD) accounts
Simple and easy to do (where permitted)

VIII. Odds & Ends

- Some of the tax implications of these kinds of gifts
A common misconception: Probate vs. Estate Taxes

IX. Questions and discussion

Your Reliable Planned Giving Partner



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- Your Custodian of Choice
- Your Investment Manager of Choice
- Our System Maps to YOUR Chart of Accounts
- Robust Staff Reporting Features
- Behind-the-Scenes, "Private Label" Solution
- Customizable Templates & Content
- General Ledger Integration
- Grants Management
- Detailed Reporting of Multiple Gift Types
- Secure Donor Access
- Customizable Downloadable Reports
- Distribution, Grant & Contribution Reports
- Tax Reporting



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With over 20 years of industry-leading experience in charitable planning and administration, Renaissance is uniquely positioned to serve your organization by acting as your back-office support team. Our technical expertise has been instrumental in helping financial institutions, charities and donors establish more than 20,000 donor-advised funds, charitable remainder trusts, CGAs and other planned gifts. Renaissance will support your organization through all phases of planned giving: Consulting/Marketing, Implementation and Administration.

To discuss a customized solution for your organization, call our Consulting Department at 1.800.843.0050



ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Best Practices in Charitable Gift Annuity Programs

Presented by:

Charles B. Gordy
Director of Planned Giving
Harvard Law School
1305 Main Street
Concord, MA 01742
P: 203-376-4276
E: cbgordy@yahoo.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

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. Develop a gift policy that specifies what assets will be accepted
Cash, appreciated securities
Other assets – real estate, tangible personal property, intangible property
Process for making exceptions

7. Invest the entire face amount of the annuity
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. Invest the assets appropriately given the fact that the gift annuity assets back the issuing charity's obligation to make annuity payments
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. 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
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. Marketing Your Gift Annuity Program
Emphasize the charitable nature of the gift in prospect meetings proposals, advertising, and direct mail
Exercise caution when comparing gift annuity rates with returns from other financial instruments, e.g. “yield” or “rate of return”
Do not use the phrase “guaranteed income”
Use examples specific to your organization or develop your own generic examples
Make sure you are not providing legal and financial advice in your materials
Encourage donors to consult with their advisors before proceeding
12. Communicate regularly with your gift annuity income beneficiaries
13. 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

“\$34 million in new planned gifts.”

Bill Yaeger
Assistant Vice President of Principal and Planned Gifts
The Citadel Foundation



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BUILDING RELATIONSHIPS IS THE KEY TO BRINGING RESULTS!

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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

***Focusing on the Donor by
Asking the Right Questions***

Presented by:

Roger Ellison, CFP
Senior Advisor for Philanthropy
West Texas Rehabilitation Center Foundation
3001 South Jackson
San Angelo, TX 76904
P: 325-656-5637
E: rellison@wtrc.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

Slide 1

**Focusing on the Donor
by Asking the Right Questions**

Roger Ellison, CFP

30th ACGA Conference on Planned Giving

San Francisco, California

Thursday, April 19, 2012

Slide 2

**How do I put
First Things First?**

Slide 3

**What is my
Ethical Framework?**

- **Personal ethical philosophy**
- **Model Standards**
- **Garrett Standards**
 - Never do to a donor what you would not do for your own mother and father.
 - No gift is worth the good name of your charity.

Slide 4

**What is my
Philosophy of Work?**

- Systematic application of passion
- Systematic search for passion

Slide 5

**What is my
Commitment to Professionalism?**

- Serve your donors
 - Their best interests
 - Absolute Integrity
 - Confidentiality
- Know your stuff
- Sharpen you saw

Slide 6

**How do I
Understand My Donors?**

- Who are they?
- Where are they?
- From where had the come?
- How did or had they made their way?
- What were they like?
- How do they look at your charity?
- Why and how do they give?

Slide 7

**How do I
Understand My Charity?**

- When did we begin?
- Why did we begin?
- Who made it happen?
- What did we do?
- How did we do it?
- Why have we been so successful?
- What is our image?

Slide 8

Do I Fit?

Slide 9

**How do I connect donors to my
charity through my work?**

Slide 10

**How do I
Develop a Style
with is culturally harmonious with
my charity, my donors and my
work?**

Slide 11

**How do I develop a
Way to See Donors?**

- We were appreciative of their gifts
- It is only appropriate to thank them
- Neighbor helping neighbor is our history
- Our donors were our neighbors and our friends
- Drop by and thank them
 - On their turf, in a manner which fit them, but with my agenda

Slide 12

**How do I
Tell the Story?**

- My introduction
- What do I do?
 - Seven words or less
- Elevator speech
- My business card

Slide 13

How do I take into account Behavioral Styles?

- Discern
- Understand
- Adapt

Slide 14

Emotion = \$

- Emotional needs
- Financial issues
- Decision-making process

Slide 15

The entire process in a nutshell

- Plan your meeting
- Open the meeting
- Explore donor needs
- Nurture concerns
- Discuss benefits
- Gain commitment
- Honor the relationship

Slide 16

Plan Your Meeting

- Research
- Conceptual plan
- Purpose
- Objective
- Preparation

Slide 17

Open the Meeting

- Begin with an end in mind – Covey
- Build rapport
- Share the purpose
 - NOT the objective
- Seek permission to question

Slide 18

Explore Donor Needs

- Ask questions
- Nurture their emotions
- Offer solutions
- Resolve issues
- Reach agreement

Slide 19

Nurture Concerns

- I can't do any more...
- Everything is going to my...
- Are these things safe?
- My uncle's...
- I'm not doing any more than...

Slide 20

Present Benefits

- Convince mode
- When?
- Transition
- Beware of yourself
- Benefit Statement Planning

Slide 21

...Present Benefits

- Match your benefit statement to the donor's behavioral style
- Personalize the opportunity
- Tie their passion to the gift
- Never present on paper what you can present in person!

Slide 22

Gain Commitment

- Get agreement part by part
- Take the pulse often
- Stop and go back as necessary
- Apply no pressure

Slide 23

...Gain Commitment

- Sometimes there is no need for an ask
- Summarize
- Simple ask
- Be patient
- Nurture concerns
- Details

Slide 24

Honor the relationship

- Thank early!
- Thank often!
- Thank differently!
- Find ways!

> Want to spend **less time worrying** about the risks and costs associated with your Charitable Gift Annuity program and **more time raising new donor gifts?**

FIND OUT HOW
"REINSURING"
YOUR GIFT ANNUITY
PORTFOLIO
MAY BE THE
ANSWER.



VISIT THE METLIFE BOOTH
IN THE EXHIBIT HALL FOR
MORE INFORMATION ON
OUR CHARITABLE GIFT
ANNUITY SOLUTIONS.

John B. Kvernland
Senior Sales Director
(212) 817-6052
jbkvernland@metlife.com

MetLife

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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Gift Administration—Harmony or Discord?

Presented by:

Mike Sutton

Director of Investment Operations

The Salvation Army

1424 Northeast Expressway

Atlanta, GA 30329

P: 404-728-1325

E: mike_sutton@uss.salvationarmy.org

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

GIFT ADMINISTRATION - HARMONY OR DISCORD?

MIKE SUTTON

DIRECTOR OF INVESTMENT OPERATIONS
THE SALVATION ARMY, SOUTHERN TERRITORY



HOW WILL YOU RUN YOUR PROGRAM?



THINGS TO CONSIDER

- LABOR INTENSIVE
- LEGAL / REGULATORY ISSUES
- COSTS: INTERNAL VS. EXTERNAL
-OR- HYBRID
- PERSONNEL
- ATTENTION TO DETAILS



OUR APPROACH

GIFT ANNUITIES

- OUTSOURCE INVESTMENTS
- USE OF CRESCENDO ADMIN
- GIFT ANNUITY SPECIALIST POSITION
- CROSS TRAINING / BACKUP
- ASSET DELIVERY/PRICING CONSIDERATIONS
- CLOSE WORKING RELATIONSHIP WITH
PLANNED GIVING (DEVELOPMENT)



OUR APPROACH

TRUSTS

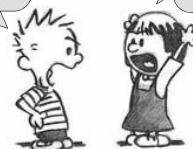
- OUTSOURCE INVESTMENTS
- OUTSOURCE ADMINISTRATION
- TRUST ACCOUNTING CLERK POSITION
- CLOSE WORKING RELATIONSHIP WITH
PLANNED GIVING (DEVELOPMENT)



DEVELOPMENT / BUSINESS OFFICE INTERACTION

It's the fundamental
nature of our relationship
that causes us to
disagree every so often...

It's ironic that we have
the same goal, yet we
can't see eye to eye on
the processes needed
to reach them.



DEVELOPMENT / BUSINESS OFFICE INTERACTION

- NATURAL TENSIONS EXIST
- OPEN LINES OF COMMUNICATION
- CLEAR DELINEATION OF DUTIES
- WELL ARTICULATED POLICIES
- DEPARTMENT COVERAGE



CASE STUDY

GIFT OF PRECIOUS METALS CUSTODIED OUTSIDE USA



DEVELOPMENT / BUSINESS
OFFICE INTERACTION

CASE STUDY -THE DEVELOPMENT PERSPECTIVE

- DONOR NOTIFICATION OF GIFT POTENTIAL
- TIMING
- COMMITMENTS
- DONOR PRESSURE / DEMANDS
- DONOR REMORSE



DEVELOPMENT / BUSINESS
OFFICE INTERACTION

CASE STUDY -THE BUSINESS PERSPECTIVE

- RESEARCH – “COULD WE ACCEPT THIS GIFT?”
- ISSUES:
 - LEGAL
 - ACCOUNTING
 - INTERNAL CORPORATE POLICY
 - CROSS BORDER TAX
 - TAX TREATIES
 - REGULATORY ISSUES
 - OTHER



DEVELOPMENT / BUSINESS
OFFICE INTERACTION

CASE STUDY -THE BUSINESS PERSPECTIVE

- LIQUIDATION OPTIONS
 - PURCHASE ASSET INTO CORPORATION
 - SELL THROUGH BROKER
 - SELL THROUGH EXISTING CUSTODIAN
 - TRANSFER TO NEW CUSTODIAN



DEVELOPMENT / BUSINESS
OFFICE INTERACTION

PROCESSES

- PAYMENT PROCESSES
- TERMINATION PROCESSES
- GENERAL PROCESSES
- QUALITY CONTROL PROCESSES
- OTHER PROCESSES



ELECTRONIC PAYMENTS



THE BEST METHOD



PAYMENT PROCESSES

BENEFITS OF ELECTRONIC PAYMENTS

- SAFE, SECURE, TIMELY DELIVERY OF PAYMENTS
- CONTROL OVER SPECIFIC DELIVERY DATES
- REDUCED COSTS
- REDUCED PAPERWORK
- BENEFICIARY CONVENIENCE
- OTHER BENEFITS



PAYMENT PROCESSES

PHYSICAL PAYMENTS

- MORE EXPENSIVE
- USPS ISSUES
- NECESSARY EVIL
 - BENEFICIARIES REFUSAL TO ADOPT ELECTRONIC
 - FOREIGN BENEFICIARIES
- PRONE TO CAUSE DONOR RELATION ISSUES







PAYMENT PROCESSES

PHYSICAL PAYMENTS

PHYSICAL PAYMENT ISSUES CAN BE A SOURCE OF INTER-DEPARTMENT CONFLICT







PAYMENT PROCESSES


PROCESSES

- PAYMENT PROCESSES
- TERMINATION PROCESSES






- NOTIFICATION IS RECEIVED OF BENEFICIARY PASSING
- PLACE HOLD ON ALL FUTURE PAYMENTS
- BEGIN DOCUMENTATION SEARCH PROCESS
- FINAL PAYMENTS, PRO-RATAS, AND ESTATE ISSUES
- ALLOCATION OR CONTINUANCE



TERMINATION PROCESSES

PROCESSES

- PAYMENT PROCESSES
- TERMINATION PROCESSES
- GENERAL PROCESSES



- ADDRESS CHANGES
- SEASONAL ADDRESSES
- W-9 UPDATES
- ACH PRENOTE




PROCESSES

- PAYMENT PROCESSES
- TERMINATION PROCESSES
- GENERAL PROCESSES
- QUALITY CONTROL PROCESSES



- PROCESSING WORKSHEETS
- REVIEW PROCESS
- BACK END ONGOING REVIEW



GRI Annually - Processes Worksheet	
DONOR: _____	TYPE OF GA: _____
RESTRICTED (Y OR N): _____	GA NUMBER: _____
GIFT DATE: _____	DATE RECEIVED AT TNG: _____
<p>1. To ILL or JAHL:</p> <ul style="list-style-type: none"> a. Liable Affidavit, CGDS, Acknowledgment, W-9, Disclosure Statement, ADI Form, Funding (i.e. stock and stock power checks) letter of instruction for initial fund transfer. (submitted to area leaders) 	
<p>2. Verify gift date and add to CGDS ILL or JAHL</p>	
<p>3. Gift package to Mary</p> <ul style="list-style-type: none"> a. Ready gift letter b. Enter in gift annuity log c. Information update existing donor file, if appropriate d. Make copies of Funding and Acknowledgment for OOI intake. 	
<p>4. a. Enter gift package to Office of Investments b. Date stamp Processing Worksheet and Acknowledgment w/funding copy c. Office of Investments to email Acknowledgment copy to acknowledge receipt of funds d. Put in for paper to follow up within 3 days to receive gift package back from Office of Investments</p>	
<p>5. Office of Investments</p> <ul style="list-style-type: none"> a. Receive and verify gift valuation, initial Acknowledgment copy <ul style="list-style-type: none"> 1. Cash 2. Stock Certificate 3. Wire Transfer 4. Mutual Funds b. Funding properly transferred gift annuity account c. Run Clearinghouse (if existing gift, verify DOB and SSN with GRI/ADMIN) d. Invest into CGDS e. Invest (variable non-rollover value on CGDS) f. Verify the accuracy of all information and forms. g. PFS sign CGDS h. Return gift package to PG. 	
<p>6. To PG</p> <ul style="list-style-type: none"> a. Prepare contract and appropriate supporting documentation (see training guide for details) b. Prepare cover letter to BCT c. Package sent to BCT d. Close permanent CGDS and gift file. e. Enter new gift on Master GRI List in correspondence folder. f. Enter new gift (date: _____) GRI Ann Tot. _____ and IC. _____ g. ACCESS (Donor: _____) GRI Ann Tot. _____ and IC. _____ 	

GRI Annually - Processes Worksheet		Donor Last Name _____	GA Number _____
<p>7. To Office of Investments</p> <ul style="list-style-type: none"> a. Place recipient in filing to print check on a certain date (check if confirmed (check as blue star)) b. Enter gift details c. Print check d. Place on hold in Checkmate Admin 		_____	_____
<p>8. To PG</p> <ul style="list-style-type: none"> a. Track return of donor executed agreement b. Notify Office of Investments once all that agreement has been executed c. Make two copies of fully executed agreement <ul style="list-style-type: none"> (1) - Submit this over the monthly package (2) - Legal Department (3) - Send package to legal d. Attach Checkmate to copy of fully executed agreement and put in pending Tax Reporting portfolio. 		_____	_____
<p>9. Office of Investments</p> <ul style="list-style-type: none"> a. Print-out check is forwarded to PG for mailing to annuitant b. Quality Control completed c. Return held in Checkmate Admin d. All information entered in GRI Annually Log 		_____	_____
<p>10. PG</p> <ul style="list-style-type: none"> a. Print-out check mailed to annuitant (date: _____) b. Attach funding sheet to permanent file c. File the permanent donor file. 		_____	_____

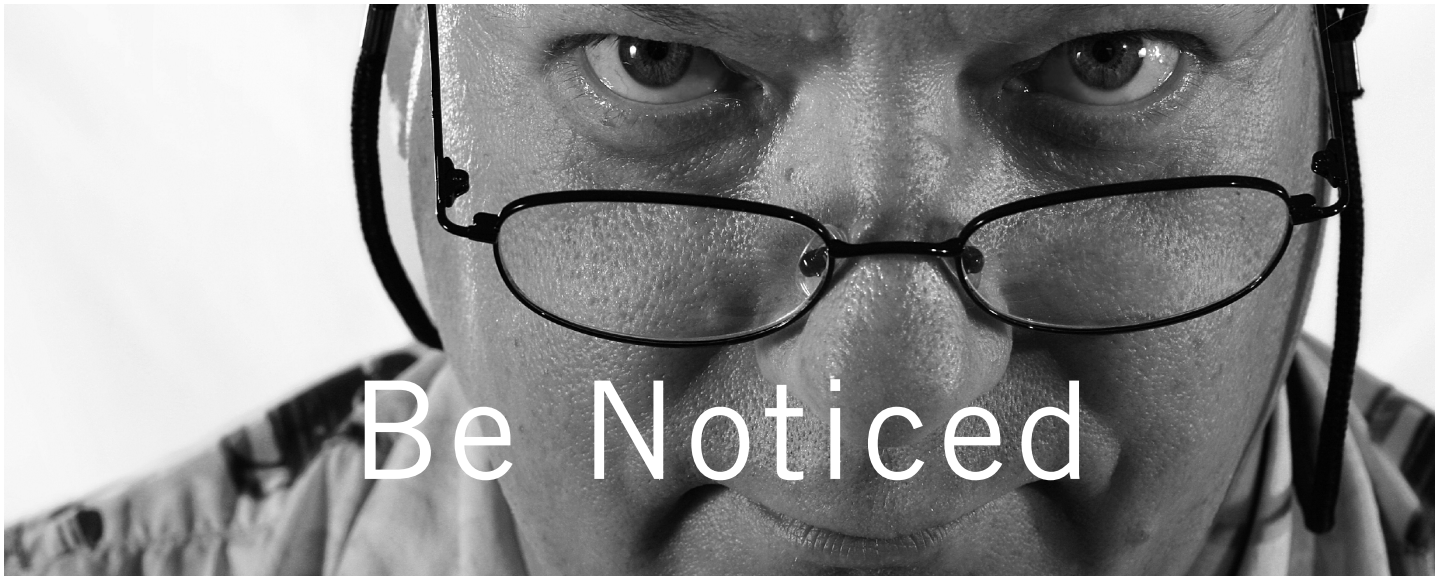
The Salvation Army Planned Giving Department 114 NE Expressway Atlanta, GA 30329		John Smith, Sr. Charitable Remainder Unitrust Account # 12446189	
PORTFOLIO SUMMARY			
Market Value	Estimated		
Current	12/31/12	12/31/11	12/31/10
Cash and Cash Equivalents	894,473.19	8.32	\$0.00
Bond	969,982.75	66.86	4,788.62
Stock	922,841.35	33.79	12,746.62
Total Assets	\$1,827,297.29	100.00	\$99,535.24
ACTIVITY SUMMARY			
Beginning Market Value	2/1/12	2/1/11	2/1/10
Payments to Donor/Beneficiary	\$1,081,081.88		
Income Earned	41,266.40		
Fee Paid	-1,774.47		
Ending Market Value	\$1,827,297.29		
TIME WEIGHTED RETURNS			
Category	Calendar Yr	Calendar Yr	Calendar Yr
Stock	2008	2009	2010
Stock	0.69	-27.69	22.38
Bond	0.46	12.16	12.32
Bond	0.61	12.14	12.32
Equity	11.20	17.10	-2.28
Fixed Income	10.19	18.08	19.08
Fixed Income	-1.22	6.71	6.71
Bestcase Case Aggregated Bond	-1.50	6.94	6.94
INVESTMENT BY SECTOR			
Detailed Settlement Data: Portfolio as of 12/31/2011			
Account	Cost	Market Value	% of Asset
US Govt	16,471.10	16,471.10	0.90
State Gov	16,471.10	16,471.10	0.90
Local and Cash Equivalents	16,471.10	16,471.10	0.90
Large Cap	21,850.00	24,826.41	1.36
Mid Cap	8,996.12	8,926.82	0.49
Small Cap	1,813.24	2,170.86	0.12
International	11,628.84	10,767.82	0.59
Biotech/Health	11,628.84	10,767.82	0.59
Other Stocks	26,784.88	27,475.12	1.50
Other	89,911.86	89,911.86	4.92
Real Estate	11,628.84	11,628.84	0.64
Other Investments	14,822.27	13,826.52	0.76
Fixed Income	24,826.41	24,826.41	1.36
TOTAL INVESTMENTS	\$1,827,297.29	\$1,827,297.29	100.00
2012 PAYMENT SCHEDULE			
Unitrust Calculation			
For Market Value (FMV) as of 1/30/2012			
FMV (Market Value)	\$1,818,018.04		
Due FMV from Beneficiary	0.00		
Adjusted Fair Market Value	1,818,018.04		
Unitrust Payout Percentage	0.26%		
2012 Annual Payment	\$474,804.75		
Due To (From) Beneficiary	0.00		
Total Annual Payment	\$474,804.75		
Beneficiary Payment Schedule			
2012 Quarterly Payments:	March	\$117,201.19	
	June	\$117,201.19	
	September	\$117,201.19	
	December	\$117,201.19	
Total 2012 Payments:	\$468,804.76		

GIFT ADMINISTRATION -
HARMONY OR DISCORD?

QUESTIONS ???



DOING THE MOST GOOD



Be Noticed

Marketing is critical to your success

EDS can help you step up your planned gift marketing through innovative print, website and e-marketing products designed to meet your specific needs. Get thought-provoking, motivating messages to your donors, with:

- unmistakable branding and
- instant recognition of your organization and your mission.

Be focused

We know you are focused on developing relationships and spending time with donors and supporters. That's why we focus on making it as easy as possible for you to promote your organization's mission and smart gift planning options.

For information, give us a call, send an email, or visit us at **endowdevelop.com**. It would be our pleasure to help you implement cost-effective marketing ideas that get you noticed and enable you to make the best use of your time.



ENDOWMENT DEVELOPMENT SERVICES



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***Visit our booth to learn more about our turnkey
administration services and enter to win a VISA gift card!***



CTAC offers constructive, expert administration services of gift annuities and other charitable vehicles to assist you and your donors in managing your philanthropic endeavors.

Gift Annuity Administration Platform

- Prepare and process distributions via check or electronic transfer
- Perform state registrations, filing, and notifications
- Monitor and report income and disbursement activity
- Produce charitable receipt letters
- Prepare and file IRS forms 1096 and 1099-R
- Calculate annual reserve requirements or FASB liability reports
- Provide online access to donor contracts, reports, tax returns, and other documents
- Provide private-label capabilities (if preferred)

For more information on our services, contact:

Kristen Schmidt
Marketing Coordinator
CTAC
Plaza South Two
7261 Engle Road, Suite 202
Cleveland, Ohio 44130
(800) 562-2045
kschmidt@ctacadmin.com
www.ctacadmin.com



ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Gift Planning Marketing - Who, What and When

Presented by:

Rebecca Scott
Director of Gift Planning
Tufts University
80 George Street, 3rd Floor
Medford, MA 02155
P: 617-627-3616
E: rebecca.scott@tufts.edu

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org



**ACGA Conference 2012
Gift Planning Marketing**

Rebecca Scott
Director of Gift Planning


Outline

1. To whom should you market gift planning? Using predictive analytics to find your best prospects.
2. What to say and what to send to create donor-centered gift planning marketing materials.

2


Traditional Methods for Targeting Prospects

- Consistent donors
 - Ranked by number of years giving
 - (i.e., 10+ years, 8-10 years, 5+ years, etc.)
- FLAG
 - Frequency of giving
 - Longevity of giving to the organization
 - Age
 - Giving history

3 




Predictive Analytics – Wikipedia definition


- **Predictive analytics** encompasses a variety of techniques from statistics and data mining that analyze current and historical data to make predictions about future events.
- Such predictions rarely take the form of absolute statements, and are more likely to be expressed as values that correspond to the odds of a particular event or behavior taking place in the future.
- For an easy-to-read explanation of predictive analytics with data mining:
<http://www.dmreview.com/specialreports/20050215/1019956-1.html>

4 

Who – Predictive analytics


- a.k.a. Predictive Models or Data Models
- It is not the exclusive domain of fundraising.

5 


Predictive Analytics - Tufts data model

Who we should send materials to and whom we should visit?

6 

Predictive Analytics - Tufts data model


- Tufts uses three "look alike" data models to determine who is more likely to 1) include Tufts in their will, 2) create a CGA, 3) create a CRT.
- We analyze donors who have done each behavior to find the donors who resemble them, from a data perspective.
- It can be just as useful to figure out who doesn't look like a gift planning prospect as who does.



7

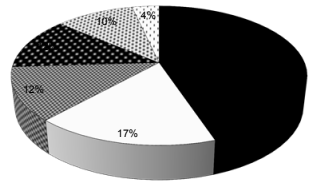
Predictive Analytics

- Common sense assumptions still apply
 - Gift planning donors are older and are consistent donors
- Patterns that are unique to your organization may emerge
 - Event attendance, multiple connections to the institution, for example.




8

Tufts' Bequest Model - Variable categories by impact




■ Engagement □ Capacity ▨ Demographics ■ Contact ▩ Giving □ Academic



9

Tufts' Bequest Model - Variable categories by impact

Category	Variable	Coefficient
Capacity	Income 14 plus	-0.73
	Capacity	0.56
Giving	First	0.13
	Length of Giving	0.28
Demographics	Age	0.67
	Marital: D	1.92
	Marital: M	0.95
	Marital: W	1.76
	Bin Linked Records	0.29
	Bin Relation: Alumni	0.73
	Alum	0.44
	Parent	-2.28
	Children	-0.56
	Homes	1.22
	State: CA	0.53
	State: FL	1.36
Engagement	Event attend: 2 plus	2.21
	Address	1.50
Contact	Email	0.70
	No Contact: Phone	1.81
	No Contact: Direct Mail	-1.75
Academic	Division: Vet Med	-2.18




10

Predictive Analytics - Tufts' bequest data model

Planned Giving Rank Label	Planned Giving Donor	Not Planned Giving Donor
0 Lower 50%	17	211,841
1 Top 50%	69	105,834
2 Top 25%	142	63,445
3 Top 10%	135	21,049
4 Top 5%	121	10,472
5 Top 2.5%	141	6,215
6 Top 1%	90	2,024
7 Top 0.5%	60	1,003
8 Top 0.25%	53	583
9 Top 0.1%	55	369
Total	883	422,835


- 90% of planned giving donors rank in the top 25% of the model; 60% rank in the top 5% of the model.
- Opportunity:** 3,979 individuals who are not planned giving donors scoring in top 1% (box)



11

Predictive Analytics - The application

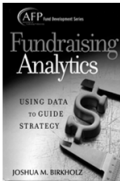
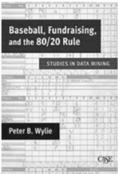
- Mass communication (one-to-many)
 - To top 5% or 21,186 donors
 - email, postcard, newsletter
- Donor visits (one-to-one)
 - To top 0.5% or 2,123 donors




12

Predictive Analytics - Who does it?

- Consulting Companies
 - Bentz Whaley Flessner
 - Joshua Birkholz, Principal and Founder of DonorCast
 - www.donorcast.com
 - Blackbaud Analytics
 - www.blackbaud-analytics.com
 - Marts & Lundy
 - www.martsandlundy.com





13 


Predictive Analytics - Who does it?

Your friendly, neighborhood statistician


- A student/professor at your college or university
- Someone on your Board or another volunteer
- Someone who can use statistical software like SPSS

14 

Questions about predictive analytics?


15 

What to say and what to send

16 

What to say - Need a will to have a bequest

- Harris Interactive for Martindale-Hubbell conducted a research study in 2007 finding that for the last three years, 55% of all adult Americans do not have a will.
 - Only one in three African American adults (32 percent) and one in four Hispanic American adults (26 percent) have wills, compared to more than half (52 percent) of white American adults.
- People usually make or amend their wills and trusts when they have a life event such as a marriage, birth, death, divorce, or move to another state. They rarely do it to simply include a charitable gift.

17 

What to say - Make a will and put us in it

CHARLES TUFTS INVITES YOU

You are cordially and enthusiastically invited to join the ranks of Charles Tufts, Joseph B. Fuchsler, and P. Anthony. We will all have to contribute to all of the members of the Charles Tufts Society.


As a member, you'll be invited to the Charles Tufts Society and Scholarship Dinner (which each year at the president's home and will receive some small gifts, but this will not be in knowing that your family and others are building a strong future for Tufts. We would love to have you as a member of the Charles Tufts Society. Contact us for more information and we'll be happy to have the different ways you can join.


AHEAD OF THE GAME!

Make sure you already include the President's House in your will or estate plan! It is a unique opportunity to be a part of our history. If you have a will, please let us know so we can help you make sure you have a will that includes the President's House. **Please let us know so we can help you make sure you have a will that includes the President's House.**

We are the most visible and prominent organization in our community. We are a great place to be involved in. If you have a will, please let us know so we can help you make sure you have a will that includes the President's House. **Please let us know so we can help you make sure you have a will that includes the President's House.**

Phone: 603-748-6287 Email: gpl@charles-tufts.org




18 

What to say - Why do people give?

Donor-centered gift planning marketing

19



What to say - Why do people give?

Altruism You, the mission of your organization or your organization itself resonates with the donor's sense of making the world a better place

Appreciation Your organization has affected the donor's life in a positive manner, or the donor is proud of the work you do

Competition The donor is interested in "keeping up with the Joneses" – Philanthropy style. They want their names prominently situated on your donor list, or want their class to raise more money than last year's class

Devotion Religion and religious belief highly influence the donor's giving strategies.


Guilt Your organization can help relieve the donor's feelings of remorse or responsibility for negative circumstances which have befallen them or others

Self interests Help with tax circumstances, or advancing the donor's professional or social life

Tradition The donor has a habit of giving to organizations that have systematically asked them over a period of time, or it is traditional in their family to give to the organization

Kim H. Erskine, Philanthropic Advisor, Univ. of Oxford's North American Offices


20 - from the website www.socialedge.org



What to say

Your constant hum of gift planning marketing should circle through all the possible motivations to try to push everyone's buttons.

21



What to say - Planned gifts have an impact



MAKE AN IMPACT FOR THE GREATER GOOD. ROLLOVER YOUR IRA TODAY.

Your Bequest to the Dental School Will Have an Impact

"We will be known less for what we do for ourselves in our lifetimes than for what we do for others."

22



What to say - Planned gifts have an impact



Mainly 90% contribute to more than 19,000 child deaths around the world every day.

2008, the ADA uncovered 10 breakthroughs in diabetes research...

...thanks to YOUR support!


23




What to say - Planned gifts have an impact

If your organization is new, then you may have to make the case that you will need gifts 10-30 years in the future.

24




What to say - Planned gifts have an impact




You know these things take time...

...but it's worth it.



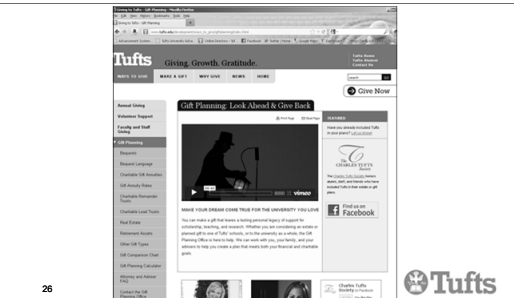
Leave a Legacy



Support a healthy, thriving New England


Tufts

What to say - Planned gifts have an impact




Tufts

What to say - Connect your name in perpetuity



leave a legacy



Leave Your Mark at Tufts

Tufts

What to say - Make a tax efficient gift

Earn income up to 9.8%

You can boost your mark at Tufts by establishing a charitable gift annuity that benefits both you and the university.


Charitable gift annuities can be established with \$10,000 or more and may provide these benefits:

- Payment for life to you and/or a loved one
- An immediate charitable deduction
- A payment guaranteed to 50%

CHARITABLE GIFT ANNUITY RATES*

AGE	RATE
65	5.6%
70	5.8%
75	6.0%
80	7.5%
85	8.0%

* Rates are annually included in your estate table. Set us loose! All our annuities pay out to the Charles River Society.




A WIN-WIN GIFT

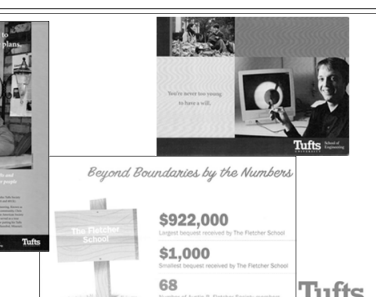
Charitable Annuity Payment (CAP) offers an income stream and tax benefits.

Tufts

What to say - Planned giving isn't just for rich, old people



You're never too young



Beyond Boundaries by the Numbers

- \$922,000**
Largest amount received by The Fletcher School
- \$1,000**
Smallest amount received by The Fletcher School
- 68**
Number of Austin B. Fletcher Society members

Tufts

What to say - Planned giving isn't just for rich, old people

Gift Planning at Any Age

IN YOUR 20s and 30s

With almost every one still living in their parents' home, it's a good idea to start planning for the future. Consider a charitable gift annuity to help you get started.

IN YOUR 40s

A 401(k) plan is a great way to save for retirement. Consider a charitable gift annuity to help you get started.

IN YOUR 50s

As you approach retirement, it's important to start planning for the future. Consider a charitable gift annuity to help you get started.

IN YOUR 60s

As you approach retirement, it's important to start planning for the future. Consider a charitable gift annuity to help you get started.

IN YOUR 70s

As you approach retirement, it's important to start planning for the future. Consider a charitable gift annuity to help you get started.

IN YOUR 80s

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IN YOUR 90s

As you approach retirement, it's important to start planning for the future. Consider a charitable gift annuity to help you get started.

Tufts

What to say

- Planned giving isn't just for single people without children

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What to say

- If we are family, include us in your plans

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What to say

- If we are family, include us in your plans

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What to say

You can break out of your constant hum of gift planning marketing with an immediate call to action by using deadlines and triggers.

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What to say

- Use deadlines and triggers

- When a leader needs to make a campaign gift
- When an alumnus/a needs to make a reunion gift
- When tax laws or other regulations change or will expire, making expedient action financially worthwhile (change in CGA rates, charitable lead trusts, IRA charitable rollover)
- When you receive permission to issue gift annuities in a particular state

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What to say

- Use deadlines and triggers


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What is each format best for?

- **Postcards**
 - Short, timely messages, one-topic each
- **Newsletter**
 - Longer stories. Themes tied together with technical and inspirational stories
- **Magazine articles, ads or profiles**
 - Wide audience – bequests
- **Website**
 - Everything (technical details, inspirational stories, video, photos)
- **E-mail**
 - Timely information, deadlines, and launches
- **Facebook/Social Media**
 - Creating community, link to articles to create credibility, celebrate gifts in a timely fashion

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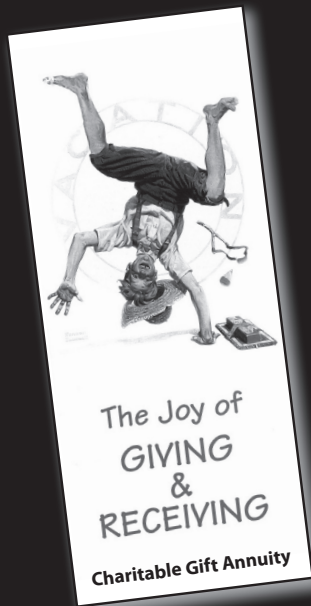
Rebecca Scott
Director, Gift Planning Office
Tufts University
80 George St., 3rd Floor
Medford, MA, 02155
617-627-3616
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Gifts of Complex Assets

Presented by:

Lawrence P. Katzenstein
Partner

Thompson Coburn, LLP
One US Bank Plaza
St. Louis, MO 63101

P: 314-552-6187

E: lk Katzenstein@thompsoncoburn.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

SOME OBSERVATIONS ON CHARITABLE GIFTS OF UNUSUAL ASSETS

Lawrence P. Katzenstein
Thompson Coburn LLP
St. Louis, Missouri

We will review some of the issues involved in charitable contributions of complex or unusual assets, concentrating on a few discrete less frequently discussed areas of interest. An outline of this scope cannot cover the waterfront: an entire program could be devoted to charitable gifts of life insurance, retirement plan assets or S corporation stock, all of which have been exhaustively and expertly covered in detail by others. We will also not spend any time looking at some of the property gifts that rarely come up in practice, either because the dollars involved are small (household clothing, for example¹) or because of the esoteric nature of the gift (such as taxidermy property².) Instead, we will examine some of the less often visited but important questions involving gifts of complex or unusual assets to charity.

Some Things Are Not Deductible At All

Not all contributions of complex assets are deductible. For example, gifts of ordinary income property such as inventory are, with a few discreet exceptions, deductible only to the extent of basis.³ If basis is zero, the contribution deduction is zero. Similarly, gifts of services or the use of property are not deductible at all. This may seem odd since if I contribute services I have forgone the income I would have earned from more productive engagement. However a bit of analysis demonstrates that this makes perfect sense. Take the case where I own real estate

¹ Code section 170(f)(16)

² Code section 170(f)(15)

³ Internal Revenue Code section 170(e)

which rents for \$100,000 per year which I decide to rent on a rent-free basis to a charitable organization.

Case #1:

The charity gives me the check for \$100,000 rent and because I am such a generous person I return the check to the charity. I would have had \$100,000 of income when the check was given to me and I would have a \$100,000 offsetting deduction when I give the check back to the charity. The result is a wash.

Case #2:

I don't charge the charity at all. This case should not be different from case #1. Zero income and no deduction is equivalent to the Case 1 wash.

The basic rule we can deduce from this discussion is that with the notable exception of gifts of long-term capital gain property, a person cannot deduct the value of unrealized income which the donor has not had to take into income in the first place. That is why gifts to non-grantor charitable lead trusts are not deductible and why the price paid for a contribution to a charitable lead trust when I want the deduction is taxation on the trust income during its term even though I do not receive the income. The one huge exception to the general rule is that gifts of appreciated property which would produce long term capital gain if sold are deductible to the extent of full fair market value without having to pick up the gain in income. In a pure tax sense this is an aberration but a good one for charity. Similarly, an interest free loan to a charity is not a deduction-producing gift. I haven't had to pick up the income so I shouldn't get a deduction.⁴

⁴ This issue is somewhat complicated by the imputed interest rules of Internal Revenue Code section 7872 which impute interest on interest-free loans to charities which exceed a safe harbor of \$250,000.

The effect of the section 7872 imputed interest rules on interest-free loans to charity is discussed later in this paper.

Some Unusual Gifts Raise Questions of When the Gift Is Deductible –

A Question Raised Because of the Nature of the Unusual Asset

Checks, for example, are deductible when mailed – like the old mailbox rule we learned in law school in contracts class – so long as they clear in the ordinary course of business.⁵ Pledges are simply promises to make a gift in the future and are deductible only when paid. (See discussion of pledge issues below.) Letters of credit may be deductible at the time the donor creates the irrevocable letter of credit in favor of a charity although this seems inconsistent with the Service's position in like areas.⁶

The rules with regard to gifts of stock are so familiar as not to need much repeating here: most stock is held in street name these days and a gift is irrevocable when the stock is transferred on the books electronically if the instructions are given to the donor's broker rather than when the instructions are given. The theory is that the broker is the donor's agent and the donor could change his mind. Typically, brokers will create a temporary account for the benefit of the charity and sell the stock immediately. These are rarely practical issues. With gifts of tangible property such as personal property, gifts are effective generally on delivery with a properly executed bill of sale or, in the case of real estate, upon delivery of a properly executed deed. Recording of the deed is not necessary to transfer title between the parties in any state, to my knowledge.

Appraisal Issues Applicable to All Gifts of Property Which are Not Marketable Securities or Cash

⁵ Regulation section 1.170-A-1(b).

⁶ TAM 8420002.

One issue common to all gifts which are not of cash or marketable securities is that not only is a qualified appraisal a requirement for a deduction but strict penalties apply for overvaluation of charitable gifts. For income tax deduction purposes, no charitable deduction is available for gifts exceeding \$5,000 which are not either cash or marketable securities unless the donor has in hand a qualified appraisal by the due date of the return. Regulations under section 1.170A-13(c)-13 detail these requirements. Note that the rule is not that a qualified appraisal is required for property gifts in excess of \$5,000. Rather, the rule is that I may not deduct more than \$5,000 without a qualified appraisal.⁷ If I am willing to limit my deduction of, say, artwork to \$4,999, a qualified appraisal is not required. Note further that the requirement of a qualified appraisal applies even for depreciated property so long as the amount claimed as a deduction exceeds \$5,000. The qualified appraisal requirement applies to donors who are individuals and to pass-through entities such as S corporations, etc., but does not apply to C corporations which are not closely held.

Finally, note that a qualified appraisal is required even if the property is sold immediately after the gift. One would think that the best evidence of fair market value is what the charitable donee was actually able to sell the property for, but no exception exists currently in the regulations for this situation. All property not marketable securities or cash is subject to the qualified appraisal rules. There is sometimes a difficult question as to whether stock is in fact publicly traded. The regulations go into detail about what is considered an established securities market. For example, stock traded in regional or over the counter markets qualifies for the no-appraisal exception if market quotations are readily available as are shares in mutual funds where redemption prices are shown in a newspaper of general circulation. At some point, these

⁷ In the case of stock which is not publicly traded, the threshold is \$10,000 for appraisal requirements.

regulations may need to be revised as fewer and fewer newspapers give quotations in this day of ready availability via the Internet. The appraisal rules applies to property of similar types. If, for example, I give an antique dinnerware set to a charity, an appraisal is required if the set as a whole exceeds \$5,000 even if each individual item has a value less than that – again, assuming I want to deduct more than \$5000.

Qualified Appraisals of Unusual Assets

Because of the regulation restrictions on who can be a qualified appraiser, in some cases it is difficult to know whether a qualified appraisal can even be obtained and who a qualified appraiser would be. For example, take the gift of a life insurance policy to charity. This is not cash or marketable securities so presumably a qualified appraisal is necessary. However, a party to the transaction in which the donor acquired the property being appraised cannot be a qualified appraiser, which eliminates the insurance company issuing the policy. Further, “qualified appraiser” is defined in the regulations as someone who holds himself out to the public as being an appraiser in that specific kind of property. Who holds himself out to be an appraiser of life insurance policies? Another case in which it seems silly to require a qualified appraisal, but which may be desirable given the uncertainty, is the situation in which a beneficiary of a charitable remainder trust contributes his or her remaining life income interest to the charity. If the trust is funded with cash or marketable securities, a quick look at the IRS valuation tables will tell us exactly how much of the gift is deductible. But a gift of an income interest in a charitable remainder trust is not a gift of cash or marketable securities per se, so is a qualified appraisal required? Who holds himself out to the public as being in the business of appraising these interests besides actuaries? It may be that no qualified appraisal at all is required in this situation but the Internal Revenue Service has never told us. If I create a charitable remainder

trust with cash I am not contributing cash to the charitable remainder beneficiary but a remainder interest in a trust funded with cash. In that situation no one thinks we need a qualified appraisal of the remainder interest. Why should a gift of an income interest in a trust then require a qualified appraisal? But cautious practitioners are obtaining them until we know the answer.

Other Specific Qualified Appraisal Issues

According to the proposed regulations under section 170 defining a qualified appraiser, a qualified appraiser must have certain “verifiable education and experience in valuing the relevant type of property for which the appraisal is performed.” Education and experience is defined as either successful completion of professional college level course work in valuing the relevant type of property, or a recognized appraisal designation for the relevant type of property. This definition certainly excludes lots of people who may be the best possible appraisers. For example, a curator at a major museum may be the world’s greatest living expert on Etruscan pottery but may not have the educational background required by the proposed regulations – maybe because in college the curator concentrated on non-Italian Renaissance painting. Similarly, years of experience may have made an expert at an auction house such as Sotheby’s or Christie’s the world’s greatest living expert on a certain painter and current prices, but without the educational requirements described in the proposed regulations, that person may not be a qualified appraiser.

Finally, remember that a qualified appraisal is not simply “any old appraisal” but has to meet the specific requirements of the regulations, including statements that the appraiser is aware of the fact that the appraisal will be used for tax purposes and so forth. The relevant language in the form 8283 which the appraiser must sign helps, but the magic words should also be in the appraisal itself.

Overvaluation Penalties

In addition to the appraisal requirements, the law also includes substantial penalties for misstatement of value or tax basis of contributed property on an income tax return. The penalties are tiered: a substantial valuation misstatement is defined as one where the claimed amount of a deduction is 200% or more of the actual value. If the overvaluation results in a tax underpayment that exceeds \$5,000, the underpayment is subject to a penalty of 20% of the resulting tax underpayment. In the case of a gross valuation misstatement – one where the value or tax basis claimed is 400% or more of the actual value – the penalty is 40% of the resulting tax underpayment. And, of course, since charities are required to notify the Service of any sales of contributed property made within three years after the gift, a difference between the deducted value and the actual fair market value is likely to be discovered by the Service.

Partial Interests

Gifts of complex or unusual interests can also implicate the partial interest rule. The partial interest rule is a trap enshrined in Internal Revenue Code section 170(a)(3) which provides that with certain exceptions, no charitable deduction is allowable for gifts of less than a donor's entire interest in property.⁸ Similar rules apply for gift⁹ and estate¹⁰ tax purposes. The partial interest rule can apply not only to gifts divided on a temporal basis – such as a gift of a remainder interest with retention of a non-qualifying life estate – but also to different kinds of interests given outright in certain assets. The partial interest rule can be further complicated by the fact

⁸ The common exceptions are charitable remainder trusts, remainder interests in a personal residence or farm, conservation easements, and undivided interests.

⁹ Internal Revenue Code section 2522(c)(2).

¹⁰ Internal Revenue Code section 2055(e)(2).

that one rule may apply for income tax purposes and another for gift or estate tax purposes. For example, a gift of an artwork to charity with retention of the copyright is a split interest gift for income tax purposes – no charitable deduction is allowable – but as discussed below a work of art and a copyright in the work of art are separate property interests deductible for estate tax purposes.¹¹ I can bequeath the physical painting to a museum and the copyright in the painting to a child without violating the partial interest rule even though a similar gift during lifetime would generate no deduction at all.

So while a gift of an undivided interest is permitted by section 170, many rulings, both private letter rulings and published rulings, illustrate the partial interest trap in other situations in which a donor made a charitable contribution in perpetuity of an interest in property not in trust but the donor still retained substantial rights. For example, the Service has ruled that the owner of a working interest under an oil and gas lease was not entitled to a charitable contribution deduction for the contribution of an overwriting royalty interest or a net profits interest.¹² The Service cited Rev. Rul. 81-282,¹³ which denied a charitable income tax deduction for a contribution of stock in a corporation to a charitable organization where the donor retained the voting rights. Similarly, in Rev. Rul. 76-331,¹⁴ the Service denied a charitable contribution where a donor transferred land to a charitable organization but retained mineral rights, including

¹¹ Code section 2055(e)(4). That section requires that the property be used by the organization in a manner related to its exempt purpose or function-- the same rule of course that applies to gifts of appreciated tangible property to charity during lifetime where the donor wants to deduct the full fair market value rather than just the basis.

¹² Rev. Rul. 88-37, 1988-1 CB 97. As someone who is not an oil and gas lawyer I won't pretend to know what an overwriting royalty interest or a net profits interest is!

¹³ 1981-2 CB 78

¹⁴ 1976-2 CB 52

the sole right to exploit any minerals obtained from the property.¹⁵ How do I decide what retained rights are insubstantial? The test seems to be whether they would affect fair market value – see for example the hunting dog training ruling noted below.

Gifts of Art—In General

Planning charitable gifts of tangible personal property presents difficult and unique problems. Not only is tangible personal property often difficult to value, but collectibles are not income producing, which makes their use in split interest gifts more difficult.

The rules on income tax deductions for tangible personal property are themselves complex. Code section 170(e) limits the deduction for tangible personal property gifts to basis unless the use by the donee is related to the charity's exempt purpose. Art to the museum is the classic example (assuming the art is of museum quality and the museum does not intend simply to sell it). The Service has interpreted this provision liberally, allowing a deduction, for example, for a gift of art to a nursing home for use in public areas.¹⁶ Obviously if the donor's basis is high (because, for example, of a new basis at death) limitation to basis may not matter. If basis is low, a bequest to the surviving spouse who can then make the gift may be the solution in some cases. Code section 170(e) also reduces the charitable contribution deduction by the amount of gain which, if the property were sold, would not be long-term capital gain. Section 1221 excludes from the definition of capital asset a copyright, literary, musical or artistic composition created by the taxpayer or held by a taxpayer whose basis derives from the creator

¹⁵ On the other hand, Rev. Rul. 75-66, 1975-1 CB 85 held that a gift of land was deductible despite the donor's reservation of the right to train his hunting dogs on the property, a use reservation viewed by the Service as insubstantial.

¹⁶ PLR 8247062

of the property. So a painter may not deduct the fair market value of a painting given to charity even if the use is related. The same rule would apply to a gift by a donee of the creator.

Remember that all of these special rules--related use and limitation to basis for non-capital assets--apply for income tax purposes only. There are no such limitations in section 2055 for estate tax purposes.

Watch this trap in gifts of copyrighted property, especially works of art. Most art work created in the last 70 years is protected by copyright. If the donor owns both the art work and the copyright and conveys the painting to charity without also conveying the copyright, the gift is a split-interest gift and no deduction is allowable. If the owner of the art work owns only the art work and does not own the copyright, he may safely contribute the property to charity because the donor will have given all of his interest in the property, just as a person owning only a life estate or remainder may contribute the entire interest without violating the split interest rule. The reason it is so easy to fall into this trap is that under the 1977 Copyright Act, a conveyance of an art work does not carry with it the copyright unless it is specifically conveyed. For works created before the 1977 copyright revision, the presumption was just the opposite. A purchase of the art work automatically carried with it the copyright unless it was specifically reserved. In cases where the donor owns the copyright—either because it was a pre-1977 work and the conveyance was silent as to copyright or because the donor specifically purchased the copyright with the art work—a lifetime gift of the art work by itself without the copyright will be a split-interest gift and will not qualify for an income tax deduction. Interestingly, for estate tax purposes, the rule is different. Section 2055(e)(4) provides that works of art and their copyrights are treated as separate properties for estate tax purposes. Query as to the effect on the valuation of art work bequeathed to charity without the copyright where, for example, the artist's estate has

retained copyrights. In many cases a donor may not even know if he owns the copyright. In that case the donor can simply sign a copyright assignment which does not acknowledge ownership of the copyright but simply conveys any interest which the donor might own.

Fractional Interest Gifts of Art

What many donors of art would really like to do is keep a life estate and donate a remainder interest to charity, as donors are permitted to do with a personal residence. Since 1969, of course, this cannot be done because the retention of a life estate in art does not fit into one of the required forms: an annuity trust, unitrust, undivided interest etc. Until enactment of the Pension Protection Act of 2006, this rather simple case could sometimes be handled in part by gifts of undivided interests in art. This was ideal for the donor who spent a portion of the year at another residence.

Example: Donor spends four months each year at a Florida residence and resides for the remainder of the year in a cold northern city. Donor could give to Museum a one-third undivided interest in the painting and retain an undivided two-thirds interest. Museum will have the right to possess the painting for one-third of the year and the donor will have the right to possess the painting two-thirds of the year.

In fact, in the Winokur case¹⁷ the United States Tax Court ruled that the deduction would be permitted even if the museum did not in fact exercise its right so long as it had the legal right to do so. The risk the donor ran, however, if the museum did not exercise its right was that the Service would argue that there was an understanding that the museum would not exercise its right during donor's lifetime. A deduction was permitted for an undivided interest despite the

¹⁷ Winokur, 90 T.C. 733 (1988), Acq. 1989-1 CB 1

prohibition of Section 170(f)(3), which denies a deduction in the case of a contribution not in trust of an interest in property which consists of less than the taxpayer's entire interest in the property. The deduction was permitted because the taxpayer was contributing an undivided interest in all of the taxpayer's interest. In other words, a vertical division was permitted but a horizontal division was not. And in a private letter ruling¹⁸ the Service ruled that artworks bequeathed subject to restrictions on display would be fully deductible for estate tax purposes. The will did not prohibit sale, but if it had, it could very well have been includable in the gross estate at a higher value than the allowed charitable deduction.¹⁹ The ruling is interesting in part because the Service was willing to rule on what is essentially a valuation question.

A deduction has always been permitted—and is still permitted under the 2006 law changes—for an undivided interest in tangible personal property despite the prohibition of Code section 170(f)(3), which denies a deduction in the case of a contribution not in trust of an interest in property which consists of less than the taxpayer's entire interest in the property. The deduction is permitted by Code section 170(f)(3)(B)(ii) because the taxpayer is contributing an undivided interest in all of the taxpayer's interests. In other words, a vertical division is permitted but a horizontal division is not. And under the 2006 law, gifts of a fractional interest in tangible personal property are still deductible at fair market value if the property will be used by the charity in a way that is related to its exempt purpose. However, unlike pre-2006 tax act law, if a donor makes an initial fractional contribution and then fails to contribute all of the donor's remaining interest to the same donee before the earlier of ten years from the initial fractional contribution or the donor's death, then the donee's income tax and gift tax deductions

¹⁸ PLR 200202032

¹⁹ See for example *Ahmanson Foundation*, 674 F.2d 761 (CA-9, 1981)

for all previous contributions of interest in the item are recaptured with interest. (A special rule applies if the donee of the initial contribution is no longer in existence.) Furthermore, the 2006 law overruled the Winokur decision noted above by providing that if the donee of a fractional interest in tangible personal property fails to take “substantial physical possession” of the property during this period or fails to use the property for an exempt use, then the income and gift tax deductions for all previous contributions of interest in the item are recaptured plus interest. The Joint Committee report notes that inclusion of a painting in an art exhibit sponsored by the donee museum would generally be considered as satisfying the related use requirement. Adding further teeth to this provision is an additional tax equal to ten percent of the amount recaptured if there is a recapture of the deduction as above described. The Joint Committee report notes that the Secretary is authorized to provide regulatory guidance where more than one individual owns undivided interests in tangible personal property. What does that mean in the case of gift tax to recapture the deduction? If the statute has run on the gift year, does that mean that in the recapture year I am deemed to have made a taxable gift?

A contribution which occurred before the effective date of enactment is not treated as an initial fractional contribution for purposes of this provision. However, the first fractional contribution by the taxpayer after the date of enactment is considered the initial fractional contribution even if there has been a prior fractional interest contribution. This provision affects donors who have made an initial fractional contribution and intend to make continuing fractional contributions with the final contribution occurring, perhaps, not until death. Unless all further contributions of fractional interests are completed within a ten year period the recapture provisions will apply.

The estate and gift tax trap in the original act was fixed by the technical corrections signed by President Bush in January, 2008. Under the Pension Protection Act as originally enacted, in determining the deductible amount of an additional contribution of a fractional interest, the fair market value of the item for income, gift and estate tax purposes was a fraction of the lesser of (1) the value used for purposes of determining the charitable contribution of the initial fractional contribution; or (2) the fair market value of the item at the time of the subsequent contribution. That meant that if the property appreciated after the first fractional gift, the donor would have had to pay gift or estate tax on the appreciation. Fortunately, that problem was fixed. The donor's income tax deduction will still be based on a fraction of the original value, but at least the generous donor won't get socked with estate or gift tax on a subsequent gift. If this hadn't been fixed, it would have meant the end of fractional gifts of interests in art which would have been very detrimental to museums. A visit to any major museum will show gifts of fractional interests on the donor recognition plaques.

A related provision of the 2006 Act also dealt with gifts of tangible personal property. As noted above, the tax law has for many years provided that contributions of appreciated tangible personal property to charity are deductible only to the extent of cost basis unless the property will be used in connection with the donee charity's exempt purpose. The classic example is the gift of a painting to a museum. But what happens if after the gift the museum in fact sells the painting or ceases to use it for an exempt use? Under prior law, this was dealt with only by random audit. A charity selling donated property within two years after the date of the gift has long been required to report the sale on a form 8282, but the form 8282 was mostly designed to substantiate values rather than to deal with charitable uses of tangible personal property. Under the 2006 changes, if the charity disposes of the tangible personal property

within three years of the contribution, the donor is subject to a reduced contribution deduction. If the disposition occurs in the tax year of the donor in which the contribution is made, the deduction will generally be basis rather than fair market value. If the disposition occurs in a later year, the donor must include as ordinary income for the taxable year in which the disposition occurs the excess deduction claimed over the donor's basis. The adjustment can be avoided if the charitable donee certifies under penalties of perjury to the IRS that the use of the property was related to the purpose or function constituting the basis for the donee's exemption and describing the use and how the use furthered the purpose, or must state that the intended use became impossible or infeasible to implement. The reporting requirements have been modified so that any disposition within three years after receipt (rather than two years) must be reported on a form 8282. In addition, the donee must provide a description of the donee's use of the property, a statement of whether the property's use was related to the purpose or function constituting the basis for the donee's exemption and in some cases a certification of the use as noted above. This provision applies to contributions for which more than a \$5000 charitable deduction is claimed..

Use of Tangible Personal Property in Charitable Remainder Trusts

The statement is often made that no charitable deduction is allowed for a contribution of tangible personal property to a charitable remainder trust. Is that statement really correct? There are two possible problems with using tangible personal property to fund charitable remainder trusts, section 170(a)(3) and section 170(e).

Section 170(a)(3) provides that payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to actual possession or enjoyment of, the property have expired or are held

by persons other than the taxpayer or a related party. Note that this section was added to the Code in 1964, and therefore preceded the present split interest trust rules of the 1969 Tax Reform Act by five years. (There is some speculation that failure to repeal it in 1969 was inadvertent.) But section 170(a)(3) is a timing provision. It does not say that no contribution is permitted for a gift of a future interest in tangible personal property. It says that no contribution deduction is permitted until the intervening noncharitable interests have expired or are held by persons other than the taxpayer or a related person. It would appear, therefore, that if tangible personal property is contributed to a charitable remainder trust, the deduction should be permitted not when the trust is funded but when the property is sold by the trust. The Internal Revenue Service has acknowledged that this interpretation of the is statute is correct. In a 1994 private letter ruling²⁰ the taxpayer proposed funding a charitable remainder unitrust with tangible personal property – in this case a musical instrument. The Service ruled that the deduction would be allowable in the year in which the property is sold and that the trust qualified as a charitable remainder trust. What is not clear is whether the donor’s deduction will be limited to basis because of the related use requirements of section 170(e)(1)(b)(i).²¹ As we have seen, Code section 170(e) reduces the deduction for charitable gifts of personal property to basis unless the use of the property by the donee is related to the donee’s exempt charitable purpose. What does this mean in the context of a charitable remainder trust funded with personal property? If a charity sells donated property, the property will normally be considered to have an unrelated use. But can a technical argument be made that since in the charitable remainder trust context the

²⁰ PLR 9452026

²¹ In PLR 9452026 the contribution was limited to basis in any event because the remainder beneficiary was not required to be a public charity

contribution is not deemed to be made until the property is no longer owned by the trust, and since at that point the trust holds cash, the gift is essentially one of cash rather than tangible personal property and therefore the cutdown to basis is not required?

Even if only basis can be deducted, that may still in many cases be substantial – the property may have been bequeathed to the donor and received a new basis. Given percentage limitations, a deduction for basis may be sufficient for some donors. And for some generous donors with percentage limitation issues, sheltering the capital gain may be more significant than the deduction. If the deduction is important, why not mix and match: give an undivided interest outright to the museum (deductible at full fair market value with no capital gains realization) and use the rest to fund a charitable remainder trust (deduction limited to basis but no capital gain on sale). The charity can buy the undivided interest from the trust. (After all, it will get the remainder back some day.) If the trust is an annuity trust, the charity can buy the art work for a note calling for payments of interest only in an amount sufficient to cover the annuity obligation. The note would call for a balloon balance due after the donor's life expectancy. But does this meet the fractional interest requirements that in the case of a fractional gift of art, the donor contribute the remaining fractional interest within 10 years. A sale is not a contribution. Other ambiguities in the statute abound. Suppose I give a one half fractional interest in my painting to Museum and three years later work out a bargain sale of the other half. Because I have not contributed the remaining fractional interest to the recapture rules apply? This doesn't seem to make a lot of sense given that there is no problem at all with a bargain sale of the entire art work and the abuse the Congress was after is not possible in this fact scenario.

Other solutions are fun to think about but cutting edge: using a partnership or corporation to hold art in order to avoid the tangible personal property characterization is one idea. Is this a

sham? It may depend on whether the entity has other activities. Another untried method would be contribution to the trust of a deep in the money option to buy the painting, which the charitable remainder trust would sell to the museum remainderman. Has the donor given an option or tangible personal property? This seems to fly in the face of PLR 9501004.

In analyzing gifts of personal property to charitable remainder trusts, donors and their advisors often overlook another alternative which has none of the disadvantages of the charitable remainder trust: a contribution of tangible personal property to a charity in exchange for a charitable gift annuity. Section 170(a)(3) would not apply because the charity does not have a future interest but a present interest in the property. A charitable gift annuity is treated as a bargain sale of cash or property in exchange for an annuity. The unrelated use rule will not apply if the charity's exempt purpose is related to the gift.

Example: Suppose that the Museum wishes to acquire a painting from Donor. Donor has some charitable interest but also wants to have some income from the gift. Donor can contribute the property to Museum in exchange for a charitable gift annuity. The American Council on Gift Annuities sets annuity rates so that approximately one-half of the contribution supports the annuity and the other half qualifies as a charitable contribution. If there is substantial appreciation in the painting, the capital gain will be spread over the donor's life expectancy (if the donor is an annuitant) although in no event will it exceed the amount which would have otherwise been excluded from income under the section 72 annuity exclusion ratio rules.

This may be a better result than could be obtained with the charitable remainder trust, where all of the income would be taxed under the tier system at ordinary income rates, assuming

there is sufficient income to cover the payments. The charity, it is true, will have to dip into current revenues to pay the annuity. But museums have acquisition budgets and purchasing art work with a gift annuity is much cheaper than paying full fair market value.

Gifts of Patents and Copyrights

Patents

The Good Old Days. Internal Revenue Code section 170(e) has long reduced the charitable deduction for gifts of appreciated property by the amount which would not be long term capital gain if the property were sold. The theory is that a taxpayer should not be allowed to deduct ordinary income which has never been included in income. Therefore, because the Code defines patents as capital assets, for many years gifts of patents to charity were deductible at full fair market value in the year contribution without reduction to basis.

2005 law changes. Under the changes which became effective for gifts made after June 3, 2004, patents are part of the class of contributions for which deductions are limited to the lower of fair market value or basis. There are no exceptions (as there were in some prior versions of this legislation) for gifts of patents to universities for scientific research. However, although limited to basis on the initial contribution, taxpayers may elect to receive an additional deduction for income actually generated for the charitable donee by the patent in years following the initial gift to the extent that the gift has not already been deducted. The amount deductible decreases on a sliding scale so that, for example, 100% of any income earned by the charity from the patent in the first and second years after the gift is deductible, with reductions each year after that through the 12th year, at which time only 10% of the income earned on the patent by the charitable donee is deductible. (Since the deduction is deferred, as a policy matter it would seem that the deductions should not also be subject to the percentage cutdown rules. That amounts to

a double reduction.) Only income earned by the charity during the patent life and within 10 years after the gift is deductible. (Because of charitable contribution carryovers, deductions may be taken as many as 12 years after the gift.)

This provision has undoubtedly discouraged some patent contributions, but it may actually encourage some contributions of new patents. A newly obtained patent may not be worth much if it has not yet started generating royalties. Under prior law, some patent owners who expected large future royalties may have delayed their patent gifts in the hope that in future years the deduction for the patent would be much larger. Gifts of mature, profitable patents may not be too adversely affected either. The value of a patent is essentially the value of a discounted stream of royalty payments and the taxpayer will be able to deduct those future royalty earnings although the deduction will be deferred until the charity actually receives them.

Let's look at a concrete example of how this works. Let's say that I give a patent to a university, and the lower of basis or fair market value of the patent as determined by qualified appraisal at the time of the gift is \$50,000. Let's say also that in the first year following the gift the patent earns \$80,000 in royalties. I have already deducted \$50,000, so my \$80,000 deduction is reduced to \$30,000, 100% of which I am allowed to deduct because it is a year one calculation.

If a taxpayer elects to deduct income earned by a patent in future years, the donor is required to notify the charity of the election, and the charity is required to report to the Internal Revenue Service the amount of income earned by it on the patent for the taxable year in question. Notice 2005-41, issued May 4, 2005, details how notice can be given. The law also gives the Treasury the authority to issue regulations detailing calculation of donee net patent

income in cases where the donee doesn't license the property but uses it to further an exempt purpose of the charity.

Copyrights

Prior law. Because copyrights, literary, musical or artistic compositions, letters and memoranda held by a taxpayer whose personal efforts created the property are ordinary income property, contributions of such property to charity have always been deductible only to the extent of the lower of fair market value or basis. The same rule applies to contributions by persons whose basis derives from the donor, such as by gift. So if a modern-day Herman Melville gives the priceless manuscript of the Great American Novel to a research university library he can deduct only the cost of the paper and ink. The same would be true if Mr. Melville contributed his copyright in the Great American Novel to charity. However donors of copyrights which are treated as capital gain property, such as those acquired by purchase or inheritance, can deduct the full fair market value without reduction to basis.

Current law. Contributions of copyrights by the creator are still limited to lower of fair market value or basis, as under prior law. But under the 2004 law changes, the charitable deduction for donors in whose hands copyrights are capital assets, such as persons who received the copyright by inheritance or purchase, is treated like the donor of a patent as described above. As with patent gifts, an additional deduction is allowed for income earned by the charity from the copyright after the gift. If, therefore, I were Herman Melville's son and I inherited my father's copyright in the Great American Novel, I could contribute the copyright to charity, deduct my basis (possibly a substantial date of death value) plus elect to deduct the royalties received by the charity over the following ten years, to the extent they exceeded the value of the

original copyright gift, subject to the cutdown percentages after year two. The usual qualified appraisal rules apply to all of these gifts.

Nothing in the 2004 law changed the rules the IRS applied in Rev. Rul. 2003-28 dealing with the deductibility of gifts of patents subject to various restrictions on donee use. In the first situation, the patent was licensed to charity, but the donor retained ownership. The IRS ruled that no charitable deduction was allowable under the partial interest rules of section 170(f)(3). In the second situation, the donor actually gave the charitable donee the patent, but subject to a reversion back to the donor if the donee (a university) did not continue to employ a particular faculty member for a 15-year term. Because the contingency was not so remote as to be negligible, the Service held again that no deduction was allowable. In the third situation, the donor gave a patent to a university, but made the gift subject to a requirement that the university could not sell or license the patent for a 3-year period. In that situation, the Service held that the donor could deduct the gift, but noted that the restrictions might affect the value of the gift.

Property Subject to Debt

What happens if I contribute property to charity which secures a debt I have incurred? Not surprisingly, the charitable contribution deduction for encumbered property must be reduced to the extent of the debt. Also not surprisingly, the donor realizes income to the extent of the debt. In essence, the transaction is treated like a bargain sale. Perhaps more surprising, however, is the fact that the donor realizes gain to the extent of the debt even if the debt is nonrecourse.²² And if the debt exceeds the value the property, the charity might even realize debt-financed income. So it sometimes pays charities to look a gift horse in the mouth. Another issue: because a gift of property subject to a mortgage is treated as a bargain sale to the charity, does a gift of

²² See Tufts, 461 U.S. 300 (1983)

encumbered property to a charitable remainder trust violate the self-dealing rules which of course prohibit transactions between a disqualified person and a charitable remainder trust? Probably not, given the exception in the self-dealing rules for initial transfers. However if the donor is personally liable and the trust actually makes the mortgage payments, the trust will lose its qualified status because it will be a grantor trust.²³ So how to deal with the problem if the donor wants to contribute, for example, a piece of encumbered real estate to a charitable remainder trust? Let's suppose that the property is worth \$1,000,000 and the debt is \$200,000. If the lender is willing, perhaps the property can be severed into two pieces, a 20% piece which remains subject to the debt and an 80% piece which is contributed unencumbered to the CRT? Or perhaps the donor can substitute a personal guarantee or other collateral.

Charitable Pledges

Charitable pledges create their own issues. A pledge itself is not deductible because the donor has not parted with any funds. Complications arise because under state law in many states, and under the common law of many states, charitable pledges are enforceable even though a promise to make a gift to an individual would not be because of lack of consideration. Interestingly enough, however, even though a charitable pledge may be legally binding under state law, a transfer of appreciated property in satisfaction of the charitable pledge is not a realization event resulting in gain. This was the holding in Rev. Rul. 55-410, 1955-1 CB 297. The theory of the published ruling was that since no deduction was available until the pledge was satisfied, it would be incongruous to have realization of debt when the pledge is paid. Whether or not this makes any sense, the rule is helpful because it encourages charitable pledges. The problems arise because of inconsistencies in the way the Internal Revenue Service treats

²³ PLR 9015049

charitable pledges. For example, although a charitable pledge has no immediate income tax consequences and although payment of a charitable pledge with appreciated property is not a realization event, satisfaction of a donor's charitable pledge by the donor's private foundation is an act of self-dealing.²⁴ Similarly, donor advised funds will typically not satisfy a donor's charitable pledge if the fund is aware of the pledge obligation. Treating satisfaction of a charitable pledge as a self-dealing transaction makes little sense and the problems arise typically from lack of information: a donor innocently enough makes a charitable pledge and then decides later to pay the pledge from his private foundation. Few donors not schooled in these arcane rules would consider that an abusive transaction. In some cases perhaps the problem can be avoided by a joint pledge which can be satisfied by either or both the donor and the private foundation. Does this avoid the problem? Will the charity be happy if instead the donor signs a nonbinding statement of charitable intent?

What happens if the donor's binding charitable pledge is satisfied by a qualified IRA rollover distribution? In August, 2010 the Internal Revenue Service in an information letter to Harvey Dale, director of New York University's National Center on Philanthropy and the Law, analyzed whether satisfaction of a donor's charitable pledge from an IRA rollover contribution would cause realization of income by the donor and an offsetting charitable deduction. Consistent with revenue ruling, the Service advised that the distribution in satisfaction of the charitable pledge would not trigger realization of income.

One final interesting aspect of charitable pledges: the Internal Revenue Service views a legally binding charitable pledge as a debt deductible on the donor's estate tax return as a debt rather than as a charitable deduction. This difference in treatment will rarely make a difference,

²⁴ PLR 8534001

but deductibility as a debt may make qualification under section 303 or 6166 easier. Remember that qualification under those sections is determined by looking at the percentage which the closely held entity represents of the entire estate after debts but before the charitable deduction. A debt is "above the line" in the sense that it comes before what we used to call the adjusted gross estate. A client who is concerned about meeting the percentage requirements for qualification under those sections and who also has charitable bequests in a will may be able to increase the percentage by making a binding charitable pledge.

How can a charity make certain that a charitable pledge will be binding and, therefore, enforceable by means of a claim filed in the donor's estate? This will depend on state law, but enforceability can be buttressed by building in consideration. Statements such as "Donor is aware that Charity will rely on Donor's pledge in securing the pledges of others and in budgetary planning." There are lots of examples one could think of for more specific fact situations.

Loans to Charities

Interesting question: suppose my favorite charity is in financial straits. Being the generous fellow I am, I lend money to the charity on a no-interest loan. Does the loan have tax consequences? One would think not – I have simply made a no interest loan to a charity and some day when the charity is sufficiently financially secure, it will repay me. I wouldn't expect a charitable deduction, of course, because I'm not taxed on the income in the first place – see the discussion of gifts of services, rent-free use of property etc. above. However, there are other problems. Section 7872 does not include an exception to the imputed interest rules for no-interest loans to charity. The temporary regulations under section 7872, which have been temporary for many years, provide an exception for gift loans to a charitable organization, but only if at no time during the taxable year will the aggregate outstanding amount of loans by the lender to that

organization exceed \$250,000.²⁵ Why should the IRS care? The reason is that if I could make an unlimited loan to a charity I would effectively have gotten around the percentage limitation rules. If I had not made the loan and kept the \$1,000,000 and simply given the earnings to charity every year, I would have receipt of income followed by an offsetting deduction, but subject to percentage limitations. An interest-free loan to charity without some kind of restriction such as the imputed interest rules would allow an end run around the percentage limitation rules. What about a no-interest loan to a private foundation? Do the self-dealing rules apply there? Code section 4941 provides that the lending of money by a disqualified person to a private foundation is not an act of self-dealing if the loan is without interest or other charge (determined without regard to section 7872) and if the proceeds of the loan are used exclusively for charitable purposes. But an exception from the self-dealing rules is not an exception from the imputed interest rules.

Gifts of Remaining Non-Charitable Annuity and Unitrust Interests

Suppose that many years ago I established a charitable remainder trust and now, finding myself more financially secure, I decide to contribute my remaining life estate to the charitable remainder beneficiary. What are the tax implications and would they differ if instead of giving a life estate in a charitable remainder trust I give the issuing charity my remaining annuity interest in a charitable gift annuity? First, of course, we must look at the trust to determine whether it permits assignment of the income interest. A typical spendthrift clause, if included in the trust, may prohibit such assignments. So when drafting a spendthrift clause which will be included in a charitable remainder trust, it is important to except transfers to the charitable

²⁵ This is much more generous than the provision in the proposed regulations, which exempts loans to a charitable organization only if at no time during the taxable year will the aggregate outstanding amount of loans by the lender to all charitable organizations exceed \$10,000..

remainder beneficiary. If the document includes a spendthrift provision which does not except transfers to the charitable remainder beneficiary, it may be possible to obtain a court order to permit the assignment.

What about the tax deduction? We start of course with Code section 170(e) which reduces the charitable deduction of appreciated property by the amount which, if the property were sold, would be not be long-term capital gain.²⁶ However, perhaps surprisingly, an income interest in a trust is a capital asset. This was the holding in the McAllister²⁷ case. The holding may seem surprising in that the sold asset is simply income which has been discounted to take into account time value of money. But as noted in the footnote below this has been the rule for a long time. If the interest is an annuity, a low interest rate at the time of the contribution of the life estate greatly increases the value of the annuity and, therefore, the amount of the charitable deduction. In fact, if the interest rate was high when the annuity trust was created and the interest rate is low when the life estate is contributed, more than 100% of the initial value of the trust may be deductible. Of course it works the other way too if the initial interest rate was low at the time of the original contribution and high at the time of the subsequent contribution.²⁸

Another question: do I need a qualified appraisal for my contribution? On the one hand, a contribution of a life estate in a charitable remainder trust is not a gift of cash or marketable securities but, at best, an interest in a trust holding cash or marketable securities. On the other

²⁶ In addition, pursuant to Code section 1001(e) the basis of the income interest is zero.

²⁷ *McAllister v. Commissioner of Internal Revenue*, 157 F.2d 235 (2d Cir. 1946), rev'g 5 TC 714, cert. Denied, 330 U.S. 826 (1947), acquiescence announced by the Service in Rev. Rul. 72-243, 1972-1 CB 233

²⁸ Note, however, that unitrusts are essentially unaffected by interest rates

hand, if I create a charitable remainder trust I am contributing not cash or marketable securities but a remainder interest in a trust holding, perhaps, cash or marketable securities. Surely in that case no one expects that I need a qualified appraisal so why should it be different if I am giving a life estate in a trust rather than a remainder interest in a trust? In both cases, valuation amounts (usually) to no more than consulting the IRS actuarial volumes for planned giving software. But because the answer is not certain, many practitioners are obtaining qualified appraisals for such gifts.

What happens if I give a charitable gift annuity? Remember – charitable gift annuities are taxed under the section 72 rules that apply to commercial annuities. An individual transferring an annuity contract for less than full and adequate consideration is treated as having received an "amount not received as an annuity" which is ordinary income. Therefore it appears that section 170(e) reduces the deduction to the donor's unrecovered basis in the contract.



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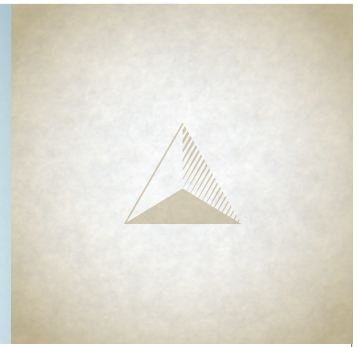
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Turney P. Berry
Partner

Wyatt Tarrant & Combs, LLP
500 W. Jefferson Street, Suite 2800
Louisville, KY 40202

P: 502-562-7505

E: tberry@wyattfirm.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

NOTABLE DEVELOPMENTS OF INTEREST TO CHARITABLE PLANNERS

Turney P. Berry
WYATT, TARRANT & COMBS, LLP
500 West Jefferson Street, Suite 2800
Louisville, KY 40202-2898
502.562.7505 – Direct Dial
502.589.0309 - FAX
tberry@wyattfirm.com

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NOTABLE DEVELOPMENTS OF INTEREST TO CHARITABLE PLANNERS

A. CHARITABLE AND TAX-EXEMPT MATTERS - Sections 170, 642, 664, 501, 509, 2055, 2522, and 4940-4947

1. Charitable Reformation.

Antonio Palumbo died in 2002 with a 1999 Will that lacked a residuary clause. Other references in the Will, and three codicils, indicated that the decedent intended the residue to go to a charitable trust and the scrivener admitted error in the 1999 drafting. At issue in Estate of Antonio J. Palumbo v. United States, 107 A.F.T.R.2d 2011-1274 (W.D.Pa. 2011), was whether the estate was entitled to a charitable deduction based on a settlement agreement. The opinion states:

Defendant relies on Pennsylvania State Law for the proposition that this Court may not consider matters external to the 1999 Will. See Defendant's Brief, doc. no. 33, p. 9. Defendant argues that the Charitable Trust had no legal right to the residuary estate, given that the 1999 Will failed to include a provision for the residuary estate due to scrivener's error; and therefore, any sum the Charitable Trust acquired cannot be said to have passed from the testator through the 1999 Will, and thus, cannot be deemed a charitable deduction.

This Court notes that it is generally the rule of law in Pennsylvania to look only to the "four corners" of a document in order to ascertain the testator's intent; however, like almost every rule there are exceptions. See, Estate of Rosenberg v. Dep't of Pub. Welfare, 679 A.2d 767, 772 n.3 (Pa.1996) ("Some of the evidence referred to is clearly outside the scope of inquiry permitted when it is necessary to go beyond the four corners of the trust instrument."); Estate of Taylor, 391 A.2d 991, 994 (Pa. 1978); and Estate of Schwarbarth, 466 A.2d 1382 (Pa. Super. 1983) (" . . . the court cannot feel confidence in distributing the estate by reference to the terms of the Will alone . . .").

* * *

Here, there is no dispute that the 1999 Will was the last written iteration of Mr. Palumbo's intent. However, the parties concur that prior testamentary documentation provided for a residuary estate, and that in all prior documentation, the residuary estate was left to the Charitable Trust. It is also uncontested that Mr. Palumbo's attorney has admitted that he made a scrivener's error when preparing the 1999 Will, in that he failed to include a provision for the residuary estate. Finally, although the parties do not agree on the extent of the dispute concerning the residuary estate which arose between Mr. Palumbo's son and the Charitable Trust after Mr. Palumbo's death, they do agree that after the dispute arose, arm's length negotiations ensued which resulted the settlement agreement at issue here. As noted above, under the facts of this case, the parties agree that the sum of \$11,721,141.00 was paid to the Charitable Trust pursuant to this settlement agreement which was negotiated among counsel for several interested parties, but primarily by counsel for the Charitable Trust and counsel for Mr. Palumbo's son.

2. **Donor Advised Funds.**

In Setty Gundanna Viralam v. Commissioner, 136 T.C. No. 8 (2011), the Tax Court denied an income tax deduction for a contribution to a donor advised fund where, despite the right language being used in the documentation, the actual use of most of the contribution was to pay tuition for the donor's children. The opinion states:

When he established his Foundation account in 1998, petitioner anticipated that each of his three children would incur 8 years of college and graduate school expenses which he estimated would approximate \$40,000 annually per child. The distributions from petitioner's Foundation account for student loans for his oldest son dwarfed the distributions for other purposes for the first 5 years, until respondent commenced an examination of petitioners' 1998 return and proposed to disallow their deduction for the contributions to the Foundation. Disregarding payment of the Foundation's startup and annual management fees, the distributions made from petitioner's Foundation account in 1999 through 2003 for purposes other than Vinay's student loans totaled \$15,500.13 The distributions for Vinay's student loans during that period totaled \$70,299, or approximately 82 percent of distributions not devoted to management fees. Respondent first proposed to disallow petitioners' charitable contribution deduction for the Foundation transfer in a 30-day letter issued in May 2002 and formally did so in a notice of deficiency issued on September 16, 2003. No distributions for student loans were made from petitioner's Foundation account in 2003. Indeed, on September 5, 2003, just before issuance of the notice of deficiency, petitioner arranged for the repayment of Vinay's student loans.14 Given these facts, we are persuaded that distributions for student loans to petitioners' children would have continued to constitute the predominant use of the assets in petitioner's Foundation account, but for the scrutiny of the Internal Revenue Service.

The Foundation's approval of petitioner's son as a student loan beneficiary was perfunctory. The Foundation sent petitioner a distribution request form on which the approval for a student loan for Vinay had already been signed by a Foundation official before petitioner executed the form. There is no evidence that the Foundation reviewed Vinay's qualifications or otherwise exercised any independent judgment in selecting him for a student loan. In the circumstances, it is obvious that the selection of Vinay as a beneficiary of the Foundation's student loan program arose from his relationship to petitioner and as a result of petitioner's direction.

Petitioner's understanding, at the time he transferred the stocks to his Foundation account in 1998, that the account's assets could be used to make student loans to his children, and the Foundation's perfunctory acquiescence in making such loans in subsequent years, provide substantial support for the conclusion that petitioner neither intended, nor in fact did, cede dominion and control over the property transferred to the Foundation in 1998.

Further, capital gain on stock contributed to the fund and sold were taxable to the donor and an accuracy-related penalty was upheld.

In order for a donor advised fund to be considered part of the sponsoring charity's assets (a "component fund"), rather than a separate entity taxed as a private foundation, neither the donor nor anyone else, may control the fund although they may give advice as to investments and distributions. In Styles v. Friends of Fiji, 2011 WL 488951, the Nevada Supreme Court noted that the sponsoring charity, the Friends of Fiji (FOF), failed to attempt in any way to satisfy Styles' charitable goals, and thus breached the implied covenant of good faith and fair dealing. However, the court found that the donor failed to prove damages and that his claim failed." The Court stated:

The court stated that "while damages may be awarded when a party breaches the implied covenant of good faith and fair dealing, here, the district court, after reviewing the testimony and evidence, including the donor-advised fund agreement, concluded the Styles suffered no damages because once he made the unrestricted gift, he no longer had any interest in or control over the donation.

3. IRA Used to Satisfy Pledge.

In an information letter issued August 20, 2010, the IRS confirmed that a distribution from an IRA to charity that satisfies a pledge will not result in income for the donor:

Rev. Rul. 55-410, 1955-1 C.B. 297, provides that the satisfaction of a pledge to a charitable organization by means of a donation or gift of property that has either appreciated or depreciated in value does not give rise to a taxable gain or a deductible loss. In effect, Rev. Rul. 55-410 holds that a charitable pledge does not create a debt for federal income tax purposes, and is not a legal obligation for purposes of § 677. Rev. Rul. 64-240, 1964-2 C.B. 172. See also Rev. Rul. 57-506, 1957-2 C.B. 65.

Likewise, by analogy, a taxpayer who satisfied a pledge by making a qualified charitable distribution under § 408(d)(8) from his or her IRA directly to a charitable organization would not include the distribution in gross income.

4. No Supporting Organization if Categories are Too Broad.

In Polm Family Foundation, Inc. v. United States, 107 A.F.T.R.2d 2011-2100 (D.C. Cir. 2011), the Court determined that an organization flunked the organizational test for Type II supporting organization status under section 509(a)(3). The opinion states:

To satisfy the organizational test, the Foundation had to demonstrate that it is "organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified [publicly supported] organizations. . . ." 26 U.S.C § 509(a)(3)(A). Regulations

implementing this provision require the articles of incorporation of a supporting organization to "designate each of the specified organizations by name. . . ." Treas. Reg. § 1.509(a)-4(d)(2)(i).

There is an exception to this requirement: a Type II supporting organization need not specify by name each publicly supported organization if its articles of incorporation "require that it be operated to support or benefit one or more beneficiary organizations which are designated by class or purpose. . . ." Treas. Reg. § 1.509(a)-4(d)(2)(i)(b). The IRS tells us that the exception applies only if the class of beneficiary organizations is "readily identifiable." In support, it points to the examples in the regulations and a related revenue ruling. See Treas. Reg. § 1.509(a)-4(d)(2)(iii); Rev. Rul. 81-43, 1981-1 C.B. 350. In each example, the description of the class allows easy identification of the beneficiary organizations -- e.g., "institutions of higher learning in the State of Y," Treas. Reg. § 1.509(a)-4(d)(2)(iii); "[tax-exempt public charities] located in the [city of] Z area," Rev. Rul. 81-43.

An agency's interpretation of its regulation is controlling unless the interpretation is "plainly erroneous or inconsistent with the regulation." *Auer v. Robbins*, 519 U.S. 452, 461 (1997). This is so even if the interpretation appears for the first time in a legal brief. *Chase Bank USA, N.A. v. McCoy*, 131 S. Ct. 871, 880-81 (2011); *Bigelow v. Dep't of Def.*, 217 F.3d 875, 878 (D.C. Cir. 2000). "Because the interpretation the [IRS] presents in its brief is consistent with the regulatory text," *Chase Bank*, 131 S. Ct. at 880, we have no basis for rejecting it in favor of some other version. In the statute's terms, the organizations the Foundation supports must be "specified." This strongly suggests that either the Foundation must identify those organizations by name or the organizations must be identifiable from the Foundation's articles of incorporation. That essentially is what the Treasury regulation provides. The IRS so interprets it in its submissions to this court and to the district court. The Foundation has offered nothing to counter the IRS's interpretation. All the Foundation has to say is that the government is forbidden from making the argument. This is frivolous for the reasons we have already given -- a winning party may support the judgment on appeal on any grounds argued below, even if the district court never reached them.

All that is left is the question whether the Foundation satisfied the organizational test, as the IRS interprets it. The Foundation has no defense. Its amended articles of incorporation designate as supported organizations "the class of organizations . . . which support, promote and/or perform public health and/or Christian objectives, including but not limited to Christian evangelism, edification and stewardship." Unlike the examples contained in the regulation and the revenue ruling, this designation does not make its beneficiary organizations readily identifiable. There is no geographic limit. There is no limit by type of publicly supported organization (such as churches or seminaries). In light of the broad purposes mentioned in Foundation's articles of incorporation, we agree with the government that it would be difficult, if not impossible, to determine whether the Foundation will receive oversight from a readily identifiable class of publicly supported organizations.

5. Conservation Easement Deduction and Mortgage Property.

Treas. Reg. § 1.170A-14(g)(6)(ii) provides:

(ii) Proceeds.--In case of a donation made after February 13, 1986, for a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. * * * For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions gives rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

In Kaufman v. Commissioner, 134 T.C. No. 9 (2010), the contribution of a facade easement to the National Architectural Trust (NAT) generated no income tax deduction because there was a mortgage on the property and thus the charitable organization might not receive the proceeds of sale if the property were condemned or damaged. The opinion states:

The interest in property conveyed by a facade easement must be protected in perpetuity for the contribution of the easement to be a qualified conservation contribution. Under section 170(h)(2)(C), a qualified real property interest must be "a restriction (granted in perpetuity) on the use which may be made of the real property." See also sec. 1.170A-14(b)(2), Income Tax Regs. Under section 170(h)(5)(A), "A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity." See also sec. 1.170A-14(a), Income Tax Regs.

* * *

Petitioners concede that the property had a mortgage and that the bank retained a "prior claim" to all proceeds of condemnation and to all insurance proceeds as a result of any casualty, hazard, or accident occurring to or about the property. Moreover, petitioners do not dispute that the bank was entitled to those proceeds "in preference" to NAT until the mortgage was satisfied and discharged. The right of NAT to its proportionate share of future proceeds was thus not guaranteed. Petitioners argue that whether NAT would receive its proportionate share of any proceeds is a question of fact. In effect, petitioners argue that they have satisfied the requirement in section 1.170A-14(g)(6)(ii), Income Tax Regs.,

because NAT might be entitled to its proportionate share of future proceeds. Yet that provision states that the donee organization must be so entitled. See *id.* The requirement is not conditional. Petitioners cannot avoid the strict requirement in section 1.170A-14(g)(6)(ii), Income Tax Regs., simply by showing that they would most likely be able to satisfy both their mortgage and their obligation to NAT. The facade easement contribution thus fails to satisfy the requirement in section 1.170A-14(g)(6), Income Tax Regs., and so fails to satisfy the enforceability in perpetuity requirement under section 170(h)(2)(C) and (5)(A).

In 1982 East, LLC, Solomon D. Asser, Tax Matters Partner, v. Commissioner of Internal Revenue, T.C. Memo. 2011-84, First Republic Bank had security interest in property on which an easement was given to the National Architectural Trust (NAT). The Bank subordinated its interest for the most part, but not entirely as the opinion notes:

The lender agreement stated that First Republic Bank was subordinating its rights in the subject property to NAT's rights to enforce the conservation purpose of the donated property in perpetuity, subject to the following conditions and stipulations:

(a) * * * First Republic Bank and its assignees shall have a prior claim to all insurance proceeds as a result of any casualty, hazard or accident occurring to or about the [subject] Property and all proceeds of condemnation, and shall be entitled to same in preference to * * * NAT until the Mortgage/the Deed of Trust is paid off and discharged, notwithstanding that the Mortgage/the Deed of Trust is subordinate in priority to the Easement.

* * * * *

(c) Nothing contained in this paragraph or in this Easement shall be construed to give * * * First Republic Bank the right to violate the terms of this Easement or to extinguish this Easement by taking title to the [subject] Property by foreclosure or otherwise.

Thus the Tax Court denied the deduction. The Court also expressed skepticism that the easement really was more restrictive than applicable local preservation rules in New York City:

By virtue of its location in the Metropolitan Museum Historic District, New York City law makes it unlawful for LLC to alter the subject property unless LPC [the New York City Landmarks Preservation Committee] approves that alteration. N.Y. City Admin. Code sec. 25-305(a)(1) (2002). In determining whether to allow such an alteration, the LPC must consider whether the alteration would "change, destroy or affect any exterior architectural feature" of the subject property and, in the case of an improvement, "whether such construction would affect or not be in harmony with the external appearance of other, neighboring improvements". *Id.* sec. 25-306(a)(1). This determination would of course consider not only the external appearance of the subject

property's facade but also the ability of LLC to alter the aesthetics of the subject property by building above it. Thus it is local law and the rules of the LPC that preserve the subject property and not the rights which NAT possessed under the deed of easement.

There was no penalty assessed because the Court concluded the rules on the effect of mortgages were not "crystal clear" until Kaufman v. Commissioner, 134 T.C. 182 (2010), decided four years after the deduction here was claimed.

At 136 T.C. No. 13 (2011) the Tax Court affirmed Kaufman after reconsidering its grant of summary judgment. The facts are almost identical, in pertinent part, to Asser. The opinion states:

On brief, petitioners head one of their arguments: "The Facade Easement Contribution Satisfies The Requirements of Treas. Reg. § 1.170A-14(g)(2)". They appear to believe that respondent is arguing that the agreement fails to establish a perpetual conservation restriction "because * * * [the bank] did not subordinate its rights to * * * [NAT's] right to receive a proportionate share of condemnation or insurance proceeds, and therefore the * * * [agreement] somehow fails to comply with Treas. Reg. § 1.170A-14(g)(6)." Put another way, they appear to believe that respondent has conflated the subordination requirement found in section 1.170A-14(g)(2), Income Tax Regs., with the extinguishment provision found in section 1.170A-14(g)(6), Income Tax Regs., so that, in order for a donor to show that its donation satisfies the extinguishment provision, any mortgagee must "subordinate its interests so that a donee organization has a priority interest in insurance or condemnation proceeds." Respondent disavows making that argument, stating that neither his motion for summary judgment nor our Opinion, Kaufman v. Commissioner, 134 T.C. 182 (2010), even references section 1.170A-14(g)(2), Income Tax Regs. He believes that he argued, and we decided, that the facade easement contribution failed to satisfy the extinguishment provision without regard to whether the bank had subordinated its rights in the property to NAT's rights therein, so as to satisfy the subordination requirement. He is correct.

Satisfying the subordination requirement immunizes against the effect of the general rule, described supra section I.B. of this report, that an easement is lost by the foreclosure of a mortgage or trust deed burdening the servient tenement, when such mortgage or trust deed was executed prior to the creation of the easement. Annotation, "Foreclosure of mortgage or trust deed as affecting easement claimed in, over, or under property", 46 A.L.R. 2d 1197 (1956 & Supp.); see also, e.g., Camp Clearwater, Inc. v. Plock, 146 A.2d 527, 536-537 (N.J. Super. Ct. Ch. Div. 1958) ("The foreclosure of a mortgage vests in the purchaser at the foreclosure sale a legal right to the property free of easements and encumbrances imposed upon it subsequent to the mortgage provided that the holders of such easement rights or encumbrances are made parties to the foreclosure."), affd. 157 A.2d 15 (N.J. Super. Ct. App. Div. 1959).

We did not base our grant of partial summary judgment for respondent on any consideration of the consequences of foreclosure of the bank's mortgage. We

based our grant solely on the fact, conceded by petitioners, that, because, following a judicial extinguishment of the facade easement, NAT might not receive its proportional share of any future proceeds, the agreement failed to satisfy the requirements of section 1.170A-14(g)(6), Income Tax Regs., and so failed to satisfy the enforceability-in-perpetuity requirements under section 1.170A-14(g), Income Tax Regs., and section 170(h)(2)(C) and (5)(A). We think it unnecessary to our result, and reach no conclusion, as to whether the bank subordinated its rights in the property to the right of NAT to enforce the facade easement so as to satisfy the requirements of section 1.170A-14(g)(2), Income Tax Regs.

The D.C. Circuit Court of Appeals upheld the Tax Court in Commissioner v. Dorothy Jean Simmons, 2011 WL 2451012 (2011). The contributions were made to the L'Enfant Trust. The opinion states:

We conclude the easements meet the requirement of perpetuity in § 170(h)(5)(A). The deeds impose an affirmative obligation upon Simmons "in perpetuity" to maintain the properties in a manner consistent with their historic character and grant L'Enfant the authority to inspect the properties and to enforce the easements. By their terms, the deeds will "survive any termination of Grantor's or the Grantee's existence." Although the deeds do not spell out precisely what would happen upon the dissolution of L'Enfant, D.C. law provides the easements would be transferred to another organization that engages in "activities substantially similar to those of" L'Enfant. D.C. Code §§ 29301.48, 29-301.56. More specifically, the State Historic Preservation Officer testified the easement initially reverts to the District of Columbia, which then seeks to assign it to a conservation organization. Accordingly, the deeds do all the Commissioner can reasonably demand to "prevent" uses of the properties inconsistent with conservation purposes, as required by Treasury Regulation § 1.170A-14(g)(1).

The clauses permitting consent and abandonment, upon which the Commissioner so heavily relies, have no discrete effect upon the perpetuity of the easements: Any donee might fail to enforce a conservation easement, with or without a clause stating it may consent to a change or abandon its rights, and a tax-exempt organization would do so at its peril. As the amici curiae -- the National Trust for Historic Preservation, L'Enfant, and the Foundation for the Preservation of Historic Georgetown -- further explain, this type of clause is needed to allow a charitable organization that holds a conservation easement to accommodate such change as may become necessary "to make a building livable or usable for future generations" while still ensuring the change is consistent with the conservation purpose of the easement.

Moreover, the Commissioner has not shown the possibility L'Enfant will actually abandon its rights is more than negligible. L'Enfant has been holding and monitoring easements in the District of Columbia since 1978, yet the Commissioner points to not a single instance of its having abandoned its right to enforce.

The court also upheld the reasonableness of the taxpayer's appraisals.

6. **A Donor Must Get a Written Acknowledgement.**

In ECC 201120022 the IRS advised that “a taxpayer who makes a donation to a charity but fails to obtain a contemporaneous written acknowledgement of the donation cannot claim a charitable deduction even if the donee files an information return that includes information acknowledging the donation.” See also ECC 201120027 to the same effect.

7. **Value of Conservation Easement Deduction.**

The taxpayer in Trout Ranch, LLC v. Commissioner, T.C. Memo. 2010-283, first tried to value the easement using comparable sales. The court rejected the effort, holding the comparables were not all that comparable:

The most obvious problem with Mr. Lengel’s [taxpayer’s expert] comparable sales analysis is that none of the four conservation easements above had an effect on the donor’s land comparable to the effect the Trout Ranch CE had on Gunnison Riverbanks Ranch.⁴ With the exception of the Guerrieri CE, the conservation easements restricted development rights to a much greater extent than the Trout Ranch CE. The Niccoli CE restricted development from at least four residential lots to none (a reduction of potential development of 100 percent); the Miller CE restricted development from nine residential lots to one lot (a reduction of potential development of 89 percent; the Trampe CE restricted development from 27 residential lots to one lot (a reduction of potential development of 96 percent). In essence, in all three cases the conservation easements all but eliminated residential development. In stark contrast, the Trout Ranch CE restricted development from at least 40 residential lots to 22 lots (a reduction in potential development of 45 percent). We are simply not convinced that the value of a conservation easement that restricts development to at most one residential lot sheds any light on the value of a conservation easement that allows as many as 22 residential lots.

Although the Guerrieri CE and the Trout Ranch CE restricted overall development to a similar degree, the details of the former are too different from those of the latter for the Guerrieri CE to be of much help in valuing the Trout Ranch CE. Regardless of the true value of the Guerrieri CE, that conservation easement provides no help in valuing the Trout Ranch CE because the restrictions of the two conservation easements had significantly different effects. The Guerrieri CE restricted all development across a block of 315 acres (the single 5-acre residential lot being in the northeast corner of the 320 encumbered acres). The appraisal stated: “There are several successful residential developments within the subject neighborhood along with sales of 35-acre parcels for homes and large ranches for development and exclusive use.” The conservation easement prevented Guerrieri Ranches, L.L.C., from developing 320 acres of “semi-secluded pristine valley, with creek frontage, views, majestic mountains, wildlife, [and] proximity to economic centers”. At Gunnison Riverbanks Ranch, however, the conservation easement restricted the land

surrounding the most valuable asset (the river) but was designed to allow the partnership to develop the entire parcel into a 21-lot shared ranch, with 21 residential lots and a clubhouse along the river.

The court next thrashed through the findings of multiple experts to determine the value of the property on a development basis. Of interest in the court's determination that it may use subsequent data, such as sales. The opinion states:

Before we discuss the data presented above, we must address petitioner's argument that we may not consider evidence of lot sales after the date of valuation (i.e., the date the partnership donated the conservation easement). Petitioner argues that "the plain language of the regulation" makes events occurring after the date of valuation "irrelevant". In support, he quotes section 1.170A-14(h)(3)(i), Income Tax Regs.: "The value of * * * a perpetual conservation restriction is * * * [its] fair market value * * * at the time of the contribution." That statement, however, does not limit the evidence one may consider in determining that value; the regulation does not support petitioner.

In Estate of Gilford v. Commissioner, 88 T.C. 38, 52-54 (1987), on which petitioner relies, we stated:

The rule that has developed, and which we accept, is that subsequent events are not considered in fixing fair market value, except to the extent that they were reasonably foreseeable at the date of valuation. See, e.g., Ithaca Trust Co. v. United States, 279 U.S. 151 (1929) * * *

* * * * *

* * * the rule against admission of subsequent events is a rule of relevance. Rule 401, Federal Rules of Evidence, applicable in this Court pursuant to Rule 143, Tax Court Rules of Practice and Procedure, and section 7453, defines relevant evidence as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more or less probable than it would be without the evidence." (Emphasis added.) See Armco, Inc. v. Commissioner, 87 T.C. 865 (1986). * * *

Estate of Gilford does not support petitioner. We find that the evidence of lot sales within a reasonable period after the date of valuation (especially those at Gunnison Riverbanks Ranch itself) tends to make a given estimate of the lot prices more or less likely; that is, such evidence is relevant.

8. Unreimbursed Expenses of Caring for Foster Cats.

The case of Van Dusen v. Commissioner, 136 T.C. No. 25 (2011), held that a volunteer who took care of foster cats could deduct many, but not all of her expenses:

We find that taking care of foster cats was a service performed for Fix Our Ferals, a section 501(c)(3) organization that specializes in the neutering of wild cats. See *infra* part I. Some of Van Dusen's expenses are categorically not related to taking care of foster cats and are therefore not deductible. These expenses are the cost of cremating a pet cat, bar association dues, and DMV fees. See *infra* part II. Some of Van Dusen's other expenses are not solely attributable to foster-cat care and are not deductible. These expenses are the cost of repairing her wet/dry vacuum and her membership dues at a store. See *infra* part III. Other expenses are attributable to the services Van Dusen provided to Fix Our Ferals. These expenses are 90 percent of her veterinary expenses and pet supplies and 50 percent of her cleaning supplies and utility bills. See *infra* part IV.B. Some payments to Orchard Supply Hardware and Lowe's for pet supplies, however, are disallowed because the amounts spent on pet supplies cannot be determined with precision. See *infra* part IV.A. In deciding whether Van Dusen kept adequate records of the expenses attributable to her volunteer services, we hold that the regulatory requirements for money contributions govern Van Dusen's expenses of less than \$250. See *infra* part IV.C.1.a. Van Dusen has met the requirements for these less-than-\$250 expenses. Her records are acceptable substitutes for canceled checks under the substantial compliance doctrine. See *infra* part IV.C.1.b. For expenses of \$250 or more, however, Van Dusen does not have contemporaneous written acknowledgment from Fix Our Ferals. See *infra* part IV.C.2. Therefore, these expenses are not deductible.

9. **Facade Easement Deduction Disallowed.**

In Billy L. Evans v. Commissioner, T.C. Memo 2010-207, a couple granted facade easements on their Washington, D.C. townhouses. The court disallowed any income tax deduction because of a defective appraisal but did not impose a penalty. The opinion states:

Petitioners called two expert witnesses: Sandy L. Lassere, who prepared appraisal reports with respect to the facade easements, and Calvin Mark Lassere, who reviewed the reports. Mrs. Lassere has a marketing degree from the University of Washington and is a certified residential appraiser in the District of Columbia and Virginia. She testified that she has been appraising property for almost 10 years and that she has appraised upwards of 30 easements. Mr. Lassere has a bachelor of science degree from Purdue University, is a certified general appraiser in the District of Columbia, and has other appraisal licenses in Florida, Georgia, New York, North Carolina, Virginia, and Maryland. Mr. and Mrs. Lassere are coowners of CML & Associates, L.L.C., and serve as principal and president of the firm, respectively.

Mrs. Lassere claimed to have used both the comparable sales method and the before-and-after approach to value the facade easements. On cross-examination, she admitted to a variety of mistakes in her prepared reports, such as incorrectly describing the restrictions imposed by the easements, making improper size adjustments with respect to sales of several comparable properties, and committing numerous miscalculations and spelling and other typographical errors. Her testimony also cast doubt on the rigor and validity of her analysis. For example, she did not adjust sale prices for amenities or garage parking, had

difficulty explaining and justifying the adjustments she did make, and did not review the deeds of easement encumbering comparable properties. In addition, Mrs. Lassere's testimony also implied, explicitly or implicitly, that she may have prepared the appraisal reports without having personally inspected the properties; relied on an inspection by, at the time the properties were actually inspected, an unsupervised trainee appraiser; incorrectly indicated in the reports that it was she who had performed the interior inspection; and claimed in the reports that the conditions for a qualified conservation contribution had been satisfied though she failed to check these conditions. In fact, Mrs. Lassere's testimony revealed that despite her expressed experience she was unfamiliar with the regulatory requirements that apply to an appraisal report prepared to support a facade easement donation. Further, she used defined terms in her reports despite being unaware of their technical tax meaning and implications.

However the parties also obtained appraisals from a Mr. Wood and Mr. Keegan that the court gave no weight to in determining value because they did not testify, but which were enough to avoid a penalty:

Petitioners claim that their reliance on Messrs. Wood and Keegan was reasonable and in good faith and constitutes the requisite showing under section 6664(c)(1), and we agree. Petitioner Billy Evans testified credibly at trial that upon request, Capitol Historic Trust, Inc., the donee organization, furnished him with a list of appraisers and that he selected Messrs. Wood and Keegan from this list after researching their qualifications and backgrounds. "I picked from a list of several people, and I called and talked to them directly * * * about what they did and whether or not they did these type of appraisals".

From the reports that Messrs. Wood and Keegan produced, it is apparent that they had access to all the relevant details regarding the properties and the contemplated facade easement contributions. Also, petitioner Billy Evans' trial testimony, which we find credible and compelling, demonstrated his actual good faith reliance on these reports. "I relied upon what I thought to be good appraisals to claim my deductions, and everything that I had read and seen at that time gave me no indication that there was any problem with these."

Finally, the reports themselves reveal that Messrs. Wood and Keegan were conversant with the regulations that authorize the comparable sales method and the before-and-after approach for valuing charitable contribution deductions.

10. Defective Acknowledgement.

In Randall A. Schrimsher v. Commissioner, T.C. Memo. 2011-71, the court denied a charitable deduction – for a facade easement – for lack of a contemporaneous written acknowledgement that said no goods or services were received by the donor.

In Henry R. Lord v. Commissioner, T.C. Memo. 2010-196, as easement deduction was denied because of a grossly defective appraisal:

The Page appraisal is not a qualified appraisal. The Page appraisal does not include the following significant information: The easement contribution date, the date the appraisal was performed, or the appraised fair market value of the easement contribution on the contribution date. Further, the doctrine of substantial compliance is not applicable if significant information is omitted. See Hewitt v. Commissioner, 109 T.C. 258, 263-265 (1997), affd. without published opinion 166 F.3d 332 (4th Cir. 1998). The appraised fair market value of the easement contribution on the contribution date is not set forth in the Page appraisal, Form 8283, or any other evidence. The Page appraisal, therefore, fails to meet the requirements of section 1.170A13(c)(3)(ii)(I), Income Tax Regs. We simply do not know what the appraiser intended in referencing the Page appraisal's "effective date" and "report date", and there was no testimony to clarify this matter because the case was fully stipulated. In sum, petitioner failed to substantiate the easement contribution and is not entitled to charitable contribution deductions relating to the years in issue.

In Maria Elena Towell v. Commissioner, T.C. Summ. Op. 2010-141; No. 8002-09S (20 Sep 2010), , no deduction was allowed for a contribution of cash and a timeshare because the taxpayer didn't get an acknowledgement of the case or an appraisal of the timeshare.

In E. Bruce DiDonato v. Commissioner, T.C. Memo 2011-153, an easement arose under unusual facts involving condemnation and litigation:

On or about July 11, 1995, Mr. DiDonato purchased two parcels of property located at 245 Cold Soil Road, Princeton, New Jersey, for \$211,690 (collectively, Schaafsma parcel).² The Schaafsma parcel was subdivided from a single lot, and as of July 11, 1995, could be accessed from Cold Soil Road by way of a dirt road or a prescriptive easement.³ The Schaafsma parcel could also be accessed from Cold Soil Road by crossing over land owned by the county. Adjacent to the Schaafsma parcel was a local park owned by the county.

On May 10, 1997, the county conveyed to Mr. DiDonato for \$1 a 50-foot-wide easement and right of way (full driveway) across the county's property by a Deed of Easement and Right of Way Agreement (deed of easement). The full driveway was adjacent to the Schaafsma parcel and was situated in the neighboring park; i.e., it was parkland property. The deed of easement granted Mr. DiDonato access to the full driveway for pedestrian and vehicular ingress and egress from the Schaafsma parcel to Cold Soil Road.⁴ The deed of easement was recorded on October 10, 1997.

At some point after the deed of easement was executed, Mr. DiDonato filed a lawsuit against the county in the Superior Court of New Jersey, Chancery Division, Mercer County (State court), with respect to the deed of easement. The New Jersey Department of Environmental Protection (NJDEP) intervened and moved the State court for summary judgment. Mr. DiDonato also moved the State court for partial summary judgment. The State court granted NJDEP's motion for summary judgment and declared the deed of easement void ab initio. The State court also granted Mr. DiDonato's motion for partial summary

judgment, finding the county liable to Mr. DiDonato for breach of "warranties" and awarding Mr. DiDonato reasonable attorney's fees. The State court, with the consent of Mr. DiDonato and the county, appointed a special master to investigate and recommend to the State court an appropriate remedy to be awarded to Mr. DiDonato. Mr. DiDonato and the county also agreed to participate in a series of mediation sessions which were overseen by the special master. At the conclusion of the mediation sessions, Mr. DiDonato and the county entered into a Memorandum of Settlement (settlement agreement) on August 27, 2004. That settlement agreement set forth the terms and conditions to resolve the lawsuit between Mr. DiDonato and the county.

Under the settlement agreement, the county agreed to convey a 35-foot-wide portion of the driveway (partial driveway) to Mr. DiDonato in fee simple. The remaining 15-foot-wide portion of the driveway was to be held by the county in fee simple to allow pedestrian and equestrian traffic entry into the neighboring park. Upon conveyance of the partial driveway interest to Mr. DiDonato, Mr. DiDonato agreed "to limit his use of the Schaafsma parcel to a single family residence, thereby giving up any and all development rights to said property." The county agreed to "provide written acknowledgment, in form and substance acceptable to [Mr.] DiDonato, of a donation to the county of [Mr.] DiDonato's development rights in the Schaafsma parcel." Mr. DiDonato also agreed to "pay for all property conveyed to him in fee simple through a donation to the Green Acres Fund".⁵ The amount of the donation was a percentage of the value of the driveway commensurate with the partial driveway interest conveyed to Mr. DiDonato. Most if not all of the substantive rights and obligations under the settlement agreement were conditioned upon receipt of the statutory and regulatory approvals required for the disposal of parkland under New Jersey State law. Given the limited record with respect to the actions taken by the county after execution of the settlement agreement, we briefly review the rights and obligations required under State law for context.

The taxpayers claimed a deduction using the Settlement agreement as the "contemporaneous written acknowledgment." The court said no:

The substantive rights and obligations created by the settlement agreement on August 27, 2004, were "subject to and conditioned upon" the county's obtaining approval for the disposition of parkland from the commission at some future date. The commission, however, did not approve the disposition of the partial driveway interest until December 12, 2005, more than 15 months after the settlement agreement was executed. When the settlement agreement was entered into on August 27, 2004, Mr. DiDonato was not under a contractual duty to convey his development rights to the county and no legal obligation was certain to occur. The county was therefore not able to acknowledge receipt of Mr. DiDonato's development rights on August 27, 2004, because his obligation to transfer those rights had not yet matured and were not certain to do so.

The settlement agreement also provided that if any term therein was not satisfied, then Mr. DiDonato and the county agreed to return to the special master for further proceedings. The outcome of those further proceedings would then replace any duty on the part of Mr. DiDonato to convey his development rights

judgment, finding the county liable to Mr. DiDonato for breach of "warranties" and awarding Mr. DiDonato reasonable attorney's fees. The State court, with the consent of Mr. DiDonato and the county, appointed a special master to investigate and recommend to the State court an appropriate remedy to be awarded to Mr. DiDonato. Mr. DiDonato and the county also agreed to participate in a series of mediation sessions which were overseen by the special master. At the conclusion of the mediation sessions, Mr. DiDonato and the county entered into a Memorandum of Settlement (settlement agreement) on August 27, 2004. That settlement agreement set forth the terms and conditions to resolve the lawsuit between Mr. DiDonato and the county.

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The taxpayers claimed a deduction using the Settlement agreement as the "contemporaneous written acknowledgment." The court said no:

The substantive rights and obligations created by the settlement agreement on August 27, 2004, were "subject to and conditioned upon" the county's obtaining approval for the disposition of parkland from the commission at some future date. The commission, however, did not approve the disposition of the partial driveway interest until December 12, 2005, more than 15 months after the settlement agreement was executed. When the settlement agreement was entered into on August 27, 2004, Mr. DiDonato was not under a contractual duty to convey his development rights to the county and no legal obligation was certain to occur. The county was therefore not able to acknowledge receipt of Mr. DiDonato's development rights on August 27, 2004, because his obligation to transfer those rights had not yet matured and were not certain to do so.

The settlement agreement also provided that if any term therein was not satisfied, then Mr. DiDonato and the county agreed to return to the special master for further proceedings. The outcome of those further proceedings would then replace any duty on the part of Mr. DiDonato to convey his development rights

B. My Children Approach the Charity.

My children, being clever souls, look at the calendar and conclude that - - despite excellent health habits - - they might not survive 50 years and thus are unlikely ever to see a benefit from my largesse. They are not encouraged by my reminder that half the people must die prematurely. Being extra-clever souls they hit upon a plan. They do not discuss the plan with me and I know nothing of it until it is completed.

My children approach Worthy Charity with calculator in hand and inquire of its development and finance department what they think the present value of \$2,000,000 will be worth in 50 years. Worthy Charity expects that it can earn 5.5% a year over the next 50 years so in fact it believes that \$2,000,000 then is worth a paltry \$137,533 now. [$\$2,000,000 / (1.055^{50}) = \$2,000,000 / 14.54196 = \$137,533$]

My children do not want to take advantage of Worthy Charity. They decide to make Worthy Charity an offer it cannot refuse: \$225,000 today for Worthy Charity's interest in the CLAT. That is an assumed earnings rate of about 4.466% a year over the term. Every bit Worthy Charity earns above 4.466% is profit on the deal. For instance, if Worthy Charity actually earns 5.5% then at the end of 50 years it would have \$3,272,000 versus the original \$2,000,000. After a few minutes of cogitation, Worthy Charity takes the offer and transfers its interest to my children.

My children are elated: they have bought \$1,000,000 for \$225,000. Ought they to be elated or is there something faulty here? Does the trust terminate with the purchase of the interests from Worthy Charity? That would seem desirable and, depending on the wealth of my children, may be necessary.

C. Is Anyone Going To Jail, Metaphorically or Actually?

Has Worthy Charity done anything wrong? Given the numbers, might Worthy Charity do something "wrong" if it does not agree to sell? (Does that mean a charity that is the beneficiary of a CLAT ought be seeking buyers for its interest?)

Is this a prohibited transaction, perhaps self-dealing. CLTs are subject to the self-dealing rules. Do those prohibit a charity from selling its interest in a CLT?

Is this a commutation and if so is it prohibited? Rev. Rul. 88-27 prohibits the trustee from having the power to commute the charitable interest. The Ruling states:

If the trustee has the discretion to commute and prepay the charitable "lead" annuity interest prior to the expiration of the specified term of the annuity, the

interest does not qualify, as a guaranteed annuity interest under section 2522(c)(2)(B) of the Code, and under section 2522(a), no deduction is allowed for the amount of the transfer to charity.

The result would be the same even if the trust instrument provided that the prepayment amount were to be calculated using the discount rate and methodology used to calculate the present value of annuity payments under the Code and regulations in effect on the date the annuity was established, because the exact amount payable to charity can not be determined as of the date of the gift.

Treas. Reg. §25.2522(c)-3(c)(2)(vi)(a) states in part:

An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of gift. For example, the amount to be paid may be a stated sum for a term of years, or for the life of the donor, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed as a fraction or percentage of the cost of living index on the date of gift.

If the trust terminates by operation of law - - the children who have the remainder interest purchasing the charitable lead interest - - is that a commutation? The trustee would not be involved in the transaction.

D. Going Forward.

The point of this illustration is not necessarily to inspire you to go out and create 50 year Shark-Fin CLATS but rather that you begin to think about the low section 7520 rate versus the likely experience of charitable investments. The longer the term the more leverage that exists. However, prudence suggests that overly long terms not be used.

**E. Don't Some People Suggest That Life Insurance Be Owned in a Shark-Fin CLAT?
Any other planning tips?**

Yes. Folks who sell life insurance. The theory is that if I have a 25 year life expectancy the life insurance will pay off and furnish the money to make the balloon payment. Life insurance in this context is an investment and it is either good or bad. However, it limits your ability to pay-off the charity early.

A CLAT may either pay its own income taxes - - and receive an income tax deduction only for distributions it makes to charity - - or all the income can be taxed every year to the grantor in which case the grantor gets an

income tax deduction in the first year for the amount with which the CLAT is funded (e.g. \$1,000,000 in my example). The first is more typical. Consideration should be given to having mini-balloon payouts every few years to “clear out” accumulated capital gains.

F. What’s In A Name?

Why the name? Jaws. Chief Brody goes out to get the shark. His boat sinks, he’s bloodied, heck he’s almost eaten, but he survives and paddles back to shore.

If music helps you think like it does me ... Flatt & Scruggs and The Beverly Hillbillies...

hum along the first verse and then choose the second verse you are happier with:

Come and listen to my story about a man named Fred,
He wasn’t ‘specially poor but he sure hated the Feds.
One day while looking at his portfolio, all flat,
Someone came along and suggested he try a CLAT.

(Not Just Any CLAT. A Shark-Fin CLAT With Chief Brody Option)

Well the next thing you know ole Fred’s passed all his wealth,
And he’s done it, with almost total stealth.
Along come his children who appear to be all grateful,
And in fact they promise always to be faithful.
(The kids will visit. Bring mac & cheese. Occasionally Sudoku.)

OR

Well the next thing you know ole Fred’s passed all his wealth,
And he’s done it, with almost total stealth.
He’s pretty pleased until that day he gets a notice in the mail,
And Fred finds out he’s gonna spend some time in jail.
(The kids will visit. Bring mac & cheese. Occasionally Sudoku.)

13. Substantiation.

In Newton J. Friedman et ux. v. Commissioner, T.C. Memo. 2010-45, the taxpayers were hammered with penalties for failing to substantiate the contribution of equipment to charity. The taxpayers claimed \$217,500 of deduction in each of 2001 and 2002. The court described the substantiation of the gifts:

To substantiate the 2001 donations petitioners attached to their 2001 return three Forms 8283, Noncash Charitable Contributions. These consisted of a Form 8283 for items appraised by Garson P. Shulman (2001 Shulman Form 8283), a Form 8283 for items appraised by Jack LeVan (2001 Jack LeVan Form 8283), and a

income tax deduction in the first year for the amount with which the CLAT is funded (e.g. \$1,000,000 in my example). The first is more typical. Consideration should be given to having mini-balloon payouts every few years to “clear out” accumulated capital gains.

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Unlike the situation in Bond, petitioners' documents fail to provide an adequate description of or the condition of the donated items. The Forms 8283 and the appraisal reports provide very generic descriptions, stating the items were in "good working condition" or "operational, clean and in good saleable condition". An adequate description is necessary because "Without a more detailed description the appraiser's approach and methodology cannot be evaluated." O'Connor v. Commissioner, T.C. Memo. 2001-90.

In fact, petitioners' documents fail to even indicate the valuation method used or the basis for the appraised values. We have previously held such information to be essential because "Without any reasoned analysis, * * * [the appraiser's] report is useless." See Jacobson v. Commissioner, T.C. Memo. 1999-401.

The court also rejected the taxpayer's attempt to let a late appraisal save a timely appraisal summary. The opinion states:

Petitioners also contend that the 2004 and 2006 Handelman appraisals can be used to supply the missing information because they validate the values reported on the Forms 8283. Although those appraisals were untimely, petitioners argue that an untimely appraisal can be used to supplement a timely-filed appraisal summary, as demonstrated in Bond v. Commissioner, 100 T.C. 32 (1993). Petitioners misstate the holding of Bond. In Bond, the submission of the information (i.e., the appraiser's credentials) required to prove that a qualified appraisal had been performed was untimely, but the performance of the appraisal itself was not. By contrast, in the instant case the 2004 and 2006 Handelman appraisals were performed years after the respective due dates of petitioners' returns. Therefore, petitioners cannot rely on those appraisal reports to cure the absence of the required information in a timely fashion.

Importantly, the court also noted that the taxpayers also failed to get the necessary written acknowledgement:

In addition to their failure to substantially comply with the regulations, petitioners also failed to demonstrate that they obtained adequate written acknowledgments for their contributions as required by section 170(f)(8). Petitioners argue that the Forms 8283 can also serve as written acknowledgments because they were signed by the donee. However, neither the Forms 8283 nor the receipts from Global Operations contain a statement that no goods or services were provided by the donee in exchange, as required by section 170(f)(8)(B)(ii). We have previously held that statement necessary for a charitable contribution deduction. See Kendrix v. Commissioner, T.C. Memo. 2006-9; Castleton v. Commissioner, T.C. Memo. 2005-58, affd. 188 Fed. Appx. 561 (9th Cir. 2006).

Petitioners argue that section 170(f)(8)(B)(ii) can be read to require the statement only when the donee actually furnishes goods or services to the donor. We disagree.

* * *

Section 170(f)(8)(B)(ii) plainly states that the written acknowledgment is sufficient if it includes information as to "Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property" donated by the taxpayer. The language used is clear and unconditional. There is no reason to read into section 170(f)(8)(B)(ii) the limitation suggested by petitioners.

The returns had been prepared by Reed Spangler, a CPA. Reliance on the CPA was insufficient to avoid penalties:

Petitioners have not established Mr. Spangler's qualifications as a tax expert. The mere fact that Mr. Spangler is a C.P.A. does not necessarily make him a competent tax adviser. See Mediaworks, Inc. v. Commissioner, T.C. Memo. 2004-177.

Furthermore, the record indicates that petitioners withheld information from Mr. Spangler and that their reliance on his advice was therefore not in good faith. Petitioners claimed they were unable to provide purchase records for the donated equipment because they were forced to dispose of those records due to an approaching fire in 1996, but the record indicates that most of the items listed on the 2001 Shulman and 2002 John E. LeVan Forms 8283 were purchased after that purported fire. Petitioners purchased a total of 26 items of laboratory equipment on December 6, 2000, and August 12, 2001. Twenty-six of the 29 items listed in the 2001 Shulman Form 8283 are identical to the equipment petitioners purchased on those two dates. Similarly, 18 of the 19 items listed in the 2002 John E. LeVan Form 8283 are identical to equipment petitioners purchased on November 17, 2002. Since petitioners did not provide Mr. Spangler with all the information available to them, they failed to provide him with necessary and accurate information, and their reliance on his advice does not constitute reasonable cause.

In ECC 201014056 Chief Counsel reviewed the appraisal requirements for a conservation easement deduction and discussed two cases decided in the last year dealing with substantial compliance.

A judicial doctrine, substantial compliance has been used to allow a deduction for a taxpayer who has substantially, but not strictly, complied with the regulations governing tax elections and deductions. See Bond v. Commissioner, 100 T.C. 32, 41 (1993).

In Prussner v. United States, 896 F.2d 218, 224 (7th Cir. 1990), the Court of Appeals referred to the Tax Court doctrine of substantial compliance as confusing and difficult to apply and concluded:

The common law doctrine of substantial compliance should not be allowed to spread beyond cases in which the taxpayer had a good excuse (though not a legal justification) for failing to comply with either

an unimportant requirement or one unclearly or confusingly stated in the regulations or the statute.

In Bond, supra, the Tax Court considered whether certain aspects of the regulations were mandatory or directory and whether the taxpayer in that case had substantially complied with the regulations. The court found that the taxpayer had substantially complied with the qualified appraisal requirements because substantially all of the information required had been provided, except for the qualifications of the appraiser on the Form 8283 attached to the return. It is worth noting, though, that Bond was decided prior to the enactment of the Jobs Act (2004) and the Pension Act (2006), both of which impose new statutory requirements for qualified appraisals.

In Hewitt v. Commissioner, 109 T.C. 258 (1997), aff'd without published opinion, 166 F.3d 332 (4th Cir. 1998), the taxpayers claimed a deduction for the donation of stock that was not publicly traded. They did not obtain qualified appraisals before filing their return. The taxpayers argued that they had substantially complied with the regulations, but the Tax Court rejected that argument because the taxpayers had not obtained a qualified appraisal and did not attach an appraisal summary to their returns.

In Bruzewicz v. United States, 604 F. Supp. 2d 1197 (N.D. Ill. 2009), the District Court found that taxpayers, who had donated a façade easement on their home, had totally failed to comply with the section 170(f)(8) contemporaneous written acknowledgment requirement. The court noted that that failure alone is fatal to their claimed deduction. The District Court also found that the taxpayers failed to strictly comply with the appraisal requirements of section 1.170A-13 of the Regulations. The court wrote that section 170(f)(8) is not unclear or confusing. Further, the very inclusion of the requirement in the Code itself signals that Congress felt that a contemporaneous written acknowledgment was of the utmost importance. The court stated that other provisions in the regulations, such as appraiser qualifications and a description of donated property, are not unimportant or confusing to follow.

In Simmons v. Commissioner, T.C. Memo. 2009-208, the taxpayer donated a façade easement to charity. The Tax Court allowed the deduction even though the taxpayer did not strictly comply with the substantiation requirements of section 170. The court wrote that based upon the holdings in Bond and Hewitt, there is a standard that the court can use to consider whether the taxpayer had provided enough information to allow the Service to evaluate the reported contributions. The court in Simmons found that the taxpayer complied with the substantiation requirements of section 170 because she "included all of the required information in the appraisals attached to her returns or on the face of the returns."

14. Reformation of CRUT to Remove §170(b)(1)(A) Allowed.

PLR 201011034 addressed a CRUT that specifically named the deceased grantor's private foundation as a charitable beneficiary but required all beneficiaries to be described in section 170(b)(1)(A). The

trustee and drafter attested to the error and a court reformed the trust. The IRS determined the reformation did not affect the trusts' status under section 664 and that there was no self-dealing. See also PLR 201016033.

15. Estate Settlement Not Approved by the IRS.

TAM 201004022 dealt with a Will lacking a residuary clause. The TAM sets forth the key facts:

Son claimed that as Decedent's sole intestate heir, he alone was entitled to the residuary estate. The Charitable Trust claimed that it was the lawful beneficiary of Decedent's residuary and that the omitted residuary clause was the result of a scrivener's error. In this regard, the attorney that drafted the Date 2 will and the three codicils, has stated in an affidavit prepared in conjunction with state court proceedings that Decedent told him that he intended that the residue pass to the Charitable Trust. In addition, the Charitable Trust asserted that other extrinsic evidence indicated that Decedent intended that the residuary pass to Charitable Trust, including: previous wills of the Decedent executed prior to Date 2 identifying Charitable Trust as the residuary beneficiary; Decedent's history of making a large number of lifetime charitable transfers.

After several months of negotiations, Son and Charitable Trust settled the dispute and executed a settlement agreement. The settlement agreement provided that Son would receive \$c outright and free and clear of all expenses and taxes. The amount remaining after the \$c payment to Son and after payment of expenses and taxes (including taxes on the \$c distribution to Son) totaling \$d and was paid to Charitable Trust. The settlement agreement was approved by the local state court, without an evidentiary hearing.

At issue was whether the amount paid to charity qualified for the estate tax charitable deduction. If it were paid merely in settlement the answer would be "no." The ruling states:

In several cases, the courts have declined to supply a missing residuary beneficiary. For example, in Citation 5, the residuary clause did not effectively dispose of the residue and the court declined to interpret the clause in a manner that would have avoided the resulting partial intestacy. The court stated, "[a]lthough it is true, . . . , that we must construe the will where possible in order to avoid intestacy, we may not do so by ignoring the testatrix's intent or by ascribing to her an intent which is nowhere evidenced in the will." (Emphasis added.)

Similarly, in Citation 6, the court stated: "If, as is probable, a residuary bequest in the will of [testator] was an accidental omission, it is an omission we cannot supply. We may conjecture that it was intended after the liberal provision made to his widow the residue should go to his next of kin, but it would only be conjecture." See also, Citation 7 ("As we have said, it is more than likely [the testator] intended that the heir should take the undisposed of portion of the income; but, at all events, if it was an oversight, the courts have no authority to insert a provision disposing of such income under the assumption that it was the

intention of the testator. It is only when the language of the will expressly or by clear implication discloses the intention of the testator that the courts may carry it out. It will not do for the courts to undertake to guess at the intention of a testator and declare that to be his will.")

In this case, the extrinsic evidence indicates that the residuary clause was erroneously omitted from the Decedent's will. However, the omission of the residuary clause does not create an ambiguity. Rather, the will is silent regarding the disposition of the residuary estate and under State law, in the absence of the residuary bequest, the residue passes by intestacy. No language in the will conflicts with the distribution of the residue under the State 1 intestacy statute. Thus, we do not believe that the absence of the residuary clause can properly be characterized as an ambiguity that would justify reference to extrinsic evidence. If this was the case, every invocation of the intestacy provisions would be considered an ambiguity. In this regard, we note that in Citation 2, although the court admitted extrinsic evidence, the evidence confirmed that the residue passed by intestacy. The court did not use the extrinsic evidence as justification for inserting a residuary beneficiary that was not named under the will.

Further, there is no evidence in the will that Decedent intended that the residuary pass to the Charitable Trust. The will does provide for the distribution of certain trust remainders to Charitable Trust, and the Charitable Trust is the taker in the event the in *terrorem* clause becomes operative. However, we can not conclude that these provisions addressing bequests other than the residue, "expressly or by clear implication discloses the intention of the testator that the courts may carry it out." Citation 7.

We also note that the relative amounts Son and Charitable Trust received under the Settlement is not indicative of whether Charitable Trust had an enforceable right under Decedent's will. Arguably, Son may have settled for \$c in order to avoid lengthy litigation and the additional expense litigation would entail. Even assuming the amount paid to Charitable Trust is indicative that Son believed Charitable Trust would prevail at the trial court level, the standard is whether State 1's highest court, no Son, would conclude that Charitable Trust had an enforceable right under State 1 law.

The estate agreed that there was ambiguity, filled in by the settlement. The IRS determined that the residue went by intestacy pursuant to state law:

In Terre Haute First Nat'l Bank, the court concluded, in a case involving a dispute over the allowance of a deduction for an amount passing to charity pursuant to a settlement:

This court is persuaded, as the Ninth Circuit was in *Ahmanson Foundation*, that the holding in *Bosch* would apply to cases of settlement -- even following a bona fide will dispute and arm's length negotiations. In other words, the parties to a settlement should not be able to disregard or misapply state law and receive favorable federal estate tax benefits. The parties to a settlement are only entitled to

federal estate tax deductions to the extent that they have an enforceable right under properly applied state law.

16. Conservation Easement Audits.

In a letter dated December 17, 2009, Christopher Wagner of Treasury wrote to Senator Udall of Colorado who had asked questions about IRS audits. In part, the letter states:

We are currently examining 344 taxpayers for charitable donations of conservation easements; 84 are Colorado easements. For fiscal years 2005 through 2009, we closed examinations on 1,115 taxpayers; 418 were of Colorado easements. The examinations involving Colorado easements came from several sources. We have an information sharing agreement with the state of Colorado Department of Revenue which requested our assistance in validating deductions taxpayers claimed on Colorado state tax returns for the donation of conservation easements. As part of our assistance, we reviewed and, where appropriate, examined the associated federal income tax returns. We examined other returns filed in Colorado that involved investigations of promoters and appraisers involved with the promotion of improper or overvalued conservation easement donation schemes in conjunction with sections 6700 and 6701 of the Internal Revenue Code (The Code).

In November 2008, we extended settlement offers to 180 Colorado taxpayers who we were examining for charitable contributions of conservation easements where we determined the existence of a valid conservation purpose, as required by the Code. After working with our Appeals division we developed three categories of settlement offers. Depending on the type and strength of the taxpayer's position, the taxpayer could retain 30, 60 or 75 percent of the claimed deduction. We offered the 30 percent settlement to taxpayers who, in our determination, had inflated the value of their deduction by reporting the form of the transaction inconsistent with the actual substance of the transaction. We offered the 75 percent settlement to taxpayers who, in our determination, overvalued their donation but used an appraisal process that was identical or similar to a process established by the state of Colorado's "Great Outdoors Colorado" (GOCO) program. GOCO provides funding to encourage conservation and preservation, including the acquisition of conservation easements. It has identified specific properties within Colorado that it seeks to preserve, and it has a rigorous process for evaluating each property and the associated appraisal before accepting the property into its program. We offered the 60 percent settlement to taxpayers who, in our determination, overvalued their donation and did not use as rigorous an appraisal process as the GOCO process, but whom we had not identified as misreporting the form of their transaction. Of those receiving settlement offers, 80 taxpayers (44 percent) accepted the offer. The remaining 100 taxpayers under examination declined to accept the offer. We have sent their examinations to Appeals for final resolution.

17. Charitable Contribution Deduction for Conservation Easements on Property with a Mortgage.

Section 170(h) allows an income tax charitable contribution deduction for conservation easements, including façade easements. In Kaufman v. Commissioner, 134 T.C. No. 9 (2010), the contribution of a facade easement to the National Architectural Trust (NAT) generated no income tax deduction because there was a mortgage on the property and thus the charitable organization might not receive the proceeds of sale if the property were condemned or damaged. The opinion states:

The interest in property conveyed by a facade easement must be protected in perpetuity for the contribution of the easement to be a qualified conservation contribution. Under section 170(h)(2)(C), a qualified real property interest must be “a restriction (granted in perpetuity) on the use which may be made of the real property.” See also sec. 1.170A-14(b)(2), Income Tax Regs. Under section 170(h)(5)(A), “A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.” See also sec. 1.170A-14(a), Income Tax Regs.

* * *

Petitioners concede that the property had a mortgage and that the bank retained a “prior claim” to all proceeds of condemnation and to all insurance proceeds as a result of any casualty, hazard, or accident occurring to or about the property. Moreover, petitioners do not dispute that the bank was entitled to those proceeds “in preference” to NAT until the mortgage was satisfied and discharged. The right of NAT to its proportionate share of future proceeds was thus not guaranteed. Petitioners argue that whether NAT would receive its proportionate share of any proceeds is a question of fact. In effect, petitioners argue that they have satisfied the requirement in section 1.170A-14(g)(6)(ii), Income Tax Regs., because NAT might be entitled to its proportionate share of future proceeds. Yet that provision states that the donee organization must be so entitled. See *id.* The requirement is not conditional. Petitioners cannot avoid the strict requirement in section 1.170A-14(g)(6)(ii), Income Tax Regs., simply by showing that they would most likely be able to satisfy both their mortgage and their obligation to NAT. The facade easement contribution thus fails to satisfy the requirement in section 1.170A-14(g)(6), Income Tax Regs., and so fails to satisfy the enforceability in perpetuity requirement under section 170(h)(2)(C) and (5)(A).

18. Effect of Step-Transaction Doctrine on Valuation.

William R. Klauer et al. v. Commissioner, T.C. Memo. 2010-65, is mostly interesting for its discussion of the step-transaction doctrine. Klauer Manufacturing was an S corporation that owned, among other assets, 2,581 acres known as the Taos Overlook. To preserve the Taos Overlook the family that owned the corporation agreed to sell the acreage to the Trust For Public Land (“Trust”). The sale could not occur all at once

because Congress was the chief source of acquisition funds for the Trust. Thus a series of complicated options were entered into and modified for various reasons, the end result of which was a purchase of the whole acreage for \$15,000,000 over a period of three years. If the sales were looked at separately there were bargain sale charitable deductions to be had, but if they were looked at together there would be no charitable deduction. The court held for the taxpayers

The opinion describes the step-transaction doctrine as follows:

The step transaction doctrine developed from the substance over form doctrine.³⁹ See *Associated Wholesale Grocers, Inc. v. United States*, 927 F.2d 1517, 1521 (10th Cir. 1991). We have considered the principles of the step transaction doctrine on many occasions. Those principles can be summarized by restating what we said about them in *Penrod v. Commissioner*, 88 T.C. 1415, 1428-1430 (1987):

The step transaction doctrine is in effect another rule of substance over form; it treats a series of formally separate "steps" as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result. * * * There is no universally accepted test as to when and how the step transaction doctrine should be applied to a given set of facts. Courts have applied three alternative tests in deciding whether to invoke the step transaction doctrine in a particular situation.

The narrowest alternative is the "binding commitment" test, under which a series of transactions are collapsed if, at the time the first step is entered into, there was a binding commitment to undertake the later step. See *Commissioner v. Gordon*, 391 U.S. 83, 96 (1968); * * *

At the other extreme, the most far-reaching alternative is the "end result" test. Under this test, the step transaction doctrine will be invoked if it appears that a series of formally separate steps are really prearranged parts of a single transaction intended from the outset to reach the ultimate result. See *King Enterprises, Inc. v. United States*, 418 F.2d at 516; * * *

The third test is the "interdependence" test, which focuses on whether "the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series." *Redding v. Commissioner*, 630 F.2d at 1177; * * *

The court rejected the finding commitment test:

The Trust's funding for land acquisition projects had in the past relied extensively, sometimes entirely, on appropriations by Congress. Appropriations that Congress made each year for land acquisition projects were uncertain, limited, and varied from year to year. As a result, there simply were no

guaranties that the Trust, which had to solicit funds on an annual basis for specified possible acquisitions, would receive any congressional (or other) funding for the purchase of a portion, let alone all, of the Taos Overlook.

If the Trust had been unable to obtain the funds needed to purchase a portion of the Taos Overlook specified in the Option Agreement, it would not have exercised its option under that agreement to purchase any such portion. In that event, Klauer Manufacturing would have retained the portion of the Taos Overlook as to which the Trust did not exercise its option to purchase under the Option Agreement. The Option Agreement did not require the Trust to exercise any or all of its options to acquire the phases of the Taos Overlook specified in that agreement. Nor did the Trust's exercise of its option to acquire one phase obligate it to exercise its option to acquire any other phase. Klauer Manufacturing and the Trust did not have an express or implied agreement or understanding (1) that the Trust would exercise all of its options under the Option Agreement and (2) that the Trust would buy, and Klauer Manufacturing would sell, all of the Taos Overlook.

On the record before us, we find that on January 23, 2001, the effective date of the Option Agreement between Klauer Manufacturing and the Trust, Klauer Manufacturing did not have an obligation to sell to the Trust, and the Trust did not have an obligation to buy from Klauer Manufacturing, the approximately 2,581 acres of the Taos Overlook for \$15 million. On that record, we further find that the binding commitment test does not apply in these cases.

The court rejected the end result test:

When representatives of the Trust initially approached representatives of Klauer Manufacturing in August 1999 about the Trust's interest in the Taos Overlook, the Trust's representatives informed the Company's representatives that the Trust was not in a financial position to be contractually and thus legally bound to purchase all of the Taos Overlook (i.e., all of the approximately 2,581 acres of that property). That was because congressional appropriations for land acquisition projects of the Trust were uncertain, limited, and varied from year to year. There simply were no guaranties that the Trust, which had to solicit funds on an annual basis for specified possible acquisitions, would receive any congressional (or other) funding for the purchase of a portion, let alone all, of the Taos Overlook. As a result, the Trust's representatives insisted that the Company grant it an option to purchase annually a portion of the Taos Overlook if and when during each year the Trust had the funds to purchase such a portion. Representatives of Klauer Manufacturing insisted that any portion of the Taos Overlook with respect to which the Company were to grant the Trust an option to purchase during the initial year border an exterior boundary of the Taos Overlook. That was because Klauer Manufacturing wanted to ensure that if the Trust were to decide not to exercise its option to purchase thereafter any of the remaining specified portions of the Taos Overlook, Klauer Manufacturing, and not the Trust, would own the property in the interior of the Taos Overlook.

If the Trust had been unable to obtain the funds needed to purchase a portion of the Taos Overlook specified in the Option Agreement, it would not have

guaranties that the Trust, which had to solicit funds on an annual basis for specified possible acquisitions, would receive any congressional (or other) funding for the purchase of a portion, let alone all, of the Taos Overlook.

If the Trust had been unable to obtain the funds needed to purchase a portion of the Taos Overlook specified in the Option Agreement, it would not have exercised its option under that agreement to purchase any such portion. In that event, Klauer Manufacturing would have retained the portion of the Taos Overlook as to which the Trust did not exercise its option to purchase under the Option Agreement. The Option Agreement did not require the Trust to exercise any or all of its options to acquire the phases of the Taos Overlook specified in that agreement. Nor did the Trust's exercise of its option to acquire one phase obligate it to exercise its option to acquire any other phase. Klauer Manufacturing and the Trust did not have an express or implied agreement or understanding (1) that the Trust would exercise all of its options under the Option Agreement and (2) that the Trust would buy, and Klauer Manufacturing would sell, all of the Taos Overlook.

On the record before us, we find that on January 23, 2001, the effective date of the Option Agreement between Klauer Manufacturing and the Trust, Klauer Manufacturing did not have an obligation to sell to the Trust, and the Trust did not have an obligation to buy from Klauer Manufacturing, the approximately 2,581 acres of the Taos Overlook for \$15 million. On that record, we further find that the binding commitment test does not apply in these cases.

The court rejected the end result test:

When representatives of the Trust initially approached representatives of Klauer Manufacturing in August 1999 about the Trust's interest in the Taos Overlook, the Trust's representatives informed the Company's representatives that the Trust was not in a financial position to be contractually and thus legally bound to purchase all of the Taos Overlook (i.e., all of the approximately 2,581 acres of that property). That was because congressional appropriations for land acquisition projects of the Trust were uncertain, limited, and varied from year to year. There simply were no guaranties that the Trust, which had to solicit funds on an annual basis for specified possible acquisitions, would receive any congressional (or other) funding for the purchase of a portion, let alone all, of the Taos Overlook. As a result, the Trust's representatives insisted that the Company grant it an option to purchase annually a portion of the Taos Overlook if and when during each year the Trust had the funds to purchase such a portion. Representatives of Klauer Manufacturing insisted that any portion of the Taos Overlook with respect to which the Company were to grant the Trust an option to purchase during the initial year border an exterior boundary of the Taos Overlook. That was because Klauer Manufacturing wanted to ensure that if the Trust were to decide not to exercise its option to purchase thereafter any of the remaining specified portions of the Taos Overlook, Klauer Manufacturing, and not the Trust, would own the property in the interior of the Taos Overlook.

If the Trust had been unable to obtain the funds needed to purchase a portion of the Taos Overlook specified in the Option Agreement, it would not have

Petter then gave units to two grantor trusts, sold additional units to those trusts, and made a gift to two community foundations of still more units. The transfers were by formula:

"Transferor wishes to assign 940 Class T Membership Units in the Company (the "Units") including all of the Transferor's right, title and interest in the economic, management and voting rights in the Units as a gift to the Transferees." Donna's document is similar, except that it conveys Class D membership units. Section 1.1 of Terry's transfer document reads:

Transferor * * *

1.1.1 assigns to the Trust as a gift the number of Units described in Recital C above that equals one-half the minimum dollar amount that can pass free of federal gift tax by reason of Transferor's applicable exclusion amount allowed by Code Section 2010(c). Transferor currently understands her unused applicable exclusion amount to be \$907,820, so that the amount of this gift should be \$453,910; and

1.1.2 assigns to The Seattle Foundation as a gift to the A.Y. Petter Family Advised Fund of The Seattle Foundation the difference between the total number of Units described in Recital C above and the number of Units assigned to the Trust in Section 1.1.1.

The gift documents also provide in section 1.2:

The Trust agrees that, if the value of the Units it initially receives is finally determined for federal gift tax purposes to exceed the amount described in Section 1.1.1, Trustee will, on behalf of the Trust and as a condition of the gift to it, transfer the excess Units to The Seattle Foundation as soon as practicable.

The Foundations similarly agree to return excess units to the trust if the value of the units is "finally determined for federal gift tax purposes" to be less than the amount described in section 1.1.1.

Recital C of the sale documents reads: "Transferor wishes to assign 8,459 Class T [or Class D] Membership Units in the Company (the "Units") including all of the Transferor's right, title and interest in the economic, management and voting rights in the Units by sale to the Trust and as a gift to The Seattle Foundation." Section 1.1 reads:

Transferor * * *

1.1.1 assigns and sells to the Trust the number of Units described in Recital C above that equals a value of \$4,085,190 as finally determined for federal gift tax purposes; and

1.1.2 assigns to The Seattle Foundation as a gift to the A.Y. Petter Family Advised Fund of The Seattle Foundation the difference between the total number of Units described in Recital C above and the number of Units assigned and sold to the Trust in Section 1.1.1.

Section 1.2 of the sale documents differs slightly from section 1.2 of the gift documents. In the sale documents, it reads: "The Trust agrees that, if the value of the Units it receives is finally determined to exceed \$4,085,190, Trustee will, on behalf of the Trust and as a condition of the sale to it, transfer the excess Units to The Seattle Foundation as soon as practicable." Likewise, the Seattle Foundation agrees to transfer shares to the trust if the value is found to be lower than \$4,085,190.

The court found no abuse in this sort of formula transfer:

The Fifth Circuit held in McCord that what the taxpayer had given was a certain amount of property; and that the appraisal and subsequent translation of dollar values (what the donor gave each donee) into fractional interests in the gift (what the donees got) was a later event that a court should not consider. 461 F.3d at 627. In Christiansen, we also found that the later audit did not change what the donor had given, but instead triggered final allocation of the shares that the donees received. 130 T.C. at 15. The distinction is between a donor who gives away a fixed set of rights with uncertain value -- that's Christiansen -- and a donor who tries to take property back -- that's Procter. The Christiansen formula was sufficiently different from the Procter formula that we held it did not raise the same policy problems.

A shorthand for this distinction is that savings clauses are void, but formula clauses are fine. But figuring out what kind of clause is involved in this case depends on understanding just what it was that Anne was giving away. She claims that she gave stock to her children equal in value to her unified credit and gave all the rest to charity. The Commissioner claims that she actually gave a particular number of shares to her children and should be taxed on the basis of their now-agreed value.

Recital C of the gift transfer documents specifies that Anne wanted to transfer "940 Class T [or Class D] Membership Units" in the aggregate; she would not transfer more or fewer regardless of the appraisal value.¹⁸ The gift documents specify that the trusts will take "the number of Units described in Recital C above that equals one-half the * * * applicable exclusion amount allowed by Code Section 2010(c)." The sale documents are more succinct, stating the trusts would take "the number of Units described in Recital C above that equals a value of \$4,085,190." The plain language of the documents shows that Anne was giving gifts of an ascertainable dollar value of stock; she did not give a specific number of shares or a specific percentage interest in the PFLLC. Much as in Christiansen, the number of shares given to the trusts was set by an appraisal occurring after the date of the gift. This makes the Petter gift more like a Christiansen formula clause than a Procter savings clause.

As in Christiansen, we find that this gift is not as susceptible to abuse as the Commissioner would have us believe. Although, unlike Christiansen, there is no executor to act as a fiduciary, the terms of this gift made the PFLLC managers themselves fiduciaries for the foundations, meaning that they could effectively police the trusts for shady dealing such as purposely low-ball appraisals leading to misallocated gifts. See Wash. Rev. Code Ann. secs. 25.05.165(1), 25.05.170 (West 2005). The directors of the Seattle Foundation and the Kitsap Community Foundation owed fiduciary duties to their organizations to make sure that the appraisal was acceptable before signing off on the gift -- they also had a duty to bring a lawsuit if they later found that the appraisal was wrong. See id. sec. 24.03.127 (West 1986).

We could envision a situation in which a charity would hesitate to sue a living donor, and thus risk losing future donations or the donor's goodwill. However, gifts are irrevocable once completed, and the charities' cause of action most likely would have been against the trusts, rather than against Anne, since the trusts held the additional shares to which the charities laid claim.

The Commissioner himself could revoke the foundations' 501(c)(3) exemptions if he found they were acting in cahoots with a tax-dodging donor. See, e.g., sec. 503(b). And Washington's attorney general is also charged with enforcing charities' rights. See Wash. Rev. Code Ann. secs. 11.110.010, 11.110.120 (West 2006). We simply don't share the Commissioner's fear, in gifts structured like this one, that taxpayers are using charities just to avoid tax.²⁰ We certainly don't find that these kinds of formulas would cause severe and immediate frustration of the public policy in favor of promoting tax audits. See Tellier, 383 U.S. at 694.

In actual fact, the IRS on audit determined that the PFLLC units were worth more than the taxpayer's appraiser. Thus, additional units were allocated to charity and Mrs. Petter was eligible for an additional income tax deduction. But, as of what date? The court concluded as of the date of the original transfer:

Here we have a conundrum, for the events of the gift happened as follows:

- March 22, 2002 -- Gift of 940 shares, split between trusts and foundations. Letters of intent to foundations.
- March 25, 2002 -- Sale to trusts
- April 15, 2002 -- Moss Adams appraisal report
- Later in 2002 -- The Seattle Foundation "books" the value of the allocated shares on the basis of the Moss Adams appraisal. The Kitsap Community Foundation's records recognize the A.Y. Petter Family Advised Fund as of December 31, 2002. In May 2003, Richard Tizzano, president of the Kitsap Community Foundation, signed Anne's Form 8283 for 2002, acknowledging receipt of PFLLC units on March 22, 2002.

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Ultimately, the IRS argues that because the foundations would not have received the additional units but for the IRS audit, the additional transfer of units to the foundations was dependent upon a condition precedent. Adopting the IRS's "but for" test would revolutionize the meaning of a condition precedent. In one sense, the IRS is correct that but for its audit, the foundations would not have obtained additional LLC units, but that is because the IRS believed the estimated value was not the true fair market value. Either of the trusts or either of the foundations could also have challenged the Moss Adams valuation of the LLC units, although it was unlikely that they would have done so. But this practical reality does not mean that the foundations' rights to additional LLC units were contingent *for their existence* upon the IRS audit. Treasury Regulation § 25.2522(c)-3(b)(1) asks whether a transfer "is dependent upon . . . a precedent event in order that it might *become effective*," not whether a transfer is dependent upon the occurrence of an event so that the transferred assets actually change hands. An analogy to a simple contract illustrates this point. Consider a contract between A and B, in which A agrees to pay B \$1000 in exchange for B's services. If A enters into this contract knowing that he has no intention to pay and if B then performs his side of the bargain, B will receive the \$1000 only if he sues A in court. But for B's lawsuit, B would not receive the money he deserves. But B's filing of the lawsuit -- though an event that must occur for B to be paid -- is not a condition precedent to B's receiving the \$1000. That is so because B's entitlement to this sum is in no way dependent upon the filing of a lawsuit; A's duty to perform arose when B performed under the contract.

Citing I.R.C. § 2001(f)(2), the IRS further argues that a value as finally determined for gift tax purposes means the value shown on a taxpayer's return, unless the IRS conducts a timely audit and challenges that value. Because the Taxpayer used the term "as finally determined for federal gift tax purposes," the IRS claims that rather than transferring a particular number of units whose fair market value added up to the dollar amounts specified in the transfer agreements, the Taxpayer actually transferred a particular number of units whose pre-defined value -- \$536.20 per unit, the value reported on the Taxpayer's gift tax return -- added up to those dollar amounts. "And at that value, the foundations had rights to 1,773.91 and 93.47 units, and no more. The additional 4,503.82 and 237.04 units that the foundations subsequently were to receive were the result of the audit and the parties' agreement that the value of each unit was \$744.74."

But the Taxpayer's transfer agreements do not specify the value of an individual LLC unit. The gift documents assign to each of the two foundations the difference between 940 units and "the number of Units . . . that equals [\$453,910]," while the sale documents assign to one foundation the difference between 8459 units and "the number of Units . . . that equals a value of \$4,085,190 *as finally determined for federal gift tax purposes*." Aside from the fact that only the dollar formula clause of the sale documents uses the phrase "as finally determined for federal gift tax purposes," a taxpayer who files a return cannot conjure up a value for federal gift tax purposes out of thin air; rather, she must use federal gift tax valuation principles. Under these principles, the value of an asset "as finally determined for federal gift tax purposes" is the fair market value of that asset. *See* Treas. Reg. § 25.2512-1 ("[I]f a gift is made in property, its value . . . is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or

to sell, and both having reasonable knowledge of relevant facts."); *cf. Succession of McCord v. Comm'r*, 461 F.3d 614, 627 n.34 (5th Cir. 2006) ("There is no material difference between fair market value determined under Federal gift tax valuation principles and fair market value as finally determined for Federal gift tax purposes." (citation and internal quotation marks omitted)). Thus, the Taxpayer did not transfer to the foundations the number of units equal to a defined dollar amount divided by \$536.20; rather, she transferred the number of units equal to the defined dollar amount divided by the fair market value of a unit. The Moss Adams appraisal confirms this point; it states, on the first page, that its purpose "is to express an opinion of the *fair market value* of the [units]."

The opinion concludes with the suggestion that the IRS change its regulations:

Contrary to the IRS's argument, the additional transfer of LLC units to the foundations was not subject to a condition precedent within the meaning of Treasury Regulation § 25.2522(c)-3(b)(1). Under the terms of the transfer documents, the foundations were always entitled to receive a predefined number of units, which the documents essentially expressed as a mathematical formula. This formula had one unknown: the value of a LLC unit at the time the transfer documents were executed. But though unknown, that value was a constant, which means that both before and after the IRS audit, the foundations were entitled to receive the same number of units. Absent the audit, the foundations may never have received all the units they were entitled to, but that does not mean that part of the Taxpayer's transfer was dependent upon an IRS audit. Rather, the audit merely ensured the foundations would receive those units they were always entitled to receive. Accordingly, we hold that Treasury Regulation § 25.2522(c)-3(b)(1) does not bar a charitable deduction equal to the value of the additional units the foundations will receive. "[W]e expressly invite[] the Treasury Department to 'amend its regulations' if troubled by the consequences of our resolution of th[is] case." *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 713 (2011) (quoting *United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 838 (2001)).

Consider a transfer made in trust pursuant to a clause similar to the following:

Upon receipt of assets by gift during the initial taxable year of this trust, Trustee will allocate the first \$ _____ to the trust administered by Article ___ for the benefit of my descendants and will allocate any additional assets to WORTHY CHARITY, INC., to be added to the Mr. and Mrs. Donor fund created thereunder (or, if such organization is not in existence or is not described in sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Internal Revenue Code, at such time to another organization which is so described selected by Trustee within 60 days of such allocation). The allocation will be made as a fractional share of all assets added to the Trust by gift and Trustee may make a preliminary allocation with subsequent adjustment if desirable. In calculating the amount to be allocated hereunder, Trustee will determine fair market value in such manner as it would be determined for federal gift tax purposes whether or not such tax applies.

20. Contribution by Corporation.

In PLR 200715015, a corporation formed a limited partnership and contributed to it exclusive ownership of certain trademarks and other intellectual property; the other partner was the owner of the corporation who contributed cash. The partnership granted the corporation a license to use that property in exchange for a royalty based on the corporation's net sales. The corporation then contributed the limited partnership units to a private foundation (created and managed by the owner). Because the limited partnership receives 95% or more of its gross income from passive sources (here, royalties), the units are not an excess business holding. Further, the foundation has no unrelated business income because royalties are exempt.

PLR 200644013 dealt with an S corporation contributing residential and commercial real estate to a 20 year charitable remainder unitrust. The facts presented were:

Company owns, leases, and manages residential and commercial real estate. Company reported its taxable income as a C corporation for all taxable years ending on or before Date 1. Company elected to be taxed as an S corporation within the meaning of § 1361 of the Code effective for tax years beginning on Date 2. Company holds three separate parcels of real property (the "Real Estate") and represents that the Real Estate does not constitute "substantially all" of its assets. Company purchased the Real Estate prior to Date 2 and will recognize gain under § 1374 if it sells the Real Estate within ten years of Date 2 (the "Recognition Period").

Company intends to form a charitable remainder unitrust under § 664 (the "Trust"). Following the formation of the Trust, Company will contribute the Real Estate to the Trust. Subsequently, but before the end of the Recognition Period, the Trust will sell the Real Estate ("Sale Date") and use the sale proceeds to invest in stocks, bonds, and other securities that pay interest and dividends. For a period of 20 years, the Trust will be required to annually distribute a unitrust amount to the Company. At the end of 20 years, the Trust will terminate and all assets remaining in the Trust will be distributed to one or more charities described in §§ 170(c), 2055(a), and 2522(a).

The Trust will be structured initially as a net income with makeup charitable remainder unitrust ("NIMCRUT") and, on the Sale Date, will convert to a fixed percentage charitable remainder unitrust ("CRUT"), as permitted under § 1.664-3(a)(1)(i)(c). As a NIMCRUT, the Trust will annually distribute to Company a unitrust amount equal to the lesser of (1) the Trust's income (as defined under § 643(b) and the applicable regulations) for the year (the "Trust Income") or (2) the fair market value of the Trust's assets multiplied by a fixed payout percentage ("Fixed Percentage Amount"). The unitrust amount for any year will also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (2), to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed under (2) in prior years. After the Trust converts to a CRUT, the Trust will

annually distribute to Company a unitrust amount equal to the Fixed Percentage Amount.

The Service granted the following rulings:

1. Company will not have recognized built-in gain under § 1374 on its contribution of the Real Estate to the Trust.
2. Company will not have recognized built-in gain under § 1374 on the Trust's disposition of the Real Estate.
3. Company will not have recognized built-in gain under § 1374 on unitrust amounts received by it during the Recognition Period, to the extent the unitrust amounts do not exceed Trust Income.
4. Company will not have recognized built-in gain under § 1374 on unitrust amounts received by it after the Recognition Period.

PLANNING CHART

<u>TYPE OF GIFT</u>	<u>DONOR BENEFITS</u>	<u>FAMILY BENEFITS</u>	<u>CHARITY BENEFITS</u>	<u>PREFERRED TYPE OF CHARITY</u>
Outright Gift of Undiscounted Assets	Full income tax deduction. No payments to donor.	-0-	Charity receives income and appreciation on the contributed assets from the date of gift.	For cash and marketable securities differences are minimal. For closely-held and real estate assets, private foundation gifts are less desirable.
Outright Gift of Discounted Assets followed by family purchase or redemption	Full income tax deduction. No payments to donor. Note that the restrictions on the gift could create a future interest thus eliminating the income tax deduction	Potential value received by the family through the purchase or redemption of assets that are discounted from pro rata value.	Charity receives income and appreciation on the contributed assets from the date of gift. However, enjoyment may be postponed if the assets are illiquid.	Donor advised fund or some supporting organizations are most desirable. Public charity is a good donee but may lack experience to handle the gift efficiently. Private foundation is undesirable because of self-dealing rules.
Defined value / charitable allocation clause transfer	Full income tax deduction. No payments to donor.	Potential for discounted assets to pass to the family transferring additional value.	Charity receives income and appreciation on the contributed assets from the date of gift. However, enjoyment may be postponed if the assets are illiquid.	Donor advised fund or some supporting organizations are most desirable. Public charity is a good donee but may lack experience to handle the gift efficiently. Private foundation is undesirable because of self-dealing rules.
Bequest	No income tax deduction. No payments to donor.	-0-	Assets available at an undetermined future date.	No substantial differences. Bequests to a private foundation may be "bought out" by the family using the Probate Exception.
Disclaimer to a Charitable Fund	No income tax deduction. No payments to donor.	Potential for discounted assets to pass to the family transferring additional value.	Assets available at an undetermined future date.	Donor advised fund or some supporting organizations are most desirable. Public charity is a good transferee but may lack experience to handle the gift efficiently. Private foundation is undesirable because of self-dealing rules regardless of the probate exception.

PLANNING CHART

TYPE OF GIFT

DONOR BENEFITS

FAMILY BENEFITS

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PREFERRED TYPE OF CHARITY

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INNOVATIVE CLAT STRUCTURES:
PROVIDING ECONOMIC EFFICIENCIES TO A
WEALTH TRANSFER WORKHORSE

Paul S. Lee, Turney P. Berry, and Martin Hall

Innovative CLAT Structures: Providing Economic Efficiencies to a Wealth Transfer Workhorse

Paul S. Lee, Turney P. Berry, and Martin Hall*

In this article, the authors outline the benefits of Charitable Lead Annuity Trusts ("CLATs") as an estate planning tool. Special attention is focused on designing CLATs without level payment streams, but with "back-loaded" or "shark-fin" annuity patterns that "zero-out" the value of the gift of the remainder interest and leverage historically low interest rates. The authors discuss the tax advantages and disadvantages if the CLAT is a non-grantor or grantor trust, if the CLAT is inter-vivos or testamentary, and if the charitable lead interest is a term of years or based upon a measuring life. The article outlines a number of technical issues that must be considered in the design of a CLAT, including the tricky endeavor of choosing which retained powers will provide grantor trust status without causing the assets of the trust to be includible in the estate of the grantor, and the income tax consequences of a termination of grantor trust status. In addition, they compare CLUTs and CLATs today if the remainder beneficiaries are skip-persons for GST tax purposes, and they review the application of the private foundations rules, the investment implications of a back-loaded annuity CLAT, and the planning implications surrounding the choice of different charitable and non-charitable beneficiaries. They conclude the article with a number of planning examples that illustrate the flexibility now afforded estate planners, including CLATs holding private equity interests, concentrated stock positions, life insurance policies, and family limited partnerships holding commercial real property or publicly-traded securities.

* Paul S. Lee, New York, New York; Turney P. Berry, Louisville, Kentucky; Martin Hall, Boston, Massachusetts; Copyright 2011. The authors would like to thank John F. McLaughlin, CFA, Quantitative Analyst; Warren Litman, CFA, Senior Quantitative Analyst; Stephanie Shen, Investment Planning Analyst; and Stephen M. Lippman, Director; all in the Wealth Management Group of Bernstein Global Wealth Management, for their assistance with the quantitative forecasting and actuarial mathematics.

BACK-LOADED ANNUITY AND "SHARK-FIN" CLATS

A. Introduction

With § 7520 rates¹ (and applicable federal rates or "AFRs"²) at near all-time lows, as illustrated in the diagram below,³ estate planners should reconsider the benefits of the charitable lead annuity trust (hereinafter, "CLAT").⁴ Although a CLAT is appropriate only for a client with some charitable intent, there are significant wealth transfer benefits as well. Two 2007 revenue procedures have confirmed that a CLAT may be structured with unequal annuity payments.⁵ Structuring a CLAT with payments to charity weighted more heavily toward the end of the CLAT term (a so-called "back-loaded" annuity has greatly increased the attractiveness of CLATs.

With interest rates likely to increase from this point forward,⁶ based on the projections of Bernstein's Wealth Forecasting System as indi-

¹ I.R.C. § 7520.

² I.R.C. § 1274.

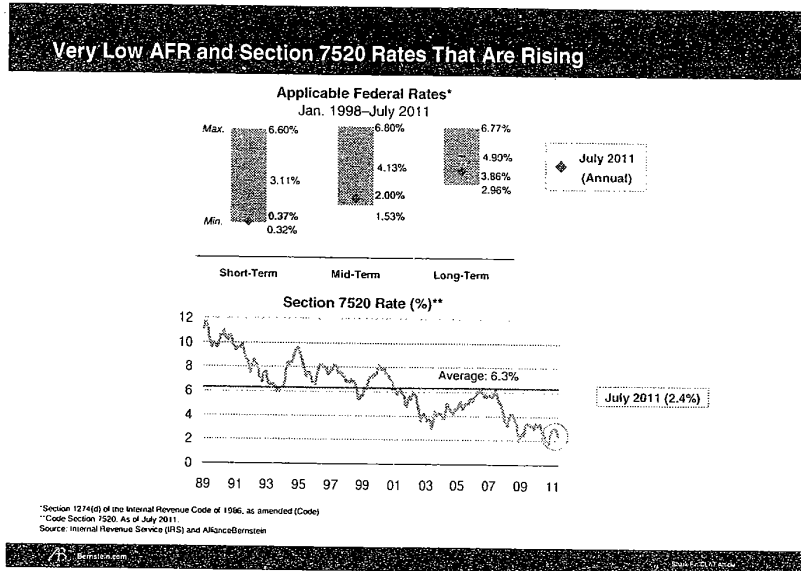
³ The I.R.C. § 7520 rate for July 2011 is 2.4%, and the short-, mid-, and long-term AFRs are 0.37%, 2.00% and 3.86% respectively (compounded annually). Rev. Rul. 2011-14, 2011-27 I.R.B. 31. The 2.4% I.R.C. § 7520 rate for July 2011 will be available through September 2011 because of the 3 month election for charitable trusts. I.R.C. § 7520(a) of the Code provides that if I.R.C. § 7520 is being used to determine the value of a charitable income, gift or estate deduction (for example, for contributions to charitable lead trusts and charitable remainder trusts), "the taxpayer may elect to use such Federal midterm rate for either of the 2 months preceding the month in which the valuation date falls for purposes of paragraph (2)." I.R.C. § 7520(a). Paragraph (2) provides the I.R.C. § 7520 rate is 120% of the Federal midterm rate rounded to the nearest 2/10ths of 1 percent. See also Treas. Reg. §§ 1.7520-2(b), 20.7520-2(b), 25.7520-2(b).

⁴ For purposes of this article, a CLAT will refer to a "split-interest" trust that provides for an annual (or more frequent) payment to a charitable organization that qualifies as a "guaranteed annuity" for income, gift, and estate tax purposes under I.R.C. §§ 170(f)(2), 2055(e)(2)(B) and 2522(c)(2)(B), for a term of years (or the life or lives of a permissible individual or individuals), as defined under Treas. Reg. §§ 1.170A-6(c)(2), 20.2055-2(e)(2), and 25.2522(c)-3(c)(2), with the remainder interest passing to or for the benefit of non-charitable beneficiaries (other than the grantor).

⁵ See Rev. Proc. 2007-45, 2007-29 I.R.B. 89 specifically for inter-vivos CLATs and Rev. Proc. 2007-46, 2007-29 I.R.B. 102 for testamentary CLATs.

⁶ Bernstein Wealth Forecasting System forecasts that there is only an 11.6% chance of the § 7520 rate remaining as low as 2.4% (July 2011) in 10 years. See Paul S. Lee, *Chomping Your Taxes in Half with Shark-Fin CLATs*, BERNSTEIN GLOBAL WEALTH MANAGEMENT, available at http://www1.ctbar.org/SectionsAndCommittees/Sections/EstatesAndProbate/D_SharkFinClats.pdf. Since July 2011, interest rates have continued to trend downward, and November's § 7520 Rate dropped to 1.4%. Rev. Rul. 2011-25, 2011-45 I.R.B. 695. Furthermore, on August 9, 2011, the Federal Reserve issued a press release that stated that it would keep interest rates near zero for the next two years. The statement provides,

To promote the ongoing economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today



cated in the diagram below, estate planners should seriously consider a CLAT for those clients who have a modicum of charitable intent and a desire to transfer wealth to non-charitable beneficiaries.

B. Traditionally Structured CLATs

In the traditionally structured CLAT, there are two primary reasons that the trust may fail to transfer wealth to the remainder beneficiaries. First, as with a grantor retained annuity trust (hereinafter “GRAT”),⁷ if the assets of a “zeroed-out” CLAT⁸ do not have a total return that exceeds the § 7520 rate applicable at the time of funding, then the trust assets will be exhausted through payment of the guaran-

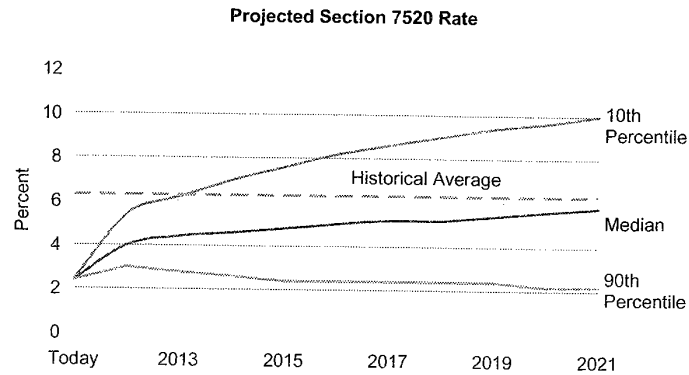
to keep the target range for the federal funds rate at 0 to 1/4 percent. The Committee currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.

Press Release, Federal Board of Governors of the Federal Reserve System, 2011 Monetary Policies Releases (Aug. 9, 2011) (on file with author). As such interest rates are likely to remain relatively low over the near term.

⁷ For a discussion of GRATs, see, for example, Craig L. Janes, *Grantor Retained Annuity Trusts: Avoiding the Petards in an Otherwise Safe Harbor*, 33 EST. PLAN. 10 (2006).

⁸ A “zeroed-out” CLAT is one in which the present value of the charity’s payments under the terms of the CLAT are equal to the amount contributed by the grantor.

CLATs: The Time Is Now



*Only 11.6% of forecasted rates resulted in a 7520 rate of 2.4% or less 10 years from now based on Bernstein estimates of the range of returns for the applicable capital markets over the periods analyzed. Source: Bernstein

ted annuities and nothing will remain at the end of the term for the remainder beneficiaries. In contrast to a CLAT, however, if the assets in a GRAT underperform, the assets are returned to the grantor, who can redeploy them in another GRAT or other planning technique. Redeployment is not available with a CLAT because the lead interest—and consequently all the underperforming assets—will have been paid to charity. Worse, if the CLAT is being used to meet a donor's charitable obligations, the obligation may not be met in full, depending on the degree of underperformance.

Secondly, even if the CLAT assets have a total return over the term of the trust that exceeds the initial § 7520 rate, the CLAT may fail because of the "path of the return." Consider a "zeroed-out" \$10 million, 10 year CLAT, created when the effective § 7520 rate is 6.0%. In order to zero-out the \$10 million contribution, a fixed annual payment of \$1.36 million for 10 years will be paid to charity. Ignoring the effect of income taxes, if the assets grow by a compound growth rate of 9.3% per year, then the remaining assets at the end of the 10 year period would be \$3.4 million. In other words, because the trust assets consistently out-perform the assumed 6% return, the grantor could shift \$3.4 million to his or her children or other non-charitable beneficiary without any federal gift tax. Unfortunately, returns in the publicly-traded capital markets

are never straight-line. So, consider two different paths that a 9.3% compound annual growth rate could take:⁹

Year	Return Path 1	Return Path 2
1	10.1%	-22.1%
2	1.3%	-11.9%
3	37.6%	-9.1%
4	23.0%	21.0%
5	33.4%	28.6%
6	28.6%	33.4%
7	21.0%	23.0%
8	-9.1%	37.6%
9	-11.9%	1.3%
10	-22.1%	10.1%
Compound Annual Growth Rate	9.3%	9.3%

If the assets of the aforementioned zeroed-out CLAT experience return path 1, the remainder interest at the end of the term will be worth approximately \$8.0 million. If, instead, return path 2 applies, the remainder interest will be worth zero, and there will be inadequate assets to pay out the year 9 and year 10 annuities. The actual path of return (particularly the return in the early years of the CLAT) is as important as the magnitude of the return. Because there is no way of knowing whether capital market returns will be positive or negative, traditional CLATs—those with level annuity payouts beginning in year one—will quite often fail or perform poorly even when the compound annual returns exceed the § 7520 rate used to determine the annuity payments.

C. “Back-Loaded” CLATs

Structuring a CLAT so that the annuity payments increase during the term can help manage the path of return problem by allowing the trustee to adjust the mix of investments held by the CLAT over the life span of the trust, and by reducing the outflow of trust assets in the early years of the trust’s administration. Planners have faced the question of whether a guaranteed annuity requires level annual distributions over the term of the trust or whether escalating or back-loaded distributions

⁹ Return Path 1 represents the annual return of the S&P 500 index from 1993-2002 and Return Path 2 is the reverse of those returns.

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9	-11.9%	1.3%
10	-22.1%	10.1%
Compound Annual Growth Rate	9.3%	9.3%

If the assets of the aforementioned zeroed-out CLAT experience return path 1, the remainder interest at the end of the term will be worth approximately \$8.0 million. If, instead, return path 2 applies, the remainder interest will be worth zero, and there will be inadequate assets to pay out the year 9 and year 10 annuities. The actual path of return (particularly the return in the early years of the CLAT) is as important as the magnitude of the return. Because there is no way of knowing whether capital market returns will be positive or negative, traditional CLATs—those with level annuity payouts beginning in year one—will quite often fail or perform poorly even when the compound annual returns exceed the § 7520 rate used to determine the annuity payments.

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⁹ Return Path 1 represents the annual return of the S&P 500 index from 1993-2002 and Return Path 2 is the reverse of those returns.

are acceptable, and if so, the shape that such back-loading may take. Two other types of trusts—the charitable remainder annuity trust¹⁰ (hereinafter, “CRAT”) and the GRAT¹¹ have provided the backdrop to this inquiry.

1. “Annuities” in CRATs

Section 664(d)(1)(A) defines a CRAT as a trust from which a *sum certain* is to be paid, not less often than annually.¹² In case there was any doubt whether “a sum certain” means that the CRAT may vary the annuity paid each year, the Treasury Regulations provide that a sum certain is “a stated dollar amount which is the same either as to each recipient or as to the total amount payable for each year of such period.”¹³ Consequently, with a CRAT, there is no ambiguity: the annuity payment may not increase during the term.

2. “Annuities” in GRATs

Section 2702, and the Treasury Regulations thereunder, set forth the requirements of the payout, in the form of a “qualified annuity interest,”¹⁴ from a GRAT. In pertinent part, the Treasury Regulations provide:

A qualified annuity interest is an irrevocable right to receive a fixed amount. The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest at least annually.¹⁵

A fixed amount means . . . [a] stated dollar amount payable periodically, but not less frequently than annually, but only to the extent the amount does not exceed 120 percent of the stated dollar amount payable in the preceding year; or . . . [a] fixed fraction or percentage of the initial fair market value of the property transferred to the trust, as finally determined for federal tax purposes, payable periodically but not less frequently than annually, but only to the extent the fraction or percentage does not exceed 120 percent of the fixed fraction or percentage payable in the preceding year.¹⁶

¹⁰ I.R.C. § 664(d)(1).

¹¹ Trust that provides the grantor with a “qualified annuity interest” under Treas. Reg. § 25.2702-3(b).

¹² I.R.C. § 664(d)(1)(A).

¹³ Treas. Reg. § 1.664-2(a)(1)(ii).

¹⁴ I.R.C. § 2702(b)(1).

¹⁵ Treas. Reg. § 25.2702-3(b)(1).

¹⁶ Treas. Reg. § 25.2702-3(b)(1)(ii)(A)-(B).

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¹⁴ I.R.C. § 2702(b)(1).

¹⁵ Treas. Reg. § 25.2702-3(b)(1).

¹⁶ Treas. Reg. § 25.2702-3(b)(1)(ii)(A)-(B).

provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded. The annuity payments may be made in cash or in kind.²²

The quoted language applies expressly to non-grantor CLATs, but Revenue Procedure 2007-45 provides substantially identical provisions for grantor CLATs.²³

The annuity distribution requirements for a CLAT are quite distinct from those for CRATs or GRATs. The amount distributed to charity must be ascertainable at the time the trust is funded, but there is no maximum or minimum payout requirement, no requirement that payments be identical from year to year and no upper limit on increases in distributions during the annuity period.²⁴ For example, one should be permitted to “zero-out” a CLAT, funded with \$10 million, and assuming a § 7520 rate of 2.4%, by making one of the following: (i) twenty level payments of \$635,428; (ii) an initial payment of \$76,999, and then providing for a 20 percent increase in each year thereafter; (iii) an initial payment of \$2,301, and then providing for a 50 percent increase in each year thereafter; or (iv) 19 annual payments of \$1,000, followed by a single payment in the twentieth year of \$16,045,091.

The last annuity stream has been nick-named the “Shark-Fin” CLAT, for the shape that the annuity pattern makes if arrayed horizontally, as illustrated in the diagram below. It may also be thought of as a “Balloon” CLAT, with the rationale of back-loading the annuity payments similar to that for structuring an installment sale to an intentionally defective grantor trust (hereinafter, “IDGT”) with interest payments only until the final year, at which time the full amount of principal is repaid.²⁵

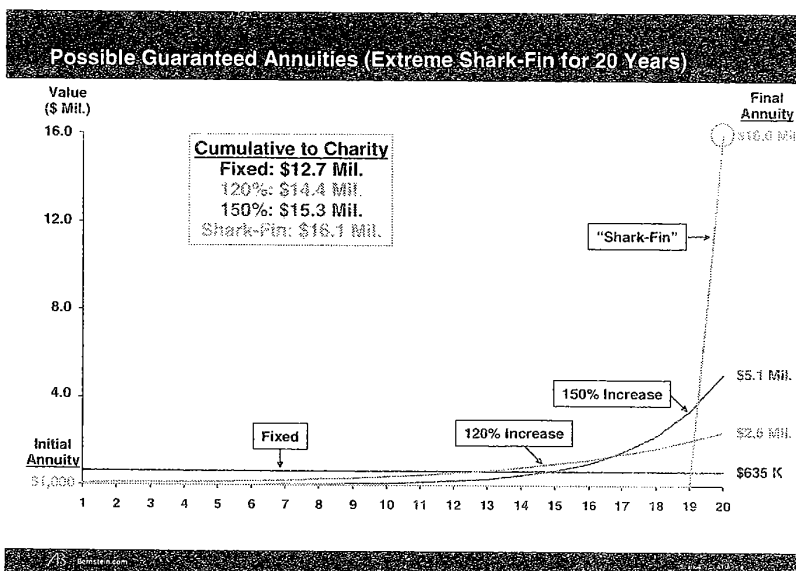
However, there are 2 critical differences between the “Shark-Fin” CLAT and an interest-only installment sale. First, the annual payment of \$1,000 is smaller than the annual interest payment that would otherwise be payable on a 20-year installment note (the long-term AFR). Second, the internal rate of return or discount rate with the Shark-Fin

²² See Rev. Proc. 2007-45 § 5.02(2), 2007-29 I.R.B. 89.

²³ Rev. Proc. 2007-45 § 8.02(1)-(2), 2007-29 I.R.B. 89. Grantor vs. non-grantor CLATs are discussed beginning in Section VI below.

²⁴ Rev. Proc. 2007-45 § 8.02(1), 2007-29 I.R.B. 89.

²⁵ See Michael D. Mulligan, *Sale to Defective Grantor Trust: An Alternative to a GRAT*, 23 EST. PLAN. 3 (2006).



CLAT is the § 7520 rate, which, in the current interest environment, is significantly lower than the long-term AFR.²⁶

These differences may permit the Shark-Fin CLAT to transfer more wealth than the other less severely back-loaded annuity patterns and possibly more than both an installment sale to an intentionally defective grantor trust (“IDGT”) and a GRAT (which, as mentioned above, is limited to 20% annual increases) over the same period of time, assuming that a donor’s objective is to also transfer assets to charity.

4. *Is a “Shark-Fin” CLAT Allowable?*

Other than Rev. Proc. 2007-45, no other guidance has been issued regarding the ability to and the extent of the back-loading in structuring a CLAT. The Treasury Regulations do, however, specifically allow for changes in the annuity payment. The Treasury Regulations state that an “amount is determinable if the exact amount which must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of transfer.”²⁷ By way of example, the Treasury Regulations provide that “the amount to be paid may be a stated sum for a term, or for the life of an individual, at the expiration of which

²⁶ For example, for July 2011, the § 7520 rate is 2.4%, while the long-term AFR is 3.86%, see Rev. Rul. 2011-14, 2011-27 I.R.B. 31.

²⁷ Treas. Reg. §§ 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(a), and 25.2522(c)-3(c)(2)(vi)(a).

it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index.”²⁸ In Private Letter Ruling 9112009, the IRS did approve a CLAT where “the ‘minimum’ annuity amount payable varies each year” but the “amount payable each year is specified in the instrument.”²⁹ However, no other information about how the annuity varied is contained in the ruling.

At least one article has expressed concern about the validity of Shark-Fin CLATs.³⁰ In it, the authors point to a number of rulings and regulations concerning charitable remainder trusts (“CRTs”)³¹ and GRATs³² to cast doubt on the clear language of Rev. Proc. 2007-45. We

²⁸ *Id.*

²⁹ PLR 9112009 (Mar. 22, 1991).

³⁰ See Richard L. Fox & Mark A. Teitelbaum, *Validity of Shark-Fin CLATs Remain in Doubt Despite IRS Guidance*, 37 *EST. PLAN.* 3 (2010).

³¹ Fox and Teitelbaum point to a number of rulings concerning CRTs that require an annuity or unitrust amount that is “payable to or for the use of a named person or persons, at least one of which is not an organization described in section 170(c).” Treas. Reg. §§ 1.664-2(a)(3)(i), 1.664-3(a)(3)(i). The authors then cite private letter rulings that state that the amount payable to non-charitable beneficiaries must be more than de minimis under the facts and circumstances. Fox & Teitelbaum, *supra* note 28, at 13. However, Rev. Proc. 2007-45 explicitly provides that “CLATs are not subject to any minimum . . . payout requirements.” Furthermore, the authors’ argument ignores the policy reason for the de minimis requirement for CRT distributions to non-charitable beneficiaries. CRTs are afforded tax-exempt status. The de minimis requirement is meant to ensure that some portion of the underlying assets will be subject to income tax, rather than forever staying in a tax-exempt environment. In other words, trusts that are not truly CRTs are not afforded tax-exempt status. CLATs are, of course, not tax-exempt. Furthermore, in the context of Shark-Fin CLATs, a de minimis requirement does not change the resulting charitable deduction because § 7520 specifically takes into account time value concepts. In fact, as pointed out in this article, back-loading the annuity actually increases the probability that charity will receive the entire amount due to it.

³² Fox and Teitelbaum state,

[t]he policy concerns expressed by the IRS regarding a lump-sum balloon payment at the termination of a GRAT, a vehicle similar in purpose and operation to a CLAT, and the lack of any guidance from the IRS regarding the extent to which CLAT annuity payments may be increased, clearly raise a question as to the validity of the shark-fin CLAT. Indeed, it is possible that the IRS might view the shark-fin strategy as abusive and, accordingly, seek to limit the CLAT’s charitable payments that may be deferred or, consistent with the GRAT regulations, seek to impose a percentage limitation on year-to-year increases in the annual payments to charity. *Id.* at 12.

Fox and Teitelbaum point to the preamble to the final Treasury Regulations for GRATs that states that allowing a grantor to zero-out a GRAT while effectively transferring the appreciation on all of the property through a balloon payment at the end of the term is inconsistent with the principles of § 2702. *Id.* The preamble provides, “[t]he proposed regulations prohibited increases (in the annual annuity payment) to prevent transferors from ‘zeroing out’ a gift while still effectively transferring the appreciation on all of the property during the term to the remainder beneficiary (e.g., by providing a balloon pay-

note in response that the Treasury and the IRS know how to describe an annuity that may not vary or may vary only in accordance with specified limits and declined to do so with respect to CLATs. Our belief is that there are policy differences that the government has considered, among them that the CRT is a tax-exempt entity and thus deferring annuity payments changes the income tax policy that underlies the general rule requiring mandatory payouts from charitable remainder trusts, and that the GRAT is a no-lose proposition for a donor unlike a CLAT that divides benefits between charity and a donor's non-charitable beneficiaries.³³ In fact, the courts have consistently found a general policy in favor of encouraging gifts to charity,³⁴ which would be supported by allowing back-loaded CLATs. The back-loading of annuity payments not only encourages gifts to charity because of the wealth transfer benefits afforded the grantor's family, but as discussed below, it provides a higher probability that charity will actually receive the full value of its gift. Regardless, we see no reason to question such a clear and definitive pronouncement.

ment in the final year of the term). The Treasury Department and the Service believe that such a result would be inconsistent with the principles of section 2702." T.D. 8395, 1992-16 I.R.B. 5 (Feb. 4, 1992). Notwithstanding the dubious truth of Treasury's statement in the preamble, it should be noted that when it was issued in 1992, the Service's position was that grantors could not fully zero-out a contribution to a GRAT. *See* *Walton v. Comm'r*, 115 T.C. 589 (2000); TAM 200245053 (Nov. 8, 2002) (the National Office stated that the preamble to the final regulations under § 2702 reflected that Congress did not intend to permit the value of the remainder to be very small, such as less than one percent of the fair market value of the property contributed to a GRAT). Fox and Teitelbaum do not point to any specific rulings, regulations, court cases or any other primary sources directly related to CLATs. Also, to state the obvious, the Code provisions for CLATs were enacted under the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969), whereas GRATs were enacted under the Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990). To say that the Treasury Regulations for GRATs have direct bearing on CLATs seems a stretch. Presumably the IRS could have adopted the GRAT position when it issued Rev. Proc. 2007-45 but, pointedly, it did not.

³³ Fox and Teitelbaum also contend that the Shark-Fin CLAT structure, which provides for level payments with a single balloon payment at the end of the term, is not permissible because an increasing annuity (each year apparently) is required. Fox & Teitelbaum, *supra* note 28, at 12. A single large annuity payment at the end of the period would seem to meet the requirement of "an annuity amount that is initially stated as a fixed dollar . . . amount but increases during the annuity period." *See* Rev. Proc. 2007-45, 2007-29 I.R.B. 89. If planners are concerned about the absence of annual increases, then the annuity could be increased by a modest amount each year without altering the positive effects of back-loading (for instance, payments could be \$1,000 in year one, \$1,100 in year two, etc.). To say that the annuity must increase in some manner over the term seems, however, overly picayune.

³⁴ *See, e.g.,* *Estate of Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. 2009), *aff'd* 130 T.C. 1 (2008); *Estate of Petter v. Comm'r*, TC Memo 2009-280, *aff'd*, 653 F.3d 1012 (9th Cir. 2011).

II. FORECASTED RESULTS AND PLANNING IMPLICATIONS

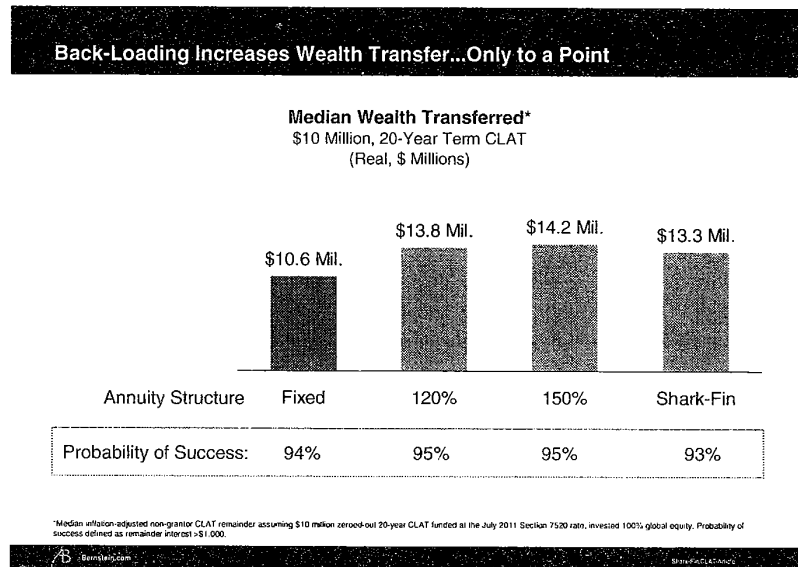
A. Forecasted Results for Non-Grantor CLATs

The latest generation of financial planning tools moves beyond historical averages and takes into account the paths of return and the often random and unpredictable nature of the markets. Generically it is called stochastic or probabilistic modeling. The colloquial term is "Monte Carlo" modeling. For this article, a proprietary analytical tool was used that marries the benefits of stochastic modeling with a proprietary structural model of the capital markets (the "Wealth Forecasting Model").³⁵ In each instance the model simulated 10,000 market scenarios or forecasts for the next 20 years, based initially upon the current state of the capital markets (for example, with very low Treasury interest rates resulting in very low AFRs and § 7520 rates). Unless otherwise noted, in each case, the model assumes 100% globally diversified equities and, for purposes of simplicity, a starting contribution of \$10 million of cash.³⁶ With 10,000 different outcomes, the analytical outputs are probabilistic. In other words, instead of saying, for example, that the remainder value will be \$10 million, the answer will be that there is a 50% chance of the remainder being at least \$10 million or more.

For 20 year "zeroed-out" CLATs, the aforementioned annuity patterns result in median (50th percentile) inflation-adjusted remainder values, after all payments to charity and after the payment of income taxes, as illustrated in the diagram below:

³⁵ Unless otherwise noted, all illustrations in this article are based upon Bernstein Global Wealth Management's proprietary capital markets engine and wealth forecasting model, which uses proprietary research and historical data to create a wide range of possible market returns for many asset classes over the coming decades, following many different paths of return. The model takes into account the linkages within and among different asset classes in the capital markets and incorporates an appropriate level of unpredictability or randomness for each asset class. Paul S. Lee, Turney P. Berry & Martin Hall, *Reeling, Rolling and Reining In "Shark-Fin" CLATs*, 51 TAX MGMT. MEMORANDUM No. 25, 435 (2010).

³⁶ The allocation to stocks is 35% U.S. Value, 35% U.S. Growth, 25% Developed International, and 5% Emerging Markets. The source of the data is Bernstein Global Wealth Management, a unit of AllilanceBernstein, LP, based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. The data do not represent any past performance and are not a promise of actual future results. *Id.*



As shown, the Shark-Fin structure actually results in a smaller remainder than both the 120% and 150% back-loaded CLATs over the same period of time. The highest probabilities of success (defined as the probability of a remainder greater than zero) and the highest remainder values peak with 150% back-loaded annuities. The Shark-Fin is only superior to the traditionally structured, fixed annuity CLAT. Despite a very low § 7520 rate and the most extreme benefit of back-loading, the Shark-Fin does not produce the result that one would expect.

This outcome is attributable to the effect of income taxes payable on the return earned by the trust assets. The traditional wealth-transfer CLAT (with the remainder passing to the grantor’s children, for example, rather than reverting to the grantor at the end of the term) is a taxable, complex trust. As such, the trust is entitled to claim a deduction each year under § 642(c) for the payment of the charitable annuity. This section provides,

In the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to

section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year.³⁷

Although § 642(c) does not limit a trust's income tax deduction as § 170 does for an individual (based on the individual's contribution base), it effectively limits the deduction in any given taxable year to the lesser of the taxable income of the trust and the payment to charity for that year. Furthermore, other than the election to treat payments in the following taxable year as having been made in the previous taxable year,³⁸ there is no mechanism to carry-back or carry-forward unused charitable deductions (in situations where the charitable deduction/payment is greater than the taxable income for the year). Moreover, unused charitable deductions may not be carried out to the remainder beneficiaries in a terminating distribution. The Code specifically limits terminating distribution tax benefits to unused carryover losses and unused deductions other than the charitable deduction and the personal exemption deduction.³⁹

The practical result of the foregoing limitations is that a Shark-Fin CLAT pays income taxes on almost all of its income each year until the last taxable year when the large final payment is made. In addition, it is unlikely that the CLAT will have enough taxable income in that final year to use the charitable deduction effectively. Consequently, the income tax benefits from the charitable payments during the term of the trust are minimal. As illustrated in the chart above, the most efficient use of the § 642(c) charitable deduction arises where the CLAT pays 50% annually increasing annuities. It should be noted that the efficacy of the 150% back-loaded annuity CLAT is specific to the investment strategy (global equities), the term of the CLAT (20 years), and the § 7520 rate. A different asset allocation, a longer or shorter term, a § 7520 rate other than 2.4%, or a combination thereof, would likely result in a different back-loaded annuity pattern being the most efficient for wealth transfer.

The efficient use of the § 642(c) deduction is an important component of successfully administering a non-grantor CLAT. In this context, the implications of realizing unrelated business taxable income (hereinafter "UBTI")⁴⁰ must be weighed carefully. While punitive excise taxes are not imposed on UBTI earned by a non-grantor CLAT, the CLAT is

³⁷ I.R.C. § 642(c).

³⁸ I.R.C. § 642(c)(1).

³⁹ I.R.C. § 642(h).

⁴⁰ I.R.C. § 512.

not entitled to offset UBTI with a § 642(c) charitable deduction. The Code provides, “[i]n computing the deduction allowable under § 642(c) to a trust, no amount otherwise allowable under § 642(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year.”⁴¹ The Treasury Regulations provide a methodology for reducing and allocating any remaining deduction between UBTI and other income.⁴²

The most common instance in which a CLAT will realize UBTI is if the CLAT has “unrelated debt-financed income” under § 514.⁴³ In particular, unrelated debt-financed income arises when “acquisition indebtedness”⁴⁴ is deemed to exist. That being said, the Code provides,

[w]here property subject to a mortgage is acquired by an organization by bequest or devise, the indebtedness secured by the mortgage shall not be treated as acquisition indebtedness during a period of 10 years following the date of the acquisition. If an organization acquires property by gift subject to a mortgage which was placed on the property more than 5 years before the gift, which property was held by the donor more than 5 years before the gift, the indebtedness secured by such mortgage shall not be treated as acquisition indebtedness during a period of 10 years following the date of such gift.⁴⁵

In Private Letter Ruling 9716023, a non-grantor charitable lead trust took advantage of this provision. Significantly, the IRS ruled that since the trust had a charitable term of less than 10 years, the trust could retain mortgaged property received from the grantor without any loss of its § 642(c) deduction.⁴⁶

The loss of the § 642(c) charitable deduction arising from UBTI may be of minimal consequence in the context of back-loaded annuities (especially the Shark-Fin) because the deduction otherwise allowable is small in the initial years. In the Shark-Fin example above, the maximum allowable deduction for the first 19 years would only be \$1,000. Furthermore, the existence of UBTI is of no consequence if the CLAT is a grantor trust.

⁴¹ I.R.C. § 681(a).

⁴² Treas. Reg. § 1.681(a)-2(b).

⁴³ See Sanford J. Schlesinger & Dana L. Mark, *Unrelated Business Income and the Charitable Organization*, 27 EST. PLAN. 177, 177 (2000).

⁴⁴ I.R.C. § 514(c)(1).

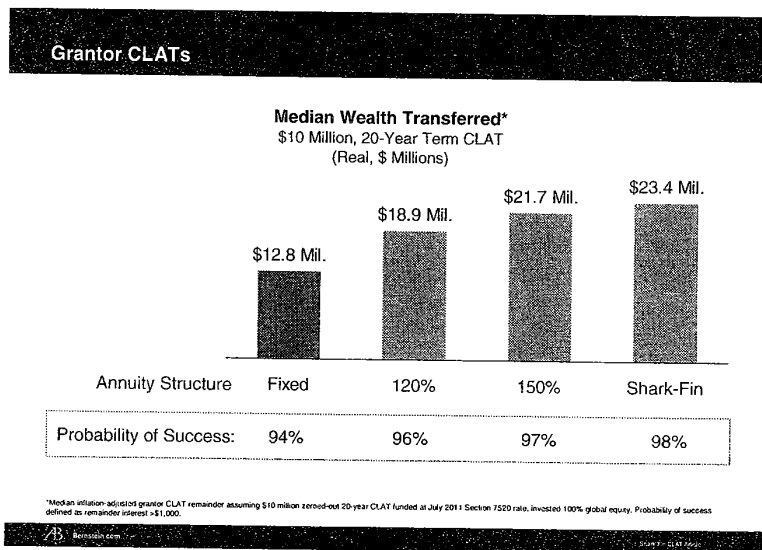
⁴⁵ I.R.C. § 514(c)(2)(B).

⁴⁶ See, e.g., PLR 9716023 (Apr. 18, 1997).

B. Forecasted Results for Grantor CLATs

If Shark-Fin CLAT benefits are limited by § 642(c), might intentionally making the CLAT a grantor trust⁴⁷ create better results? When a grantor makes a contribution to a CLAT that is considered a grantor trust for income tax purposes, the grantor obtains a personal income tax deduction equal to the present value of the charitable contribution (determined under § 7520) in return for taking on grantor trust income tax liability for the trust's assets.⁴⁸ Of course, there are wealth transfer benefits to the grantor paying the income tax liability, similar to those associated with an installment sale to an IDGT. There have been a number of rulings addressing this planning technique.⁴⁹

In the grantor CLAT form, the resulting median (50th percentile) inflation-adjusted remainder values after all payments to charity (but ignoring income taxes) are illustrated in the diagram below:



⁴⁷ I.R.C. §§ 671-79. Unless otherwise noted, a grantor CLAT for purposes of this article will refer to a CLAT that is a grantor trust for Federal income tax purposes but that is not includible in the estate of the grantor for Federal estate tax purposes. As such, it does not refer to a CLAT where the grantor has retained an interest under § 673 (a reversionary interest equal in value to at least 5% of the corpus as of the date of the transfer) because the CLAT corpus would generally be includible under § 2038 for estate tax purposes.

⁴⁸ See I.R.C. § 170(f)(2)(B); Treas. Reg. § 1.170A-6(c).

⁴⁹ See, e.g., PLR 200011012 (Mar. 17, 2000); PLR 200010036 (Mar. 10, 2000); PLR 199936031 (Sept. 10, 1999); PLR 199922007 (Jun. 4, 1999); PLR 199908002 (Feb. 26, 1999); PLR 9810019 (Mar. 6, 1998); PLR 9224029 (June 12, 1992).

The grantor Shark-Fin CLAT, unburdened by the limitations of § 642(c), now results in significantly more wealth transfer than all other annuity patterns. In fact, it provides more wealth transfer than an installment sale to an IDGT and a GRAT, as shown in the table below:⁵⁰

INFLATION-ADJUSTED REMAINDER VALUES (MEDIANS) \$10 MILLION INITIAL FUNDING YEAR 20		
Installment Sale to IDGT	GRAT	Grantor "Shark-Fin" CLAT
\$16.7 Mil.	\$18.9 Mil	\$23.4 Mil.

Significantly, even the more gentle-sloping annuity patterns, 20% and 50% annual increases, have wealth transfer figures comparable to or in excess of an installment sale to an IDGT and a GRAT.

C. Shark-Fin CLATs vs. Sales to IDGTs and GRATs

The grantor Shark-Fin CLAT provides greater wealth transfer than both of the more popular estate planning techniques, but with a number of distinct advantages in its favor that are not reflected in the remainder values above.

First, the remainder value for the installment sale to an IDGT, while based on the same initial funding amount of \$10 million, requires a \$1 million "seed" gift to the IDGT to support \$9 million installment sale.⁵¹ In other words, the installment sale transaction includes a \$1 million taxable gift, either requiring the use of exemption equivalent or the payment of gift tax. The grantor Shark-Fin CLAT, on the other hand, is zeroed-out. Second, while the GRAT results are better than the installment sale, the results assume that the grantor survives the 20 year term. The grantor Shark-Fin CLAT, on the other hand, does not have the same mortality risk. If the grantor of a CLAT dies during the trust's term, the CLAT continues to its expiration with its wealth transfer bene-

⁵⁰ All strategies are assumed to have been funded with \$10 million. The 20 year GRAT is assumed to be funded at the July 2011 § 7520 rate with 20% increasing annuities over the term of the trust. For the installment sale to the IDGT, the numbers assume a \$1 million "seed" gift to the IDGT, and a \$9 million installment sale to that trust, payable with interest only at the appropriate applicable federal rate for July 2011 and a balloon principal payment at the end of the term. All forecasted figures are based on Bernstein Global Wealth Management's proprietary estimates of the range of returns for the applicable capital markets over the periods analyzed. Please see the Notes on Wealth Forecasting at the end of this article for further details. All strategies are modeled assuming 100% global diversified equities (35% US value and 35% US growth, 25% developed international and 5% emerging markets).

⁵¹ See Stuart M. Horwitz & Jason S. Damicone, *Creative Uses of Intentionally Defective Irrevocable Trusts*, 35 EST. PLAN 35, 36 (2008).

fits intact (although the magnitude of this benefit may be impacted by the loss of grantor trust status).⁵² Third, the CLAT figures do not take into account the impact of the \$10 million charitable income tax deduction received by the grantor on the funding of the trust. Neither the installment sale nor the GRAT creates a comparable income tax benefit, but the resulting grantor trust tax liability is the same in all of the foregoing strategies.

The income tax deduction created upon funding a grantor CLAT is limited to 30% of the grantor's contribution base (or 20%, if capital gain tax property is contributed) because the transfer is treated as a transfer "for the use of" charity.⁵³ In one private letter ruling, the IRS concluded that the 5 year carry-forward for unused current year deductions was unavailable for contributions to grantor CLATs.⁵⁴ However, subsequent rulings have ruled otherwise, and it seems that the 1988 ruling is an aberration.⁵⁵

III. TERM OF THE CHARITABLE ANNUITY

A. Term Certain

CRTs are limited to terms of no more than 20 years.⁵⁶ On the other hand, CLATs do not have any statutory limitations on the length of a term. The Treasury Regulations simply require that a term CLAT have a "specified term" of years.⁵⁷

If the grantor intends to zero-out the gift to the non-charitable beneficiaries, the longer the term the smaller are the charitable annuity payments. Consequently, a long-term CLAT will potentially transfer more wealth to the non-charitable beneficiaries than would a short-term CLAT. For example, in order to zero-out a \$10 million contribution with a fixed level annuity payment at a 2.4% § 7520 rate, a 10 year term would require an annual payment of approximately \$1,137,000, but a 20 year term would require approximately \$635,000. With smaller charitable annuity payments and a longer period to out perform the § 7520 rate, longer term CLATs should result in more wealth transfer. This turns out generally to be true, as shown below in the tabulation of me-

⁵² See *infra* Part VI.C. and relevant discussion of the consequences of the loss of grantor trust status.

⁵³ I.R.C. §§ 170(b)(1)(B)(i), 170(b)(1)(D)(i)(I); Treas. Reg. § 1.170A-8(a)(2).

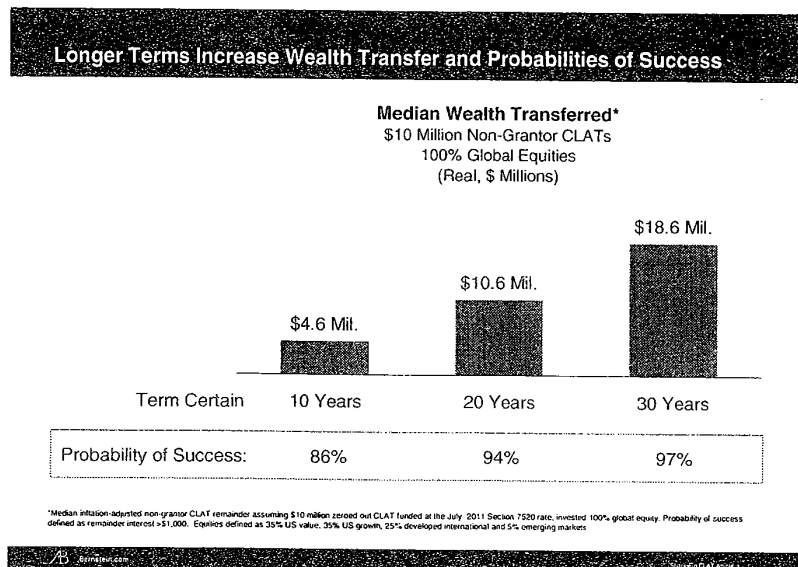
⁵⁴ PLR 8824039 (June 17, 1988).

⁵⁵ See, e.g., PLR 200010036 (Mar. 10, 2000).

⁵⁶ I.R.C. § 664(d)(1)(A) (pertaining to charitable remainder annuity trusts with a similar rule for charitable unitrust interests in I.R.C. § 664(d)(2)(A)).

⁵⁷ Treas. Reg. §§ 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a), 25.2522(c)-3(c)(2)(vi)(a).

dian inflation-adjusted remainder values for 10, 20 and 30 year non-grantor CLATs that are zeroed-out and that have fixed level annuities.



From a wealth-transfer standpoint, CLATs do not have the same “mortality risk” as GRATs⁵⁸ because if the grantor dies prior to the end of a term certain CLAT, no portion of the assets should be includible in the estate of the grantor. The CLAT will continue to be administered according to the terms of the trust for the remaining years, with the only difference being the conversion from grantor to non-grantor trust status if the CLAT was a grantor trust at the time of grantor’s death.⁵⁹ Despite the wealth-transfer benefit of longer CLAT terms, because longer terms defer both the non-charitable remainder beneficiaries’ and, to some extent, the charity’s enjoyment of the trust assets, grantors need to balance the timing of the receipt of the beneficiaries’ interests with the potential wealth transfer benefits.

B. Benefit of Inter-Vivos Versus Testamentary CLATs

Many charitable gifts including those made through CLATs are testamentary. In a low interest rate environment like today, there is an

⁵⁸ See Treas. Reg. § 20.2036-1(c)(1).

⁵⁹ As discussed in Section VI.C. below, the death of the grantor during the term of a grantor trust CLAT may result in a recapture of a portion of the income tax deduction taken by the grantor at the time the CLAT was formed. See I.R.C. § 170(f)(2)(B).

opportunity for grantors to fund these gifts now. The benefits would seem clear: (i) lock in a low § 7520 rate with all of its potential wealth transfer, (ii) if the CLAT is a grantor trust, create a personal income tax deduction that otherwise would have been lost if the charitable contribution had been made at death, and (iii) if the grantor survives the term, allow the grantor to see both charity and the remainder beneficiary enjoy the trust assets. Finally, as discussed in detail below, lifetime term CLATs can be utilized to effectuate testamentary charitable gifts with significant wealth transfer to non-charitable beneficiaries.

C. Lifetime Terms and Mortality Risk

In addition to a term certain, a CLAT may provide for annual charitable payments “for the life or lives of certain individuals, each of whom must be living at the date of transfer and can be ascertained at such date.”⁶⁰ In order to prevent abusive transactions where grantors inflated the charitable deduction by using as measuring lives unrelated individuals who were seriously ill,⁶¹ the Treasury Regulations now limit the allowable measuring lives to the donor, the donor’s spouse, a lineal ancestor of the remainder beneficiaries, and an individual who, with respect to all non-charitable remainder beneficiaries, is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries.⁶²

1. *Effect of Using a Measuring Life with a CLAT*

The Treasury Regulations provide, in pertinent part,

[a] standard section 7520 annuity factor may not be used to determine the present value of an annuity for. . . the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period. In the case of an annuity payable from a trust or other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable section 7520 interest rate at the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this pur-

⁶⁰ Treas. Reg. § 1.170A-6(c)(2)(i)(A). See also Treas. Reg. §§ 20.2055-2(e)(2)(vi)(a), 25.2522(c)-3(c)(2)(vi)(a) (containing similar language).

⁶¹ The technique typically involved designating individuals who were seriously ill but who were not “terminally ill” (greater than 50% chance of surviving one year from the date of transfer). See Treas. Reg. §§ 1.7520-3(b)(3), 20.7520-3(b)(3), 25.7520-3(b)(3).

⁶² See Treas. Reg. §§ 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a), 25.2522(c)-3(c)(2)(vi)(a). See also T.D. 8923, 2001-1 C.B. 485 (stating the same).

pose, it must be assumed that it is possible for each measuring life to survive until age 110.⁶³

This provision applicable to lifetime terms, also known as the “110 year exhaustion test” has the practical effect of forcing grantors to either (i) limit the annuity term to the shorter of a term of years (determined by when the fund will be exhausted) or the prior death of the measuring life,⁶⁴ or (ii) significantly “over-funding” the trust with additional assets (above the determined charitable amount pursuant to the 110 year exhaustion test).

With the increase of the applicable exclusion amount to \$5 million per individual and the decrease of the top transfer tax rate to 35% under the Tax Relief Act of 2010,⁶⁵ the ability to “over-fund” a CLAT at little or no transfer tax cost has dramatically increased. For this reason, in the discussion below, we have assumed the lifetime term CLAT discussed in this article has been “over-funded” with just enough assets to pass the 110 year exhaustion test, but we have ignored possible transfer tax costs and the subsequent reinvestment of such assets (so that can we compare this to a comparable zeroed-out term of years CLAT). As a result, we use the standard annuity factors set out in § 7520 based upon an annuity stream that will be payable for the life of the measuring life.

Assuming the measuring life in question is the donor of the CLAT, the calculation of the charitable deduction is determined by multiplying the amount of the annuity by the appropriate annuity factor found in Table S (for a single life annuity) in IRS Publication 1457, Actuarial Valuations Version 3A (5-2009) (for valuation dates after April 30, 2009)⁶⁶ supplemented by Notice 2009-18⁶⁷ with factors for § 7520 rates below 2.2%. The annuity factors in Table S of IRS Publication 1457, however, assume a fixed level payment, and cannot be used with an escalating or back-loaded annuity. That being said, the remainder factors

⁶³ Treas. Reg. §§ 1.7520-3(b)(2)(i), 20.7520-3(b)(2)(i), 25.7520-3(b)(2)(i).

⁶⁴ See Treas. Reg. § 25.7520-3(b)(2)(v), Ex. 5; Treas. Reg. § 25.7520-3T(b)(2)(v), Ex. 5. If the CLAT term is limited to the shorter of a term of years and the prior death of the measuring life, the appropriate valuation factors can be found in Table H (commutation factors) of IRS Publication 1457. INTERNAL REVENUE SERVICE, ACTUARIAL VALUES BOOK ALEPH, I.R.S. Pub. 1457, Table H, pp.766-865 (July 1999) available at http://www.irs.gov/pub/irs-pdf/p1457_99.pdf.

⁶⁵ Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010).

⁶⁶ If IRS Publication 1457 is not directly on point, an annuity factor may be calculated from Table S in Treas. Reg. § 20.2031-7(d)(7) by subtracting the applicable Table S remainder factor from 1.0 and dividing the result by the applicable § 7520 rate (corresponding temporary regulations were finalized and removed without any changes on Aug.10, 2011, T.D. 9540, 76 Fed. Reg. 49570-01). See Treas. Reg. § 20.2031-7(d)(7), Table S [hereinafter TABLE S].

⁶⁷ I.R.S. Notice 2009-18, 2009-10 I.R.B. 64.

(used to determine the present value of the right to receive an amount in the future) from Table S can be utilized.

For example, the 10-year term-certain Shark-Fin CLAT described above provided for a \$1,000 annual payment and a \$16,045,991 million payment at the end of year 20 (zeroing-out the \$10 million gift). If instead we assume that the trust term will be the life of a 62 year old donor (who has a 20 year life expectancy based on the 2000 mortality tables), and the annuity will follow a similar distribution pattern, the required final payment to zero-out the funding gift is determined as follows:

Present Value of Annuity for Lifetime	
Annuity Factor from Table S (2.4)	15.0740
x Annuity Amount	\$1,000
Present Value	\$15,074
Present Value of Final Payment at Death	
Remainder Factor from Table S (2.4)	0.63822
x Final Payment	\$15,644,959
Present Value	\$9,984,926
TOTAL CHARITABLE VALUE	\$10,000,000

Keep in mind that both the \$1,000 annuity amount, as prorated to the date of death, and the final payment of \$15,644,959 must be paid. The final payment at death (ignoring any prorated portion of the \$1,000 annuity) is \$400,132 less than the final payment that would be paid in the 20 year term certain trust (\$16,045,091) despite the fact that a 62 year old grantor has a 20 year life expectancy. This difference can be seen as the present value of the "mortality risk" associated with lifetime CLATs. However, the mortality risk is different depending on whether the CLAT provides for a fixed level annuity or a Shark-Fin pattern of payments. For example, in order to zero-out a \$10 million contribution to a CLAT for the lifetime of a 62 year old grantor, the charity will receive a fixed level payment of \$663,394,⁶⁸ which is \$27,966 per year more than the 20 year term annuity of \$635,428. Over 20 years, assuming the grantor survives to his or her actuarial life expectancy, the lifetime CLAT would cumulatively pay \$559,322 more to charity.

This difference reflects the inverse relationship that fixed level-annuity lifetime CLATs have when compared to lifetime Shark-Fin CLATs. If the grantor of a fixed level-annuity CLAT dies significantly before life expectancy, charity receives less than it anticipated and the

⁶⁸ Table S annuity factor for a 62 year old (1.8% § 7520 rate) of 16.1105 multiplied by the annuity (\$620,713) equals \$10 million. See TABLE S, *supra* note 64.

remainder beneficiaries reap the benefit of more wealth transfer. Of course, if the grantor dies long after his or her life expectancy, charity receives more than it anticipated. By contrast, if the grantor of a lifetime Shark-Fin CLAT dies significantly before life expectancy, charity receives final payment earlier than it anticipated and the remainder beneficiaries do not realize as much wealth transfer. In fact, if the grantor of a lifetime Shark-Fin CLAT dies at the very beginning of the term, there is a high probability that the CLAT will not have sufficient assets to pay the \$15.6 million due to charity (with the remainder beneficiaries obviously receiving no assets) unless the "over-funding" required to satisfy the 110 year exhaustion test is sufficiently large to make the payment.⁶⁹ As mentioned above, a term-of-years Shark-Fin CLAT actually provides a higher probability of charity receiving its entire share, whereas with a lifetime Shark-Fin CLAT, charity's share could be at risk if the grantor dies before his or her life expectancy. This mortality risk may be hedged by the CLAT purchasing insurance on the life of the grantor although there are a number of issues regarding the use of life insurance in CLATs, as we discuss later in this article.

2. *A Foray into Actuarial Computations*

Based upon the examples provided in Publication 1457, it is not readily evident how to calculate the value of the charitable interest and, thus, zero-out (ignoring any over-funding that may be required to satisfy the 110 year exhaustion test) a contribution to an annually increasing back-loaded CLAT (as opposed to the Shark-Fin CLAT, which is essentially a fixed annuity and a fixed payment at death). For those willing to tackle the challenge of actuarial computations, however, there seem to be a number of different methodologies that can be utilized, one of which we describe below. For the less actuarially inclined, the IRS has a procedure for requesting special actuarial factors.⁷⁰ The preamble to the § 7520 Treasury Regulations provide that unusual situations may be "computed by the taxpayer or, upon request, by the Internal Revenue Service for the taxpayer, by using actuarial methods consistent with those used to compute the standard section 7520 actuarial factors."⁷¹

⁶⁹ I.R.C. § 25.7520-3 provides that the standard § 7520 annuity factor may not be used if the trust will exhaust itself. *See* Treas. Reg. § 25.7520-3(b)(2)(i). This provision may require that all lifetime term Shark-Fin CLATs must be initially "over-funded" regardless of whether the Shark-Fin would satisfy the 110 year exhaustion test.

⁷⁰ *See* I.R.C. § 20.2031-T(d)(4) (corresponding temporary regulations were finalized and removed without any changes on Aug. 10, 2011, T.D. 9540, 76 Fed. Reg. 49570-01); *See also* I.R.C. § 25.2512-5(d)(4) (corresponding temporary regulations were finalized and removed without any changes on Aug. 10, 2011, T.D. 9540, 76 Fed. Reg. 49570-01).

⁷¹ Preamble to the Treasury Regulations applicable to I.R.C. § 7520.

One method that is “consistent with those used to compute the standard section 7520 actuarial factors” uses a standard present value formula and the probability of survival based on the 2000 mortality tables utilized by the IRS.⁷² At a § 7520 rate of 2.4%, Table S (single life annuity factors) of Publication 1457 provides an annuity factor of 15.074 for “ordinary” (fixed level) annuities.⁷³ If, as we have assumed throughout this article, the grantor is zeroing-out a \$10 million contribution, this equates to a \$663,394 fixed level annuity for the life of a 62 year old grantor (\$663,394 x 15.074 = \$10,000,000). In arriving at this figure, the IRS actuaries, in all likelihood, utilized the equations and methodology set out in this diagram:

Lifetime CLAT Formula: Mortality-Adjusted Present Value

Standard Present Value (PV) Formula for a Future Sum

$$PV = \frac{FV}{(1+i)^n}$$

FV = Value (annuity) at time n
 i = interest rate (7520 rate)
 n = number of periods (years)

Present Value (PV) for Series of Future Payments

$$PV = \sum \frac{FV}{(1+i)^n} = \frac{\$663,394}{1.024} + \frac{\$663,394}{(1.024)^2} + \frac{\$663,394}{(1.024)^3} + \dots + \frac{\$663,394}{(1.024)^{48}}$$

Mortality-Adjusted Present Value (MAPV) for Series of Future Payments

$$MAPV = PV \times P_n = \frac{\$663,394 \times 99.38\%}{1.024} + \frac{\$663,394 \times 98.08\%}{(1.024)^2} + \frac{\$663,394 \times 96.7\%}{(1.024)^3} + \dots + \frac{\$663,394 \times 0.01\%}{(1.024)^{48}}$$

P_n = Probability of surviving to time n
 (Table 2000CM)

As the foregoing diagram shows, the value of the charitable deduction under § 7520 for lifetime CLATs is essentially the sum of the present values of each annual payment with each present value then multiplied by the probability of the grantor surviving that year (the

⁷² Table 2000CM from IRS Publication 1457 provides, based initially on 100,000 lives, the number of individuals alive at each age. For example, the lx value at age 0 is 10000 and the lx value at age 1 is 99305. Thus, the probability of not surviving from year 0 to 1 year is 0.695% [(10,000 - 99,305)/10,000], which in turn means the probability of surviving from age 0 to 1 is 99.305%. See INTERNAL REVENUE SERVICE, SECTION 7520 ACTUARIAL TABLES, available at <http://www.irs.gov/retirement/article/0,,id=206601,00.html> (last visited Nov. 6, 2011).

⁷³ See *id.*

“Mortality-Adjusted Present Value”).⁷⁴ Based on the foregoing formula, we calculated that in order to zero-out a \$10 million contribution to a lifetime CLAT for a 62 year old grantor using a 2.4% § 7520 rate with annual increases of 20% and 50%, the first payments at the end of the first year would be \$28,158.27 and \$25.20 respectively.

Using these initial payments, a chart could be developed showing annual and cumulative payments over the grantor’s lifetime. Such a chart would show that by the end of year 20 (life expectancy according to the 2000 mortality tables), the level annuity would have cumulatively paid to charity \$13.3 million, whereas the 120% and 150% back-loaded annuities would have paid \$5.3 million and \$167,553 respectively to charity. That difference is startling in terms of amounts paid to charity and, consequently, amounts transferred to the remainder beneficiaries if death occurred at that time. It is not until the 27th year that more would cumulatively be paid in the 120% annuity pattern than the level annuity, and by the 36th year, the 150% annuity pattern would cumulatively pay more to charity than the 120% annuity. However, the probability of the grantor living 36 years, according to the 2000 mortality tables is approximately 4%.⁷⁵ In the 36th year, the annual amount payable to charity for the 120% and 150% annuities would be approximately \$16.6 million and \$36.7 million respectively.

⁷⁴ In arriving at the Mortality-Adjusted Present Value, three important adjustments should be noted:

First, inexplicably, to arrive at the exact figures set out in Table S, the probability of survival is not simply the probability of surviving to the end of each year (notwithstanding that all of the Table S figures are based on payments being made at the end of each year). Apparently, in the calculation, the IRS uses a figure that is based on the probability of the grantor dying half-way through the year in question. To arrive at this figure, take the average of the probabilities of (i) living to the end of a year, and (ii) living to the end of the following year, and you have the probability of living to halfway through the first year. Based upon Table 2000CM, the *lx* (number of lives at age *x*) value at age 62 is 85691. The *lx* value at age 65 and 66 are 82224 and 80916 respectively. Thus, the probability of living to age 65 is 95.95% ($1 - [(85961 - 82224) / 85691]$) and the probability of living to age 66 is 94.43% ($1 - [(80916 - 82224) / 85691]$). The probability of living to 65 ½ years of age is the average of those two percentages, which is 95.19%. That equates to year 4 of the CLAT for a grantor who is 62 years of age because by the end of year 4 the grantor is deemed to be age 66).

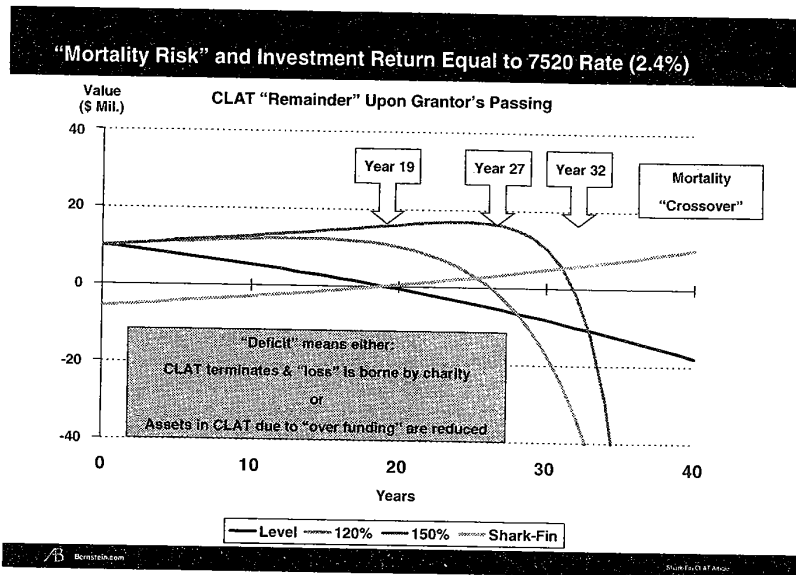
Secondly, the 2000 mortality table assumes no grantor will survive to 110 years of age. As such, the sum of the present value calculations end in the 48th year for a 62 year old grantor.

Finally, because Mortality-Adjusted Present Value calculates the present value of each payment, the payment can vary year-over-year. As such, this formula can be used to calculate an increasing annuity payment or a Shark-Fin, for that matter. *Id.*

⁷⁵ Note, the actual probability of a 62 year old living until the end of the 36th year (reaching age 98) is actually less than 3.5%, but the percentage cited above reflects the probability of living half-way through the year in question. *Id.*

3. Implications of Mortality Risk

As illustrated, the “mortality risk” associated with different increasing annuity structures can lead to wildly different amounts being required to be paid to charity over the life of the trust. Of course, this “mortality risk” must be balanced against the wealth transfer benefits to the remainder beneficiaries, which, in turn, is dependent on the investment return of the CLAT prior to the death of the grantor. As a starting point, consider the following diagram, which shows the “remainder” values (again, ignoring any assets from the reinvestment of any “over funding”) that would result if the 62 year old grantor died at some point over the next 40 years and the CLAT assets had an annual compound return exactly equal to the § 7520 rate (the IRS assumption on return) at the time of funding:



There are three significant points in time to consider (mortality “crossover”). First, in Year 19 (very close to life expectancy according to the mortality tables), the level annuity CLAT has exhausted its assets, and the CLAT goes into a “deficit.” Of course, for the grantor this is not truly a “deficit” or a continuing liability. In this instance, either (i) the CLAT will terminate because it does not have any assets and this “loss” is theoretically borne by the charity that otherwise would have continued to receive annual payments if the grantor had survived past this year; or (ii) the additional assets that were reinvested due to an

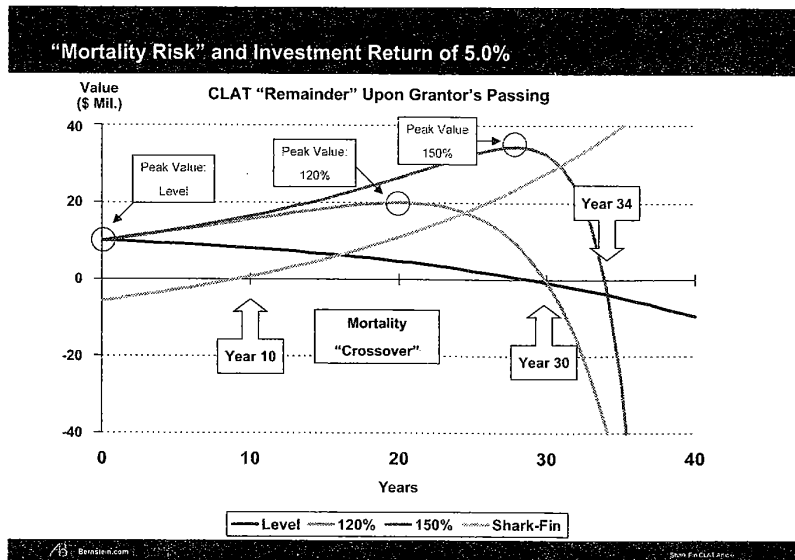
“over-funding” of the CLAT will begin to be reduced and this “loss” is theoretically borne by the remainder beneficiaries that otherwise would have received these assets if the grantor had died prior to this time. Also by year 19, the Shark-Fin CLAT assets start to exceed the \$15.6 million required payment to charity. The Shark-Fin CLAT, which initially had significant mortality risk, no longer has such risk; the longer the grantor lives past this point, the larger the remainder becomes.

Second, in Year 27 (grantor would be 89 years of age), the 120% back-loaded annuity CLAT goes into deficit. Third, in Year 32 (grantor would be 94 years of age), the 150% back-loaded annuity CLAT goes into deficit. Despite the fact that cumulatively the 150% back-loaded annuity CLAT would not have paid more to charity until the 36th year (as discussed above), if the assets earn exactly the § 7520 rate, mortality “crossover” occurs by year 32. It is also at this point that the Shark-Fin CLAT has more wealth transfer than all of the other CLATs.

It is notable that all of the annually increasing remainder values are above the level annuity CLAT until the CLAT goes significantly into a “deficit.” However, as mentioned above, this “deficit” is a phantom liability with respect to the grantor, and a theoretical loss to the remainder beneficiaries in that they receive less than they otherwise would receive had the “over-funded” assets been given to them. As such, because of the mortality-adjusted formulas used by § 7520, from a wealth-transfer perspective, there are compelling reasons to take advantage of the most severe back-loading possible in lifetime CLATs but perhaps not the Shark-Fin, which has a guaranteed “deficit” in the first few years. Of course, these illustrations have been limited to the annual increases of 20% and 50%. Imagine how far out the mortality “crossover” point would be with a 75% or 100% annual increases.⁷⁶

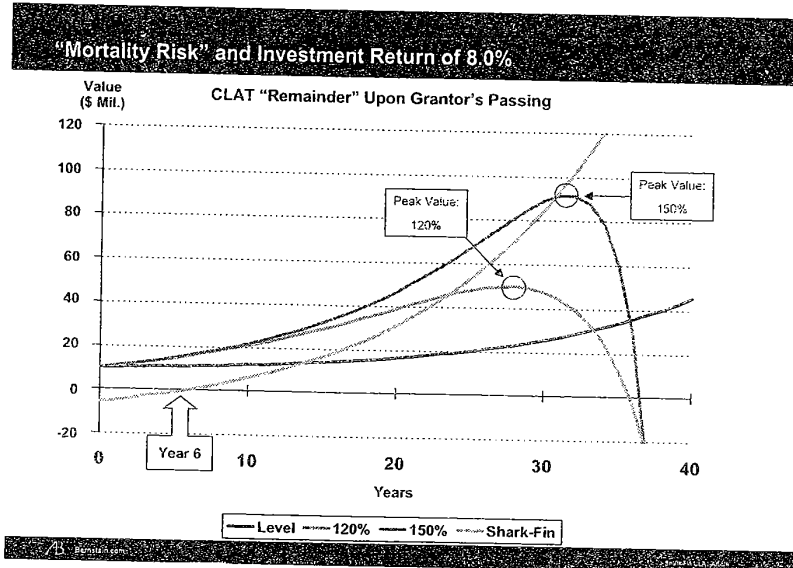
One hopes and expects that the investments of the CLAT will exceed the § 7520 rate. If the CLAT assets earned 5% per year, “mortality risk” and wealth transfer benefits change significantly, as shown by the following diagram:

⁷⁶ Based on our calculations mortality “crossover” with a 75% annually increasing payment would occur in year 35 (assuming a compound annual rate of return equal to the § 7520 Rate). *Id.*



As one can see, a very different picture starts to emerge when the assets exceed the § 7520 rate. Notably, in Year 10, the Shark-Fin CLAT has assets that exceed the \$15.6 million charitable payment. From this point forward, if the grantor survives, the remainder value continues to increase and by the 31st year will exceed all of the other CLATs. Next, in Year 30 (grantor would be 92 years of age), the 120% back-loaded annuity CLAT goes into deficit, but the peak remainder value was in the 20th year. However, you will note that the remainder value is never above the 150% back-loaded annuity CLAT. You will also note that by the 29th year, the level annuity CLAT has gone into deficit. This is 10 years past the point it would have gone into deficit at the assumed § 7520 rate, so investment return can significantly change the mortality risk associated with lifetime CLATs by extending the mortality "crossover" point. However, as with the previous rate of return, for level annuity lifetime CLATs, the peak remainder value was at the outset of the term. Finally, in Year 34 (grantor would be 96 years of age), the 150% back-loaded annuity CLAT goes into deficit, but the peak remainder value was in the 28th year. As between the 120% and 150% back-loaded annuity CLATs, grantors who are looking to maximize wealth transfer would always choose the 150% back-loaded annuity because the remainder values are always greater than the 120% CLAT and the "mortality" crossover point is later.

If the investment return is even higher, say 8.0% per year, the “mortality risk” and wealth transfer picture changes even more. Consider the following diagram:



As one can see, when the investment return is 8% per year, “mortality risk” becomes largely irrelevant and what annuity structure a grantor may choose is largely dependent on the outlook for his or her longevity. Thus, in Year 6, the Shark-Fin CLAT has assets that exceed the \$15.6 million charitable payment. Perhaps more significantly, it is not until the 36th year when the grantor will be 98 years of age that the Shark-Fin remainder will be greater than the 150% annually increasing CLAT. The probability of the grantor living to that age is 4.1%, according to the methodology used by the IRS. In contrast, the traditional level-annuity CLAT has no mortality risk at all (unlike all of the other annuity patterns). At this rate of return, regardless of how long the grantor survives, the assets continue to grow. In Year 37 (grantor would be 99 years of age), both the 120% and 150% back-loaded annuity CLATs go into a “deficit.” Peak remainder values are in Years 28 and 32 respectively. As with the other rates of return, if the grantor seeks to maximize wealth transfer to the non-charitable beneficiaries, and the grantor is opting for an annually increasing annuity, the grantor should always choose the higher annual increase (in this case, 150%).

The "mortality risk" (whether defined in relation to maximum wealth transfer or the point that the CLAT will go into "deficit") associated with each of these annuity patterns has a number of significant planning implications for Shark-Fin, annually increasing, and level-annuity CLATs. The lifetime Shark-Fin CLAT has significant mortality risk but only at the outset of the CLAT when the probability of death is the lowest. While higher rates of return would reduce that risk, it would not fully eliminate it (unless one assumed astronomical rates of return). Interestingly, regardless of the assumed rates of return, the Shark-Fin CLAT will have the most wealth transfer only by Year 32 (based upon a grantor who is 62 years of age), so unless the grantor has confidence that he or she will survive to that point, an annually increasing CLAT is probably a better choice. Because of this dynamic, life insurance would be the optimal investment to consider because mortality costs would be the smallest in the first few years, and the need for insurance would minimize over time. However, as discussed later in this article, life insurance in a CLAT may be problematic. Thus, planners might want to consider holding the life insurance outside of the CLAT, perhaps in an irrevocable life insurance trust for the benefit of the CLAT's non-charitable beneficiaries to avoid a number of those issues.

With annually increasing lifetime CLATs, because a "deficit" is borne by charity (and under some circumstances, the remainder beneficiaries) and does not become an obligation of the grantor, grantors should choose higher annual increases if maximizing wealth transfer is the primary goal. As the foregoing discussion and diagrams show, higher annual annuity increases provide higher remainder values and more extended mortality "crossover." We have limited the discussion in this article to 50% annual increases, but larger increases should be considered. Because the remainder value is greatest with 150% back-loaded CLATs for 32 years in this example (62 year old grantor), regardless of investment return, a complementary estate planning strategy that planners might consider in conjunction with this CLAT is a series of zeroed-out GRATs (longer term or short-term "rolling" or both) because GRATs are most successful when the grantor has longevity.

With level-annuity lifetime CLATs, the only time it has substantial wealth transfer benefits over the other annuity patterns is when the investment return far exceeds the § 7520 rate. Even when the investment return is 5% (significantly greater than the § 7520 rate), the CLAT collapses in the 29th year. With an investment return of 5%, the grantor would have been better off with a 150% back-loaded annuity CLAT, which collapses in the 34th year, but during the entire period its remainder values exceed the level annuity CLAT. If the investment return far exceeds the 7520 rate (8% in the diagram above), there is no mortality

risk (even in the first few years when the Shark-Fin CLAT is more vulnerable).

As mentioned above, the 110 year exhaustion test typically requires either an “over funding” of the CLAT, or limiting the term to the shorter of a term of years (determined by when the fund will be exhausted) or the prior death of the measuring life. Up to this point, we have assumed an “over-funding” sufficient to allow the CLAT term to be set for the life of the grantor (the measuring life). From a planning standpoint, however, practitioners should consider limiting the term to the earlier of the death of the measuring life, or a term of years. In the example above with the 62 year old measuring life, if the CLAT is a 150% increasing annuity, the term of years limitation should be set at approximately 30 years because the remainder values peak at or near that point at both the 5% and 8% assumed rates of return and also for the forecasted returns (shown below). Limiting the term to 30 years significantly reduces the amount of required “over funding” (the measuring life is assumed to live until 92 rather than 110 years), and it eliminates the problem of going severely into a “deficit” for both charity and the non-charitable beneficiaries.⁷⁷

Notwithstanding the “mortality risk” statistics and discussion above, it should be noted that the mortality tables used in § 7520 tend to over-estimate the probability of death for most grantors for several reasons. For example, the statistics are based on the 2000 census data.⁷⁸ As such, the data are already 10 years old, and life expectancies have lengthened since then. In additions, the statistics are sex neutral, and female grantors have longer life expectancies than their male counterparts. In addition, the statistics are based on the total population. Generally, grantors of CLATs tend to be wealthier than the general population, and studies have shown that wealthier individuals have longer life expectancies.⁷⁹ Finally, the statistics do not take into account self-selection. In other words, grantors who wish to maximize the amount of wealth transfer to non-charitable beneficiaries but who are

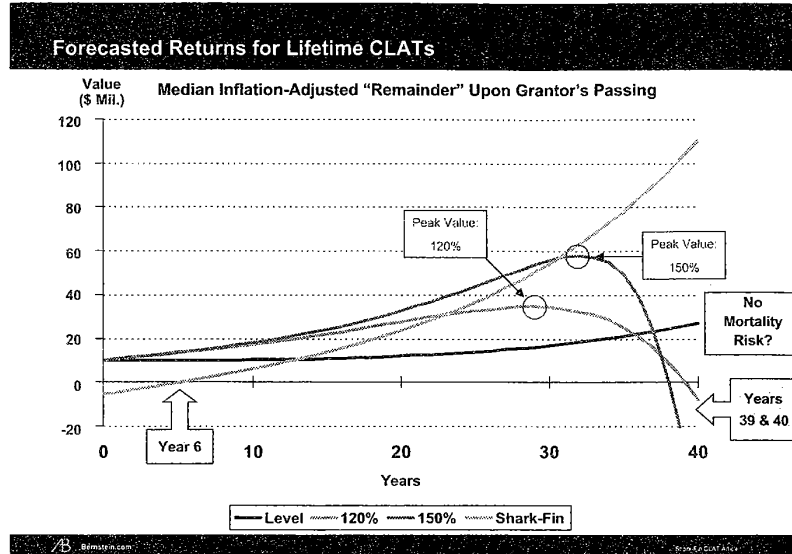
⁷⁷ Of course, those figures ignore the commutation valuation factors in Table H (commutation factors) of IRS Publication 1457, but 30 years is a sufficiently long period of time that they would not substantially change the conclusion. *Id.*

⁷⁸ IRS Publication 1457 provides the factors and tables are taken from the “Life Table for the Total Population appearing as Table 1, in ‘U.S. Decennial Life Tables for 1999-2001’ published by the U.S. Department of Health and Human Services, Public Health Service, National Center for Health Statistics.” INTERNAL REVENUE SERVICE, ACTUARIAL VALUATIONS VERSION 3C, p. 3 (May 2009) available at <http://www.irs.gov/pub/irs-pdf/p1459.pdf>.

⁷⁹ See, e.g., Kim Painter, *Can Wealth Affect Health?* USA TODAY, Mar. 24, 2008 available at http://www.usatoday.com/news/health/painter/2008-03-23-your-health_N.htm (last visited Nov. 6, 2011).

healthy and have a family history of longevity are less likely to create lifetime CLATs because they are more likely to live longer (and pay more to charity) than the mortality tables assume.

Furthermore, the discussion above assumes a constant rate of return. As we have discussed, the path of the investment returns are just as important as the overall magnitude of the returns. Based upon Bernstein's forecasts of investment returns for global equities, the median inflation-adjusted remainder values over the next 40 years for these lifetime CLATs are in the diagram below:

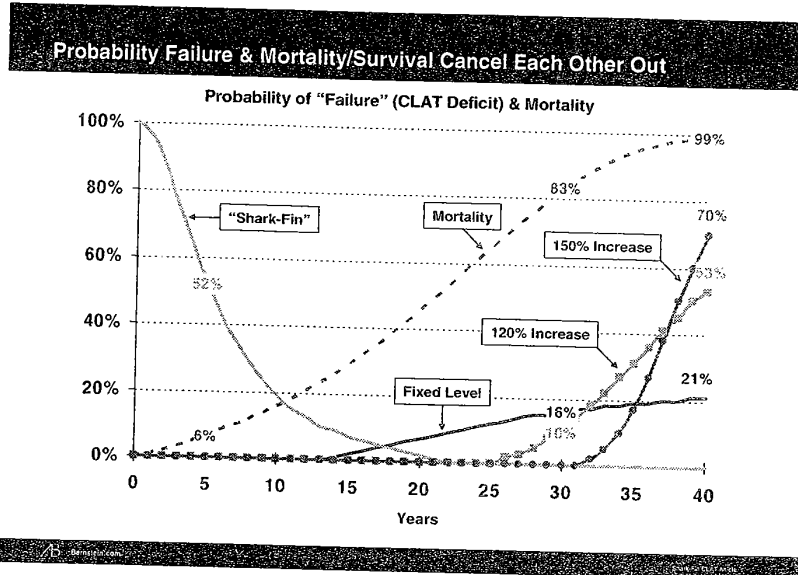


As one can see, based upon this forecast of returns, the mortality risk profile is similar to the assumed 8% annual return above (although these are inflation-adjusted values, so the nominal returns are on average greater than 8%).⁸⁰ However, "mortality risk" for all of the lifetime CLAT annuities is greatly minimized. For the Shark-Fin CLAT, mortality crossover is expected to occur by Year 6, and by Year 31, the remainder values will exceed those of the other CLATs. For the 150% back-loaded CLAT, peak value occurs in Year 32, and the CLAT is not expected to go into a deficit until Year 39 (at which point the grantor

⁸⁰ Based on Bernstein's forecast of returns, global equities will have a median compound annual growth rate of slightly higher than 9% over the next 40 years. https://www.alliancebernstein.com/abcom/segment_homepages/private_client/us/pcus.htm (last visited Nov. 6, 2011).

would be 101 years of age). In contrast to the 5% assumed rate of return, the 120% back-loaded CLAT has virtually no mortality risk, but peak value is expected to occur in Year 28. As with the previous diagram, the level annuity CLAT has no mortality risk

These are, of course, median or 50th percentile results, and although the chart implies that both the 120% and level annuity CLATs have little or no mortality risk, the real probabilities of “failure” (the CLAT going into a “deficit”) due to investment returns and death occurring at different times is illustrated below:



The solid lines (both smooth and with markers) show the probability of each lifetime CLAT exhausting its assets, but assumes the grantor survives for 40 years. The dotted line shows the probability of the grantor passing away over the next 40 years. These two variables tend to cancel each other out because when probability of failure (due to investment returns and the cumulative charitable payments) is highest, the probability of mortality or survival is quite low.

By way of example, consider three specific time periods. In Year 5, there is a 52% chance that the Shark-Fin CLAT will go into a “deficit” but the probability of death occurring at this point is only 6% according to the mortality tables (as computed by the IRS). There is no chance, according to these forecasted returns, that any of the other CLATs will be in a “deficit” at that point. In Year 30, the level annuity and the

120% back-loaded CLATs have a 16% and 10%, respectively, chance of being in a deficit at such time. However, there is an 83% chance that the grantor has already passed away at that point. Thus, there is only a 17% chance that the CLAT will still be in existence for those probabilities of failure to occur. Finally, in Year 40, all of the lifetime CLATs (other than the Shark-Fin) have probabilities of failure that range from 21% to 70%. However, there is only a 1% chance that the grantor has survived to that point (102 years of age).

From a probability-weighted standpoint, there does not seem to be a clear winner in terms of which CLAT structure provides the most wealth transfer and the highest probability of the grantor's mortality working for the benefit of the non-charitable beneficiaries. That being said, of the lifetime CLAT structures considered in this article, most practitioners will likely opt for the 150% back-loaded annuity lifetime CLAT. It provides the highest remainder values of all of the other CLATs for 30 years and does not significantly fall under the Shark-Fin values until Year 34. The probability that the grantor will survive to Year 34, according to the mortality tables, is only 7%. As mentioned above, practitioners will likely limit the term to a term of years (set around 30 years of age) and the prior death of the measuring life. Again, we have limited our discussion to an annual increase of 50%; practitioners may want to consider how this mortality risk discussion would be altered if the annual increase exceeded 50%, and how that will likely limit the term of years if a lifetime term is not utilized.

D. Purchasing the Charitable Lead Interest

If a Shark-Fin CLAT is created with a very long term, the remainder beneficiaries may want to consider purchasing the lead charitable interest from the charity. The rationale for considering this purchase is the reasonable assumption that charity would prefer to receive a smaller amount today, rather than having to wait a considerable amount of time for the bulk of the trust assets, particularly if the charity estimates that it can invest those assets at higher rate of return than the prevailing § 7520 rate. Under these circumstances, the remainder beneficiaries could conceivably purchase the charitable lead interest at a significant discount to the actual assets held in the CLAT at the time of purchase. Thus, assuming the state law applicable to the trust provides for the merger doctrine,⁸¹ the remainder beneficiaries could purchase the interest, which would collapse the trust and accelerate the transfer of the assets to them.

⁸¹ See UNIF. TRUST CODE § 402(a)(5) (2005); RESTATEMENT (THIRD) OF TRUSTS § 69 (2003); RESTATEMENT (SECOND) OF TRUSTS § 341 (1959).

To illustrate, consider the following, perhaps extreme, example. In a month when the § 7520 rate is 2.4%, if a grantor contributes \$10 million to a 100 year Shark-Fin CLAT that provides for a \$1,000 annual payment for 99 years, then a fixed payment of \$106,747,065 would be required at the end of the 100th year in order to zero-out the gift. Charity's present right to receive the \$107 million in 100 years may be worth considerably less than the \$10 million contributed. For instance, if charity invested its assets at a 5% compound annual return, the present value of that last payment is worth only \$873,177 (also including \$1,000 each year for the next 99 years). As a result, the remainder beneficiaries might negotiate the purchase of charity's lead interest for, say, \$1 million. The remainder beneficiaries would thus net \$9 million (assuming exactly \$10 million of assets in the trust at the time of purchase).

The self-dealing rules applicable to private foundations (discussed in more detail below) would, in most cases, prohibit the purchase of the charitable lead interest by the remainder beneficiaries if the charity selling the lead interest is a private foundation. The private foundation rules would not apply, however, if (i) the charity in question is a public charity and (ii) the CLAT trustee is an unrelated, independent trustee who is not involved in the negotiation of the transaction and not a party to the transaction.

Commutation clauses are generally prohibited in CLATs. Revenue Procedure 2007-45 provides, "a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period."⁸² At least in form, if the CLAT trustee is not a party to the transaction and the collapsing of the trust under the merger doctrine is forced upon the trustee by the remainder beneficiaries, this transaction would not constitute a commutation. A CLAT with a term so long that a reasonable grantor would not have created the CLAT but for the expectation that the charitable interest would be purchased may be more subject to attack than a CLAT of shorter term.

IV. WHAT ABOUT HIGHER § 7520 RATES?

All of the figures in this article are based on today's § 7520 rate of 2.4%. The obvious question that must be addressed is if interest rates rise from this point, are Shark-Fin or other back-loaded annuity CLATs still compelling? Quite simply, in higher interest rate environments,

⁸² Rev. Proc. 2007-45 § 5.02(1), 2007-29 I.R.B. 89, citing Rev. Rul. 88-27, 1988-1 C.B. 331; See PLR 9844027 (Oct. 30, 1998), where the IRS allowed for prepayment of the charitable lead interest where the payment was an undiscounted amount of all distributions and where the trust was prepaying the charitable lead interest to avoid the imposition of an excise tax under the excess business holdings rules.

Shark-Fin or other back-loaded CLATs become even more important, although the amount of wealth transfer will likely be less than it is when interest rates are very low. CLATs shift wealth whenever the investment returns of the trust exceed the § 7520 rate. The § 7520 rate is currently very low, and forecasted investment returns of global equities (the assumed investment) are relatively high.⁸³ It is not just the § 7520 rate that determines whether a CLAT will result in significant wealth transfer. While the § 7520 rate determines the size of the annuity required to “zero-out” a contribution, it is the magnitude of the return in excess of the § 7520 rate that is more determinative of the resulting wealth transfer. Interest rates and equity returns are correlated. Equity returns have a historical premium above fixed income returns (the equity risk premium). However, there are times when interest rates are very low but expected equity returns are also very low. In that type of environment, even with a low § 7520 rate, a CLAT will result in little or no wealth transfer. Conversely, there are other times when interest rates are high, but expected equity returns are significantly higher. Thus, even with high § 7520 rates, a CLAT would still be compelling in that type of environment.

In order to see how different CLAT annuity structures might perform in a higher interest rate environment, consider the following forecasted results from September 2008 when the prevailing § 7520 rate for CLATs was 4.2%.⁸⁴ For 20 year “zeroed-out” CLATs, the median inflation-adjusted remainder values were forecasted as follows:⁸⁵

As with the current forecasts, for non-grantor CLATs, the Shark-Fin does not produce the most efficient wealth transfer (120% back-loaded CLAT does), but for grantor CLATs, the Shark-Fin results in the highest remainder values and probabilities of success. However, when compared with the current forecasts, the remainder values are approximately 40% lower, and the probabilities of failure are significantly higher. As mentioned above, failure with a CLAT means that no assets return to the grantor (as with a GRAT, for example), and no wealth passes to the non-charitable beneficiaries. As such, having the highest probability of success is critical. For grantor CLATs, the highest remainder values and probabilities of success result when the back-loading is the steepest. Thus, in higher interest rate environments, back-loading

⁸³ Based on Bernstein’s forecast of returns, global equities will have a median compound annual growth rate of over 9% over the next 40 years. https://www.alliancebernstein.com/abcom/segment_homepages/private_client/us/pcus.htm (last visited Nov. 6, 2011).

⁸⁴ *Section 7520 Interest Rates for Prior Years*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/businesses/small/article/0,,id=204934,00.html#2008> (last visited Nov. 6, 2011).

⁸⁵ Martin Hall & Paul S. Lee, *Innovative CLAT Structures: Providing Economic Efficiencies to a Wealth Transfer Workhorse*, SS045 ALI-ABA 809, 842 (June 2011).

Median Wealth Transferred \$10 Million, 20-Year Term CLAT (Real)				
	Fixed	120%	150%	Shark-Fin
Non-Grantor CLAT	\$7.4 Mil.	\$10.3 Mil.	\$10.5 Mil.	\$9.9 Mil.
Probability of Success	87%	90%	89%	86%
	Fixed	120%	150%	Shark-Fin
Grantor CLAT	\$8.1 Mil.	\$13.0 Mil.	\$15.6 Mil.	\$17.2 Mil.
Probability of Success	87%	93%	94%	95%

becomes even more critical for both charitable and non-charitable beneficiaries. The only way to improve on these results to a point that they would be comparable to the current 20 year forecasts is to extend the term to, for example, 30 years, as seen below:

Median Wealth Transferred \$10 Million, 30-Year Term CLAT (Real)				
	Fixed	120%	150%	Shark-Fin
Non-Grantor CLAT	\$13.8 Mil.	\$19.9 Mil.	\$20.2 Mil.	\$19.2 Mil.
Probability of Success	94%	96%	94%	93%
	Fixed	120%	150%	Shark-Fin
Grantor CLAT	\$17.5 Mil.	\$32.4 Mil.	\$36.5 Mil.	\$38.3 Mil.
Probability of Success	94%	>98%	>98%	>98%

V. IS A SHARK-FIN CLAT ADVISABLE?

Notwithstanding the superior wealth transfer results with grantor Shark-Fin CLATs, there are number of reasons why most grantors should not choose the Shark-Fin annuity, but rather should consider annually increasing annuities (like 120%, 150% or greater back-loading). First, as discussed above with lifetime term CLATs, the Shark-Fin is virtually guaranteed to fail if the grantor (or other measuring life) dies in the first few years. Although very high returns would shorten that time period, those high returns result in more wealth transfer with the annually increasing annuities than the Shark-Fin (unless the grantor or other measuring life lives far beyond life expectancy).

Second, although term CLATs do not have the same type of mortality risk as lifetime terms, as discussed later in this article, if the grantor dies during the term of a grantor CLAT, the trust becomes a non-grantor trust, resulting in recapture of a portion of the grantor's income tax deduction taken when the CLAT was formed. We have already seen that the Shark-Fin does not produce the most wealth transfer when the

CLAT is a non-grantor trust because of the inability to efficiently use the charitable deduction under § 642(c). If, in our 20 year grantor Shark-Fin CLAT example, the grantor dies in the first year, the non-charitable beneficiaries would ultimately receive more with a 150% back-loaded annuity than with the Shark-Fin. Although the probability of the grantor dying so early in the term is probably quite low, estate planners are likely to choose 150% back-loaded annuities today because doing so ensures the best results if the grantor dies unexpectedly and provides for remainder values that are comparable to a Shark-Fin if the grantor does survive the term (\$27.1 million vs. \$28.9 million, inflation-adjusted median remainder values).

Although we do not currently see any technical or policy reasons why a Shark-Fin annuity pattern should not be allowable in a CLAT, some practitioners feel that nominal payments each year with a large payment at the end of a term may be pushing the envelope.⁸⁶ For these practitioners, annually increasing annuities of 20%, 50% or greater each year “feels” better than a Shark-Fin. As illustrated above, in today’s interest rate and economic environment, annually increasing annuity CLATs provide results comparable to Shark-Fin CLATs.

There are at least a couple of circumstances when a Shark-Fin annuity pattern would be advisable. First, the nature of the asset (illiquidity, volatility, lack of marketability, etc.) may require a severely back-loaded annuity pattern. Second, for testamentary charitable bequests, a lifetime grantor Shark-Fin CLAT is a superior way of fulfilling that gift. Not only would the Shark-Fin CLAT satisfy the charitable gift, it would likely provide significant wealth transfer and an income tax deduction that the donor would otherwise have foregone. Other than situations similar to these, most planners will likely choose annually increasing annuities over the Shark-Fin.

VI. GRANTOR CLATS

If much of the wealth transfer benefit afforded to the Shark-Fin CLAT is predicated on the trust having grantor trust status over the entire trust, but not also having the trust assets be includible in the estate of the grantor for estate tax purposes, it is crucial that tax planners carefully consider which grantor trust power to use with a CLAT.

A. What Grantor Trust Power?

The typical power used to achieve grantor trust status for a CLAT is one described under § 675(4)(C), namely giving the grantor, or a per-

⁸⁶ Paul S. Lee, *Innovative CLAT Structures: Providing Economic Efficiencies to a Wealth Transfer Workhorse*, SS002 ALI-ABA 1, 12 (Mar. 2011).

son other than the grantor, the power, in a non-fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value.⁸⁷ In Rev. Proc. 2007-45, the promulgated CLAT forms suggest giving someone other than the grantor the power of substitution. Specifically, the Revenue Procedure provides,

[d]uring the Donor's life, [an individual other than the donor, the trustee, or a disqualified person as defined in § 4946(a)(1)] shall have the right, exercisable only in a nonfiduciary capacity and without the consent or approval of any person acting in a fiduciary capacity, to acquire any property held in the trust by substituting other property of equivalent value.⁸⁸

In Private Letter Ruling 9224029, a person who was neither a trustee nor a § 672(a) adverse party had the substitution power exercisable in a non-fiduciary capacity, without the approval or consent of fiduciary. The IRS determined that the CLT was a grantor trust under § 675(4) without discussing any possible self-dealing issue.⁸⁹ The IRS also ruled that the grantor was entitled to a § 2522(a) charitable gift tax deduction equal to the present value of the charitable interest and that no part of the trust property would be includible in the grantor's estate for estate tax purposes.⁹⁰ More recently, however, the IRS has declined to affirmatively rule on the grantor trust status of trusts under § 675(4)(C) saying that such a determination is dependent on all the facts and circumstances.⁹¹

Giving the grantor the retained power of substitution is not, in and of itself, a violation of the private foundation rules (discussed below). However, given the steep penalties for engaging in a self-dealing transaction (as the exercise would be), the IRS could argue that this power is not a bona fide power, and as such, should be ignored for grantor trust purposes. Thus, giving someone other than the grantor the power would seem to be an important safeguard. Some practitioners will want to go further and include additional bases for establishing grantor trust status.⁹²

⁸⁷ I.R.C. § 675(4).

⁸⁸ Rev. Proc. 2007-45 §7(11), 2007-29 I.R.B. 89.

⁸⁹ PLR 9224029 (June 12, 1992).

⁹⁰ *See id.*

⁹¹ *See, e.g.*, PLR 199908002 (Feb. 26, 1999).

⁹² Additional powers, not otherwise discussed in this article, that potentially achieve grantor trust status without causing includibility for estate tax purposes include: (i) permitting the income of the trust, without the approval or consent of an adverse party, to be "applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse." I.R.C. § 677(a)(3); and (ii) using a foreign-situs CLAT because a foreign trust created by a U.S. grantor with one or more U.S. beneficiaries is a grantor trust under § 679. In each case, the facts and circumstances of the client situation should

The IRS has ruled favorably on the grantor trust status of a CLAT involving the application of § 674.⁹³ The grantor's children were the remainder beneficiaries of the trust, but the trustees had the power to add one or more charities as remainder beneficiaries eligible to receive trust corpus upon termination of the term. The grantor had a power to remove the trustees and to appoint successor trustees who were not related or subordinate to the grantor or to any person having a trustee removal power. Neither the grantor nor the grantor's spouse could serve as trustee. The trustees were non-adverse parties under § 672(b). The IRS ruled that the grantor was the owner of the trust under § 674(a).⁹⁴

B. Using Appreciated Property to Pay Charity

With respect to non-grantor CLATs, the IRS takes the position that the satisfaction of the annuity payment with appreciated property is a taxable event, thereby triggering capital gain.⁹⁵ Citing Revenue Ruling 83-75,⁹⁶ the IRS forms provide, “[i]f the trustee distributes appreciated property in satisfaction of the required annuity payment, the trust will realize capital gain on the assets distributed to satisfy part or all of the annuity payment and the trust will be allowed a § 642(c)(1) deduction for the realized capital gains.”⁹⁷

Surprisingly, with respect to grantor CLATs, the IRS takes the same position, notwithstanding that if the grantor “owned” the appreciated property and gave the same property to charity (whether in satisfaction of an enforceable pledge or not), no capital gain would be

be carefully evaluated. For example, with respect to the payment of premiums on life insurance on the life of the grantor or the grantor's spouse, it should be noted that the CLAT needs to have an insurable interest for state law purposes. *See, e.g.*, PLR 9110016 (Mar. 8, 1991) (citing N.Y. INS. LAW § 3205(b)(2) (McKinney 2011)). In this PLR, the Service ruled that the taxpayer who sought to transfer a life insurance policy to a charitable entity would be denied a charitable deduction, in large part, because New York state law would not provide the charitable entity sufficient insurance interest in the policy. PLR 9110016 was later revoked by PLR 9147040 (Nov. 22, 1991) because New York state law was subsequently amended to allow the immediate transfer of an insurance policy to charity, and allowing the charitable entity to obtain an insurable interest. Thus, the taxpayer indicated to the Service that it was not going to proceed with the transaction in question and the earlier PLR was revoked.

⁹³ PLR 199936031 (Sept. 10, 1999). The IRS did point out that the exception to § 674(a) under § 674(c) does not include a power held by non-adverse parties to add to the beneficiaries who are entitled to receive trust corpus.

⁹⁴ *Id.*

⁹⁵ *See* Rev. Proc. 2007-45 § 5.02(2), 2007-29 I.R.B. 89.

⁹⁶ Rev. Rul. 83-75, 1983-1 C.B. 114.

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⁹⁶ Rev. Rul. 83-75, 1983-1 C.B. 114.

⁹⁷ Rev. Proc. 2007-45 § 5.02(2), 2007-29 I.R.B. 89.

initial income tax deduction upon contribution and not realizing sufficient taxable gain during the term of the CLAT is covered by the recapture rules of § 170(f)(2)(B), as discussed in more detail later in this article. Nonetheless, the IRS position is clear: the satisfaction of a charitable annuity in a grantor CLAT with appreciated assets triggers capital gain.

C. Grantor to Non-Grantor Trust Status

When a grantor either relinquishes the power that affords him or her grantor trust status or dies during the term of the CLAT, the trust becomes a non-grantor trust. Under those circumstances, three significant consequences must be considered:

- Income tax consequences resulting from the change in status;
- Recapture of the original income tax deduction; and
- The ongoing § 642(c) deduction from that point forward.

1. *Income Tax Consequences*

The termination of grantor trust status during the lifetime of the grantor is treated as the transfer by the grantor of the trust assets to a non-grantor trust (separate taxpayer) in exchange for any consideration given to the grantor for the transfer.¹⁰⁹ Typically, the simple relinquishment of grantor trust powers does not involve any consideration. Thus, unless the trust holds property encumbered with debt in excess of the adjusted tax basis (which will cause the grantor to realize gain on the constructive transfer),¹¹⁰ there should be no income tax consequence upon a change in tax status. Assuming no debt, the constructive transfer will result in a gratuitous transfer for income tax purposes, with the trust receiving assets with a carryover basis under § 1015.

The income tax treatment of the termination of grantor trust status as a result of the grantor's death is less clear because there is no court case, Treasury Regulation or ruling that directly addresses this issue. In all likelihood, a change in grantor trust status will not be considered a taxable event.¹¹¹ Notwithstanding the foregoing, the IRS may take the

¹⁰⁹ See *Madorin v. Comm'r.*, 84 T.C. 667 (1985); Treas. Reg. § 1.1001-2(c), Ex. 5; Rev. Rul. 77-402, 1977-2 C.B. 222.

¹¹⁰ Treas. Reg. § 1.1001-2.

¹¹¹ See generally *Crane v. Comm'r.*, 331 U.S. 1 (1947) (holding that upon death of grantor, the beneficiary was still allowed to exclude deductions from consideration in computing a gain); Rev. Rul. 73-183, 1973-1 C.B. 364 (finding that the passing of property upon descendant's death does not constitute a realization of income, even if the value of such property has appreciated since acquired by decedent); Jonathan G. Blattmachr, Mitchell M. Gans, & Hugh H. Jacobson, *Income Tax Effects of Termination of Grantor*

position that the termination should be treated as a constructive transfer (like a change in status during lifetime, as discussed above). As mentioned above, generally, this will not be an issue under most circumstances and, even if debt existed on the property, the basis adjustment rules of § 1014 would seemingly apply.

In the unusual circumstance where a non-grantor CLAT is converted to a grantor CLAT,¹¹² the conversion will not be considered a transfer for income tax purposes.¹¹³

2. Recapture

The Code provides, in pertinent part:

[i]f the donor ceases to be treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution.¹¹⁴

Effectively, this Code provision provides at the time of relinquishment or death, an amount of income may be included on the grantor's income tax return to "recapture" the benefit of the original income tax deduction if the grantor has not effectively given back that benefit in terms of realized income over the time that the trust was a grantor trust. Interestingly, while the Code calculates the recapture amount in terms of "income earned by the trust and taxable to the" grantor, the Treasury Regulations calculate the recapture amount in terms of amounts paid to charity. The Treasury Regulations provide:

[i]f for any reason the donor of an income interest in property ceases at any time before the termination of such interest to be

Trust Status by Reason of the Grantor's Death, 96 J. TAX'N 149, 149-151 (2002); Elliot Manning & Jerome M. Hesch, *Deferred Payment Sales to Grantor Trusts, GRATs and Net Gifts: Income and Transfer Tax Elements*, 24 TAX MGMT. EST. GIFTS & TR. J. 3, 21-26 (1999) (arguing that upon death, neither the grantor nor his estate recognize gain on death and therefore it is not a taxable transaction).

¹¹² This would occur if there is an appointment of related or subordinate trustee to replace an independent trustee. See I.R.C. § 674(c). There are other circumstances where this would occur but they would likely be considered self-dealing transactions under the private foundation rules.

¹¹³ I.R.S. Chief Counsel Advice 200923024 (June 5, 2009).

¹¹⁴ I.R.C. § 170(f)(2)(B).

treated as the owner of such interest for purposes of applying section 671, as for example, where he dies before the termination of such interest, he shall for purposes of this chapter be considered as having received, on the date he ceases to be so treated, an amount of income equal to (i) the amount of any deduction he was allowed under section 170 for the contribution of such interest reduced by (ii) the discounted value of all amounts which were required to be, and actually were, paid with respect to such interest under the terms of trust to the charitable organization before the time at which he ceases to be treated as the owner of the interest.¹¹⁵

As such, there remains the possibility that as long as amounts that are "required to be, and actually were, paid" to charity in a grantor CLAT, no recapture of the income tax deduction will occur, even if little or no income becomes taxable to the grantor. In fact, § 170(f)(2)(B) provides that "[t]he Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph."¹¹⁶ As such, the Treasury Regulations may not be in conflict with the Code but rather are an alternative method of avoiding recapture of the income tax deduction.

In either case, whether the recapture amount is calculated against trust income taxable to the grantor or payments made to charity, the maximum amount includible in gross income is the original deduction amount even if the recapture event occurs many years after the original contribution. In other words, even if the entire recapture amount is recognized, the grantor had the time benefit of the income tax deduction (assuming the donor is able to use the deduction given the lower threshold limits applicable to charitable contribution deductions generated through CLATs).

3. *The Remaining § 642(c) Deduction*

The Treasury Regulations point out that upon termination of grantor trust status, after recapture has been calculated and recognized, the trust becomes a non-grantor trust, entitled to any then allowable § 642(c) deduction.¹¹⁷ As such, recapture of the deduction under § 170(f)(2)(B) is not a loss of the deduction. Rather, the deduction is converted to a charitable deduction under § 642(c). In the case of a CLAT it may often produce a larger aggregate deduction than the origi-

¹¹⁵ Treas. Reg. § 1.170A-6(c)(4); See Treas. Reg. § 1.170A-6(c)(5), Ex. 3.

¹¹⁶ I.R.C. § 170(f)(2)(B).

¹¹⁷ Treas. Reg. § 1.170A-6(c)(5), Ex. 3(d), provides that after the grantor ceases to be the owner for grantor trust purposes, for the amounts paid to charity "see section 642(c)(1) and the regulations thereunder."

nal deduction. To illustrate, in the extreme Shark-Fin example above, if the trust becomes a non-grantor trust in year 19, even if the entire \$10 million original deduction is recaptured (assuming no taxable income and nominal distributions to charity), the trust would still be entitled to over \$14.3 million in deduction in the last year of the trust when it is a non-grantor trust.¹¹⁸ Interestingly, it is theoretically possible to get both deductions. If, as the Code provides, recapture is calculated by determining the discounted value of the income taxable to the grantor, then, from a planning standpoint, grantor trust status can be relinquished at the point that just enough taxable income is realized by the grantor so that there would be no recapture. From that point forward, the trust would be entitled to offset taxable income with the § 642(c) deduction, with all of the limitations noted above (particularly with the Shark-Fin CLAT) but, just as importantly, without any AGI threshold limitations. This can be particularly useful where the trust holds appreciated assets that otherwise would be used to pay charity in-kind and trigger capital gain tax liability to the grantor, as discussed above. Under these circumstances, grantor trust status can be relinquished and the capital gain realized can be offset fully by the § 642(c) deduction, which is equal in value to the payment to charity.

4. *Income Tax Planning: Grantor to Non-Grantor Trust Status*

One of the significant benefits of contributing to a grantor CLAT is the resulting income tax deduction under § 170(a). This can provide significant tax savings to the grantor if the deduction can be used against ordinary income at the outset, in exchange for deferred grantor trust liability over the term of the CLAT, especially if the CLAT generates income at beneficial tax rates. For example, the grantor could use the deduction to shelter ordinary income tax in exchange for deferred grantor trust liability at long-term capital gain and qualified dividend rates (for example, the CLAT reinvests in U.S. equities) over the next 20 years. Recapture under § 170(f)(2)(B) does not distinguish between ordinary income and long term capital gain. It speaks in terms of “income earned by the trust and taxable to the” grantor.

Grantors can further maximize their income tax savings by monitoring the cumulative grantor trust tax liability over time. When enough income has been earned by the trust under § 170(f)(2)(B), the grantor can relinquish grantor trust status. As mentioned above, the trust then becomes a non-grantor CLAT entitled to offset trust taxable income with the § 642(c) deduction. Because this deduction is limited to the

¹¹⁸ But see *supra* Section II.A., regarding the possible inability of Shark-Fin CLATs to make effective use of this deduction.

charitable payment each year, the grantor should carefully consider what annuity pattern to choose for the CLAT. For example, if a grantor CLAT generates enough income by the 14th year of a 20 year CLAT and the trust becomes a non-grantor trust starting in year 15, a 150% back-loaded CLAT provides for a \$671,844 charitable payment/deduction (which will grow by 50% each year) but the Shark-Fin CLAT still provides for a \$1,000 charitable payment/deduction. It is likely under these circumstances that the 150% back-loaded CLAT will provide sufficient income tax savings vis-à-vis the Shark-Fin CLAT that both the charitable and non-charitable beneficiaries would prefer the 150% back-loaded CLAT over the Shark-Fin CLAT. That being said, losing grantor trust status is often not voluntary, as grantors sometimes die during the terms of CLATs.

VII. PRIVATE FOUNDATION RULES

CLATs are split interest-trusts for which § 508(e) sets forth various governing instrument requirements. In pertinent part the Code provides:

In the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e) (relating to governing instruments) to the extent applicable to a trust described in this paragraph, section 4941 (relating to taxes on self-dealing), section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation.¹¹⁹

If, however, the present value (as determined under § 7520) of the charitable interest does not exceed 60% of the trust assets, the governing instrument of a charitable lead annuity trust is not required to prohibit acquisition and retention of § 4943 excess business holdings and § 4944 jeopardy investments.¹²⁰ Most CLATs are designed to generate

¹¹⁹ I.R.C. § 4947(a)(2).

¹²⁰ See I.R.C. § 4947(b)(3)(A); See also Treas. Reg. § 1.170A-6(c)(2)(i)(D); Treas. Reg. § 20.2055-2(e)(2)(vi)(e); Treas. Reg. § 25.2522(c)-3(c)(2)(vi)(e); Rev. Rul. 88-82, 1988-2 C.B. 336.

a charitable deduction, at least for gift tax purposes, well in excess of 60%. If the private foundation rules are violated, income, estate or gift tax charitable deductions may be disallowed¹²¹ and excise taxes may be imposed.¹²²

Section 508(e) provides that the governing instrument of a private foundation must require the foundation to distribute income in such a way to avoid the excise tax imposed on undistributed income under § 4942. In addition, the governing instrument must prohibit the trust from: (i) engaging in self-dealing under § 4941(d); (ii) retaining excess business holdings under § 4943(c); (iii) making jeopardy investments under § 4944; and (iv) making taxable expenditures under § 4945(d).¹²³

The most common private foundation rules issues arise with CLATs in conjunction with the sale, exchange or leasing of property between the CLAT and a disqualified person and the retention of excess business holdings. A “disqualified person,” in the context of CLATs, includes:

- A “substantial contributor,”¹²⁴ which includes the grantor and any persons “who contributed or bequeathed an aggregate amount of more than \$5,000 to a private foundation, if such amount is more than 2% of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person;”¹²⁵
- A “foundation manager,”¹²⁶ which includes a trustee or any individual having similar powers or responsibilities;¹²⁷
- A “family member”¹²⁸ of any of the foregoing, which includes an individual’s “spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren;”¹²⁹ and
- Trusts in which persons described above own more than 35% of the total beneficial interests.¹³⁰

Fortunately, an exception to the self-dealing prohibitions allows reasonable and necessary compensation to be paid to a disqualified per-

¹²¹ I.R.C. § 508(d)(2).

¹²² See I.R.C. §§ 4941-4945.

¹²³ It would be a rare circumstance that a termination tax would apply to a CLAT, so this provision of the private foundation rules is not further discussed in this article.

¹²⁴ I.R.C. § 4946(a)(1)(A).

¹²⁵ I.R.C. § 507(d)(2)(A).

¹²⁶ I.R.C. § 4946(a)(1)(B).

¹²⁷ I.R.C. § 4946(b)(1).

¹²⁸ I.R.C. § 4946(a)(1)(D).

¹²⁹ I.R.C. § 4946(d).

¹³⁰ I.R.C. § 4946(a)(1)(G). Beneficial interest is determined in accordance with the attribution rules under § 267(d). See I.R.C. § 4946(a)(4).

son, thereby permitting a trustee—including the grantor acting as such—to be compensated. In addition, the IRS has ruled that the payment of fees to an investment management company owned by the grantor's descendants is not an act of self-dealing.¹³¹

The Treasury Regulations do provide an exception for transactions with respect to a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death).¹³² This exception has been relied upon to allow an estate's sale of real property to a disqualified person so that the CLATs could be funded with a promissory note instead of the real property.¹³³

Section 4943 imposes an excise tax on the value of the "excessive business holdings" of a private foundation. A private foundation is deemed to have excess business holdings to the extent that it, together with all disqualified persons, own in the aggregate more than 20% of the voting stock of an incorporated business enterprise.¹³⁴ For unincorporated entities like partnerships and limited liability companies, the percentage ownership requirement is replaced with profits, capital and beneficial interest concepts.¹³⁵

A "business enterprise" includes the active conduct of a trade or business and any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which constitutes an unrelated trade or business under § 513.¹³⁶ A business that derives more than 95% of its gross income from "passive sources" will not constitute a "business enterprise" within the meaning of § 4943, and a foundation's investment in such an entity will not constitute a "business holding."¹³⁷ Gross income from passive sources includes dividends, interest, payments with respect to securities loans and annuities, royalties (whether measured by production or by gross or taxable income from the property in question) rents, and gain from the sale or exchange of property (other than inventory or stock in trade).¹³⁸ Generally, where a private foundation acquires excess business holdings, it has five years from the date of acquisition to dispose of them in order to avoid the imposition of the excise tax.

¹³¹ PLR 200018062 (May 5, 2000).

¹³² Treas. Reg. § 53.4941(d)-1(b)(3).

¹³³ See PLR 200124029 (June 15, 2001), PLR 200024052 (June 16, 2000).

¹³⁴ I.R.C. § 4943(c)(2)(A).

¹³⁵ Treas. Reg. § 59.4943(c)(2).

¹³⁶ Treas. Reg. § 53.4943-10(a)(1).

¹³⁷ I.R.C. § 4943(d)(1), (3)(B).

¹³⁸ I.R.C. §§ 512(b)(1)-(3), (5), 4943(d)(3).

VIII. NON-CHARITABLE BENEFICIARIES AND THE GST
TAX EXEMPTION

A. GST Tax Exemption with CLATs

Most practitioners limit the identity of the non-charitable beneficiaries of a CLAT to persons who are considered “non-skip persons”¹³⁹ for generation-skipping transfer (hereinafter, “GST”) tax purposes. Commonly, CLATs are viewed as wealth transfer vehicles only for the benefit of the grantor’s children, rather than grandchildren or more remote descendants. Unlike other trusts that allow allocation of the GST exemption in an amount equal to the gift taxable portion of the original contribution, § 2642(e) provides that the denominator of the applicable fraction for a trust is not determined until after the termination of the charitable lead term. In calculating the applicable fraction (and thus determining the inclusion ratio for GST tax purposes), the numerator is equal to the “adjusted GST exemption,”¹⁴⁰ which is calculated by starting with the original GST exemption allocated to the trust but increased at a rate of return (over the term of the trust) equal to the § 7520 rate used to calculate the original charitable deductions. The denominator is the value of the trust property at the expiration of the charitable lead term. Thus, if assets out-perform the § 7520 rate, as one typically would expect when rates are low as they are today, then some portion of the remainder will be subject to GST tax if it passes to a skip person. Further, if assets under-perform the § 7520 rate, it effectively results in an over allocation (and loss) of GST exemption.

Although different strategies have been discussed and attempted to circumvent this limitation, the IRS continues to take the position that leveraging of the GST tax beyond the § 7520 rate is impossible. For example, in Private Letter Ruling 200107015, the trustees of a “zeroed-out” 25-year CLAT proposed to amend the trust (pursuant to a power granted to them in the trust document) to allow a portion of the remainder interest to immediately vest in the son of the grantor. It was proposed that the son of the grantor would then make a taxable gift of his vested remainder interest to his own children at a time when the interest was a small portion of the trust assets (approximately 2%, after taking into account the value of the remaining charitable annuity payments). The trustees requested a ruling that the distribution of the gifted remainder interest to the son’s children would not be subject to GST tax because the son is the transferor for such purpose. The IRS ruled that there would be two transferors of the CLAT for GST tax purposes.¹⁴¹

¹³⁹ I.R.C. § 2613.

¹⁴⁰ I.R.C. § 2642(e)(2).

¹⁴¹ I.R.C §§ 2642(e), 7520; See e.g., PLR 200107015 (Feb. 16, 2001).

The son would be the transferor of that fraction of the CLAT assets that was subject to gift tax (2%), and the original grantor would continue to be the transferor of the balance of the CLAT assets.¹⁴²

For charitable lead unitrusts ("CLUTs"),¹⁴³ on the other hand, the gift or estate tax charitable deduction is available to reduce the denominator of the applicable fraction for GST tax purposes, and the denominator is determined based on values at the time of the contribution. Thus, if GST exemption is applied in an amount equal to the original taxable gift,¹⁴⁴ then an inclusion ratio of zero will result, thereby allowing any remainder to pass to skip persons free of GST tax. Thus, many practitioners view CLUTs as a vehicle to use in order to pass wealth to grandchildren, and CLATs as a vehicle that is limited to children.

B. CLATs vs. CLUTs for the Benefit of Grandchildren Today

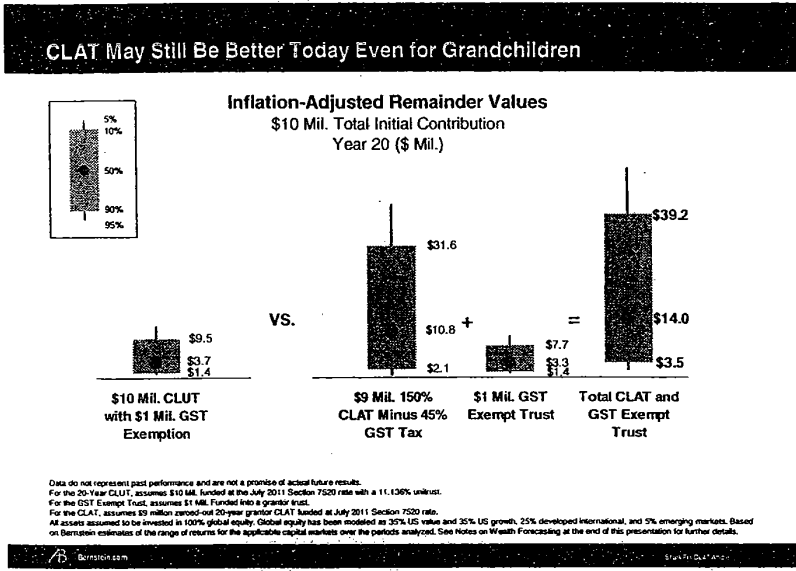
Given how attractive CLATs are today because of the low § 7520 rate, the authors wondered how a CLAT would fare against a CLUT, even if the non-charitable beneficiaries were skip persons for GST tax purposes. Surprisingly, even if one assumes a 45% GST tax rate (currently the rate is 35% under the Tax Relief Act of 2010 but it is unclear what the GST tax rate will be in the future), the CLAT results in significantly more wealth transfer than a comparable CLUT. For purposes of the comparison, we assumed a 20 year grantor CLUT, with an 11.136% unitrust percentage payable to charity, funded with \$10 million. With a § 7520 rate of 2.4%,¹⁴⁵ this results in a taxable gift of \$1 million, and we assumed that the gift was fully covered by a portion of the grantor's applicable gift tax exemption, and that the grantor applied \$1 million of GST exemption to the taxable gift. We compared that CLUT to an "apples-to-apples" comparison, constructed as: (i) a 20 year "zeroed-out" grantor CLAT (150% back-loaded annuities) funded with \$9 million, and (ii) GST exempt grantor trust funded with \$1 million (fully covered by the applicable gift tax exemption). The resulting inflation-adjusted remainder values at the end of the term, after the payment of a 45% GST transfer tax on the CLAT remainder, are displayed below:

¹⁴² See, e.g., PLR 200107015 (Feb. 16, 2001).

¹⁴³ See I.R.C. §§ 170(f)(2), 2055(e)(2)(B), 2522(c)(2)(B) (collaboratively defining a CLUT as a "split-interest" trust that generally provides for an interest in favor of a charitable organization that is a "fixed percentage distributed yearly of the fair market value of the trust property" for income, gift and estate tax purposes). See also PLR 200043029 (Oct. 27, 2000).

¹⁴⁴ One cannot "zero-out" a contribution to a CLUT.

¹⁴⁵ With annual payments and the first payment made at the end of a 12 month period.



As one can see, the median CLUT remainder of \$3.7 million is significantly lower than the CLAT remainder of \$10.8 million (even after GST tax). However, this is just the median outcome of the forecasted results. One of the benefits of a CLUT is that the non-charitable remainder beneficiaries are not disproportionately penalized by negative returns because the charitable payment is a percentage of the value of the assets each year. Thus, even if returns are very bad, the CLUT is guaranteed to pass assets at the end of the term to the remainder beneficiaries. With a CLAT, on the other hand, there may be no assets left. In fact, on this CLAT, there is a 3% chance that there will be no assets left at the end of 20 years. However, because the § 7520 rate is so low today, it's a very small probability, and when one takes into account the assets in the GST exempt trust (which had no required payments to charity), then the CLAT and GST exempt trust combination is a superior strategy to a CLUT today, even with the remainder passing to grandchildren or other skip persons.

IX. INVESTMENT IMPLICATIONS

Section 4944 imposes an excise tax on a private foundation for investing any amount in such a manner as to jeopardize the carrying out of its exempt purposes. The Treasury Regulations provide:

an investment shall be considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is de-

terminated that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. In the exercise of the requisite standard of care and prudence the foundation managers may take into account the expected return (including both income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return).¹⁴⁶

In evaluating whether an investment is jeopardizing, the IRS has generally followed this "prudent trustee" standard, looking to where and how such investment fits in the overall portfolio.¹⁴⁷ The Treasury Regulations provide that no investment is per se considered a jeopardy investment, however "trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of 'puts' and 'calls,' and 'straddles,' the purchase of warrants and selling short" all require close scrutiny.¹⁴⁸

Importantly, the Treasury Regulations provide,

[s]ection 4944 shall not apply to an investment made by any person which is later gratuitously transferred to a private foundation. If such foundation furnishes any consideration to such person upon the transfer, the foundation will be treated as having made an investment (within the meaning of section 4944(a)(1)) in the amount of such consideration.¹⁴⁹

In other words, it is permissible to contribute a speculative investment to a CLAT, but it would be a jeopardizing investment if the cash to purchase that same investment was first contributed and then the trustee of the CLAT made the investment.

CLATs do not have the same restrictions on investments as CRTs. Under the Treasury Regulations, "[a] trust is not a charitable remainder trust if the provisions of the trust include a provision which restricts the trustee from investing the trust assets in a manner which could result in the annual realization of a reasonable amount of income or gain from

¹⁴⁶ Treas. Reg. § 53.4944-1(a)(2)(i).

¹⁴⁷ See, e.g., TAM 9205001 (Jan. 31, 1992); TAM 9627001 (July 5, 1996); see also PLR 9451067 (Dec. 23, 1994).

¹⁴⁸ Treas. Reg. § 53.4944-1(a)(2)(i).

¹⁴⁹ Treas. Reg. § 53.4944-1(a)(2)(ii).

the sale or disposition of trust assets.”¹⁵⁰ This restriction is not applicable to CLATs. That being said, the Treasury Regulations do provide that if the facts and circumstances suggest that charity will not receive some or all of the annuity payments, then any resulting tax deduction will be limited to the minimum amount charity will receive. The Treasury Regulations provide,

[i]f by reason of all the conditions and circumstances surrounding a transfer of an income interest in property in trust it appears that the charity may not receive the beneficial enjoyment of the interest, a deduction will be allowed . . . only for the minimum amount it is evident the charity will receive.¹⁵¹

The examples in the Treasury Regulations focus on circumstances where either by the terms of the trust document or by virtue of state law, the tax deduction should be limited to a lesser amount than would be calculated under § 7520.¹⁵² The examples do not focus on situations involving the investments of the trust. Notwithstanding that fact, because this test is based upon “all the conditions and circumstances” it could conceivably be used to limit or disallow a charitable income or transfer tax deduction. For example, if the trust required the trustee to only invest in deferred annuities that had a return less than the § 7520, then it is quite possible the tax deduction would be reduced using the lower discount rate of return of the deferred annuities.

From an investment standpoint, the ability to back-load the annuity payments in a CLAT allows the trustee to invest in higher volatility (and, theoretically, higher returning) asset classes and strategies. Because failure with a CLAT is unforgiving, in a traditionally structured CLAT the trustee has to balance the competing interests of lower volatility portfolios with higher probabilities of success but lower return potential against higher volatility portfolios with lower probabilities of success but higher return potential. As the following diagram shows, as a CLAT’s asset allocation moves from 100% globally diversified equities toward a more diversified, less volatile portfolio, probabilities of success rise but often at the cost of potential wealth transfer.

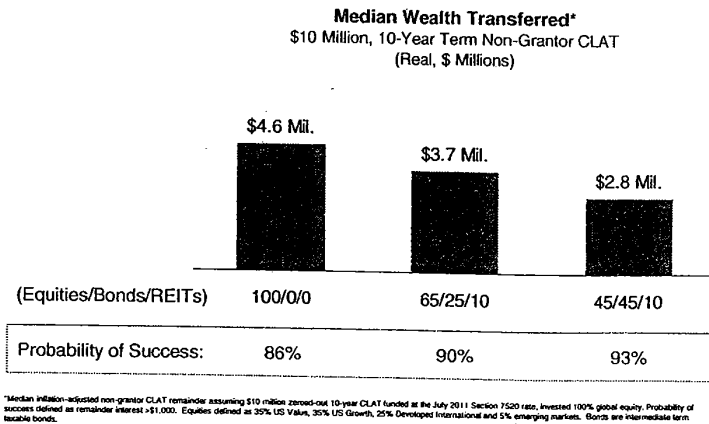
The foregoing examples assume a 10 year, zeroed-out non-grantor CLAT with level annuity payments. The differences between probabilities of success and the projected wealth transfer can be muted by extending the term and making the CLAT a grantor trust. However, as

¹⁵⁰ Treas. Reg. § 1.664-1(a)(3); See PLR 7802037 (Oct. 14, 1977), where a charitable income tax deduction was denied because the trust document required the trustee to invest in tax exempt securities.

¹⁵¹ Treas. Reg. §§ 1.170A-6(c)(3)(iii), 20.2055-2(f)(2)(iv), 25.2522(c)-3(d)(2)(iv).

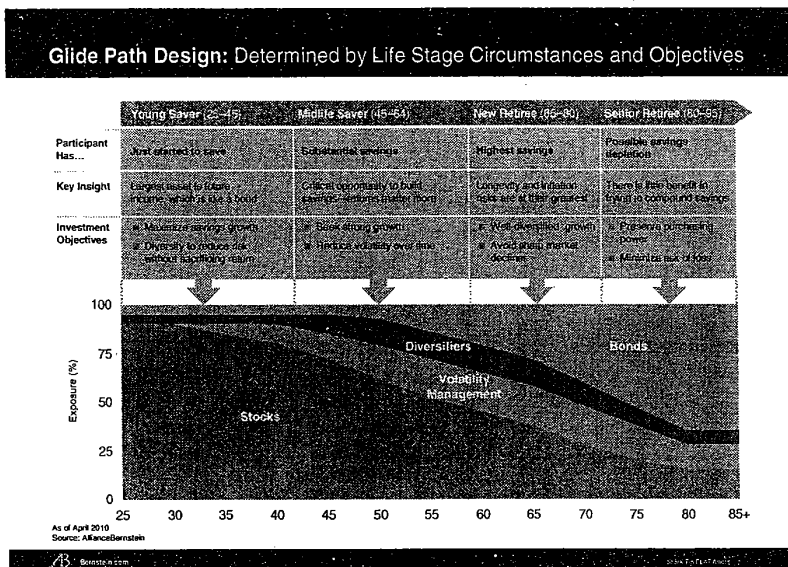
¹⁵² *Id.*

Higher Probabilities of Success at the Cost of Potential Wealth Transfer



pointed out above, higher probabilities of success and higher potential wealth transfer can best be achieved by back-loading the annuity payments in some manner. A trustee need not be as concerned with volatility during the initial years in a CLAT with a sufficiently long term if the bulk of the charitable payments are deferred to the end of the term.

One logical investment implication with back-loaded payments is a concept called “glide path” investing that is common in retirement and educational funding planning (for example, § 529 Plans). “Glide path” investing involves a gradual adjustment of an investor’s asset allocation as the investor gets closer to the point (retirement, matriculation, etc.) at which the portfolio will have significant outlays (living expenses, tuition, etc.). As the theory goes, the more time a portfolio has to be invested without any drawdown, the more volatile the portfolio can be. Thus, over time, as one gets closer to the point at which drawdowns begin, the portfolio should reflect a lower risk profile, as the following diagram on retirement glide path investing shows:



In addition to the foregoing, the flexibility to back-load the annuity payments in a CLAT provides a potential opportunity for planners to contribute certain types of assets and do certain types of planning that historically were not practical. This opportunity arises because very low annuity payments in early years reduce the concern that large mandatory payments each year may either require that the asset be sold to generate funds to make the annuity distribution, or be transferred in-kind to charity at a time when the asset either has no liquidity or very little value.

The planning in this arena is complicated by the application of the private foundation rules, discussed above. However, for careful planners who are willing to take on this additional set of considerations, the benefits to donors and charities can be substantial.

X. PLANNING EXAMPLES

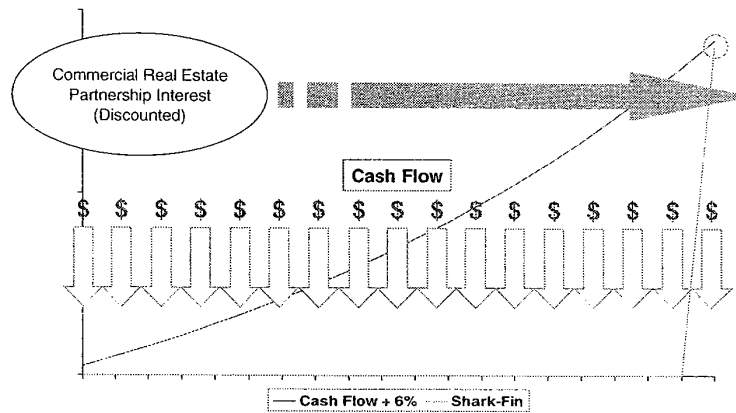
A. Interests of FLPs Holding Commercial Real Property

Interests in family limited partnerships and LLCs (collectively, “FLPs”) owning commercial real property have been thought poor candidates to contribute to CLATs because of the danger that cash flows from the property might fall, leaving insufficient cash to make the annuity payment. The choices at that point were dire: sell or mortgage the underlying property to generate the cash required for the distribution,

distribute FLP interests in-kind and have charity become a partner of the FLP, or have the trustee borrow from a third party in order to make all or a portion of the annual payment.

In a back-loaded CLAT, however, early cash flows from the real property may accumulate and be invested in the CLAT, providing a significant cushion for the larger payments to charity toward the end of the term, as illustrated in the diagram below. The term of the CLAT may be adjusted to ensure a high likelihood that there will be sufficient cash or liquid securities to satisfy the large charitable payments toward the end of the term.

Interesting Application #1: Commercial Real Estate LP Interest



One feature common to commercial real property is the existence of debt. In general, a grantor can transfer mortgaged property to a CLT. If, however, the mortgage was acquired immediately prior to the transfer, UBTI problems may arise.¹⁵³

Private letter ruling 7808067 is instructive. In the ruling, real property subject to a mortgage was transferred to a CLAT. The IRS ruled that there was no acquisition indebtedness for purposes of determining whether the trust had debt-financed income under the UBTI rules because the mortgage had been placed on the property more than 10 years

¹⁵³ See I.R.C. § 514(c)(2)(A).

prior to the transfer.¹⁵⁴ Interest on the mortgage, depreciation, amortization of leasehold, commissions, management expenses, and legal and accounting fees, as well as the annuity paid to the charity were all deductible by the trust and not deemed paid for a private purpose.¹⁵⁵ The ruling held that the excess business holdings provision was inapplicable because conducting the real estate business was found not to constitute a business enterprise on the grounds that over 95% of the gross income was derived from passive sources (i.e., rents).¹⁵⁶ The IRS also ruled that the jeopardy investment provisions were not violated by holding the real estate.¹⁵⁷

As discussed previously,¹⁵⁸ the existence of UBTI in a grantor CLAT is of no consequence. If the grantor dies during the term of the CLAT, however, the trust will become a non-grantor trust and at that point UBTI will impose an impediment to the trust's investment performance because of limitations on the deductibility of the charitable distributions. To facilitate the disposal of the investment under these circumstances, planners should consider contributing the interests in the FLP subject to a purchase option at fair market value. The Treasury Regulations provide that, under the right terms, such a purchase from the CLAT by a disqualified person (for instance, the estate of the grantor) will not be considered an act of self-dealing.¹⁵⁹ Also, it is worth reiterating that if property is encumbered by debt which exceeds the

¹⁵⁴ See I.R.C. § 514(c)(2)(B).

¹⁵⁵ PLR 7808067 (Nov. 28, 1977).

¹⁵⁶ *Id.*

¹⁵⁷ Treas. Reg. § 53.4944-1(a)(2)(i) provides "[n]o category of investment shall be treated as a per se violation of" the jeopardy investment rule. See also PLR 9451067 (Dec. 23, 1994) (ruling that a relatively small investment in distressed real estate would not constitute a jeopardizing investment).

¹⁵⁸ See *supra* Section II.A.

¹⁵⁹ Treas. Reg. § 53.4941(d)-1(b)(1) provides:

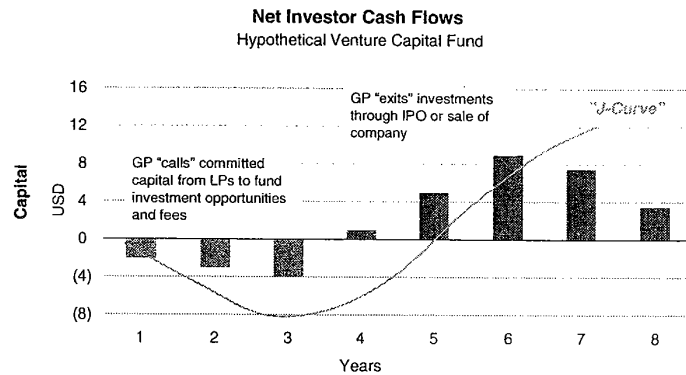
The term "indirect self-dealing" shall not include any transaction described in § 53.4941(d)-2 between a disqualified person and an organization controlled by a private foundation (within the meaning of paragraph (6)(5) of this section) if: [t]he transaction results from a business relationship which was established before such transaction constituted an act of self-dealing (without regard to this paragraph); [t]he transaction was at least as favorable to the organization controlled by the foundation as an arm's-length transaction with an unrelated person, and [e]ither: [t]he organization controlled by the foundation could have engaged in the transaction with someone other than a disqualified person only at a severe economic hardship to such organization, or [b]ecause of the unique nature of the product or services provided by the organization controlled by the foundation, the disqualified person could not have engaged in the transaction with anyone else, or could have done so only by incurring severe economic hardship.

grantor's basis in the property, there will be recognition of gain when the trust's income tax status changes.¹⁶⁰

B. Private Equity Investments

Private equity investments, in particular venture capital investments, commonly have no liquidity or readily ascertainable value at the outset of the investment. Where the investment is made through a fund, these features are compounded because the fund likely will carry with it significant capital call obligations and restrictions on the ability to transfer, assign or liquidate the investments (generally the lock-up is 10 years). As such, private equity investments are said to follow the "J Curve" of investment return where the value of the investment falls in value before, one hopes, appreciating far above the original investment (through sale of the company, IPO or other liquidity event), as suggested in the diagram below.

Interesting Application #2: Private Equity Investments



Private equity investments, which in years past were not strong candidates for a CLAT, may be candidates for contribution to a Shark-Fin or other back-loaded annuity CLAT so the charitable payments can be matched to when the private equity investment is expected to have liquidity and value.

¹⁶⁰ Treas. Reg. § 1.1001-2.

Theoretically, one could create 20 different Shark-Fin CLATs with 20 separate private equity investments (similar to asset-splitting zeroed-out “rolling” GRATs) with the understanding that many of the investments will fail, which is common to this particular type of investment.¹⁶¹ Assuming the CLAT is not being used to satisfy enforceable charitable pledges of the grantor, the failure of the CLAT should not have adverse consequences to the grantor. By separating these investments, the spectacular returns of a few of them will not be watered down by the failure of most of them, thereby generating more wealth transfer than if they had been combined into one CLAT. Quite obviously, the transaction costs of this type of planning make it impractical in many settings.

Under any circumstance where private equity investments are the sole asset of the CLAT, one must be concerned with the jeopardy investment rules, as discussed in more detail earlier.¹⁶² As mentioned, the gratuitous transfer of a speculative investment to a CLAT is not considered a jeopardizing investment.¹⁶³ While it is true that the Treasury Regulations provide that not only is the purchase of a speculative investment a jeopardy investment but the retention of the investment is also considered jeopardizing,¹⁶⁴ it is usually not possible for the CLAT to simply purge itself of private equity investments without further jeopardizing the charitable beneficiaries. Private equity investments typically have little or no liquidity and often have severe restrictions or penalties for liquidating or selling the investment prior to the end of the lock-up period, which often last up to 10 years. In any case, whether a single private equity investment or a diversified private equity fund is contributed, planners should provide for sufficient cash to be contributed to the CLAT along with the investment, so the CLAT can satisfy the capital call obligations on a timely basis.

C. Preferred Investment FLP Interests

The contribution of preferred interests in an FLP holding investment securities is a prime candidate for contribution to a back-loaded CLAT. Anytime a preferred interest in an FLP is created or transferred, however, § 2701 must be considered. There are a myriad of ways that § 2701 can be implicated and a full discussion is beyond the scope of this article but assume that a FLP is funded with \$20 million in cash and marketable securities and receives, among other interests, a class

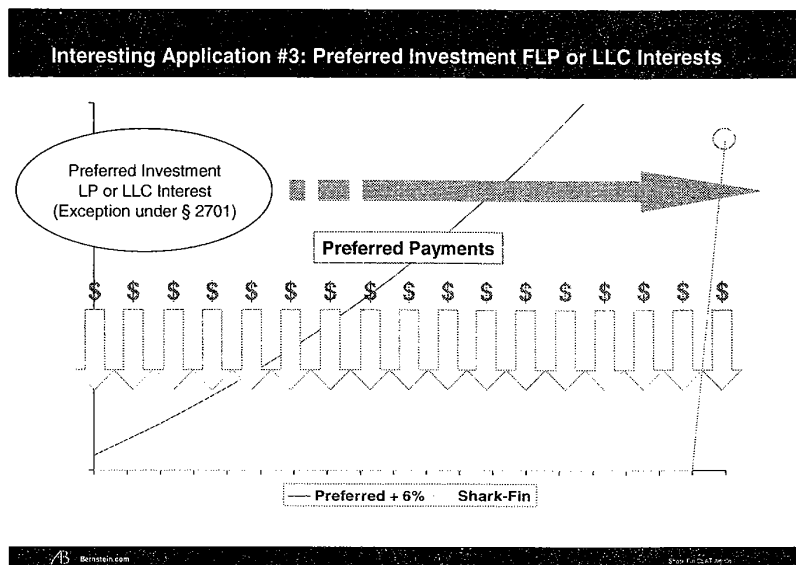
¹⁶¹ See Julie K. Kwon and Daniel J. Loewy, *GRATs: On a Roll*, 144 Tr. & Est. No. 6 (June 2005).

¹⁶² See *supra* Parts VII. and IX.

¹⁶³ Treas. Reg. § 53.4944-1(a)(2)(ii)(a).

¹⁶⁴ Treas. Reg. §§ 20.2055-2(e)(2)(vi)(e), 25.2522(c)-3(c)(2)(vi)(e).

that has a liquidation preference of \$10 million,¹⁶⁵ and an appraiser determines that the fair annual yield on the interest is 8% per year (against the liquidation preference) until maturity.¹⁶⁶



When the grantor gifts the entire 8% \$10 million preferred interest to a Shark-Fin or other back-loaded CLAT, the transfer will likely be entitled to a valuation discount which we will assume is 20%.¹⁶⁷ Now, the gift of the 8% \$10 million preferred interest, which was worth \$10 million before the discount, has a gift tax value of \$8 million. This increases the effective yield on the preferred interest from 8% to 10%.

The grantor has made an \$8 million gift that has an effective guaranteed return of 10%, which is being contributed to a CLAT that is being valued based upon an internal rate of return equal to the § 7520 rate of 2.4%.¹⁶⁸ These rates guarantee an arbitrage of 7.6% each year for the term of the CLAT. In addition, because the annuity payments are back-loaded, the preferred payment (which can be distributed in

¹⁶⁵ This interest should qualify for the so-called "vertical slice exception" to I.R.C. § 2701. See also Treas. Reg. § 25.2701-1(c)(4).

¹⁶⁶ This is according to the factors set out in Revenue Ruling 83-120, 1983-2 C.B. 170. See, e.g., Milford B. Hatcher & Edward M. Manigault, *Warming Up to the Freeze Partnership*, EST. & PERS. FIN. PLAN. (June 2000).

¹⁶⁷ The gifted interest should qualify for the so-called "junior equity interest exception" under I.R.C. § 2701(c)(2)(B)(i) and Treas. Reg. § 25.2701-2(b)(3)(i).

¹⁶⁸ The § 7520 rate for July 2011 is used throughout this discussion.

cash or in-kind) will continue to stay in the CLAT, further compounding for the remainder of the term, as illustrated in the diagram below.

Based on Bernstein's Wealth Forecasting Model, a grantor Shark-Fin CLAT providing for \$1,000 payment for 19 years and a \$12.8 million payment (based upon a discounted \$8 million contribution)¹⁶⁹ in the 20th year, the median value¹⁷⁰ of cash and securities (in nominal terms) that the remainder beneficiaries will receive at the end of the term (after charity is fully paid) is \$24.4 million, plus the remainder beneficiaries will receive a preferred interest in the FLP with \$10 million of liquidation preference and an 8% yield.

D. Single-Stock or Concentrated Stock Positions

Many wealthy individuals have highly appreciated but concentrated positions in one or a few companies. For those individuals, emotional ties to the company that created their wealth, the cost of diversifying (capital gain taxes) and the belief that a diversified portfolio will never out-perform their stock have prevented them from selling the position. Highly appreciated publicly-traded stocks are great candidates to contribute to charity because they result in an income tax deduction at fair market value, rather than adjusted tax basis.¹⁷¹ However, the only economic benefit to the grantor (and the grantor's family) is the tax savings resulting from the charitable income tax deduction.

From an investment standpoint, concentrated or single stock positions have higher volatilities than diversified stock portfolios, and as a result, they exhibit what is commonly referred to as "risk drag." Stated another way, the more volatile the investment, the lower the compound annual return that investment is likely to have over time. However, notwithstanding "risk drag" and notwithstanding the risk of concentrating one's wealth in one company (consider, Bear Stearns, Lehman Brothers, Enron, WorldCom, TWA, etc.), for a certain cohort of individuals, diversifying is out of the question. Indeed, concentrated stock positions can create enormous wealth. The issue is how to effectively transfer the concentrated stock position to the next generation (and perhaps, also to charity).

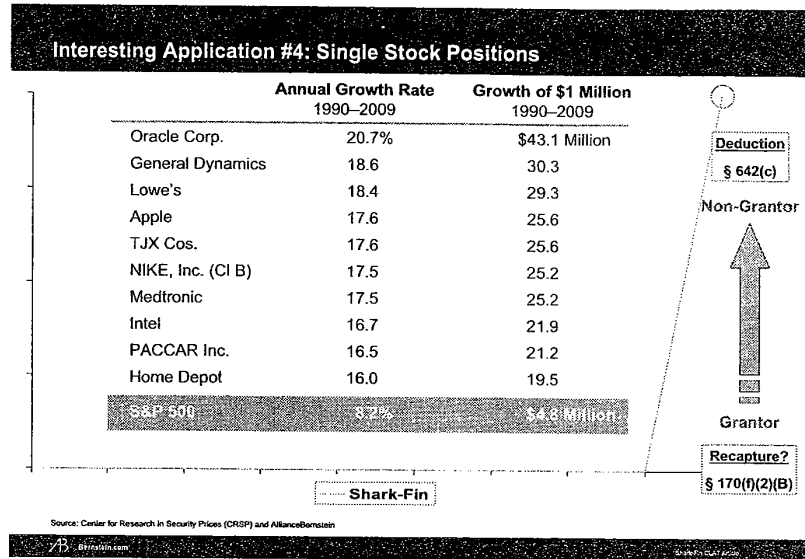
A back-loaded or Shark-Fin CLAT, as illustrated in the diagram below, may be one solution for transferring a concentrated stock position to charity and to children. Concentrated stock positions will not suffer as badly in a back-loaded or Shark-Fin CLAT structure because

¹⁶⁹ This is based upon the applicable annuity and remainder factors from Table S at a § 7520 rate of 2.4%.

¹⁷⁰ As with all of the figures in this article, a portfolio of globally diversified equities is assumed.

¹⁷¹ I.R.C. § 170(e)(1)(A).

the fixed payments to charity will not lock-in the losses of the stock when it has negative volatility. Also, with a low § 7520 rate a grantor may be able to contribute a stock whose dividend alone already exceeds the § 7520 rate. By way of example, the S&P 500 is currently yielding 2.1%, and the companies in the S&P 500 Dividend Aristocrats Index (large-cap, blue-chip companies within the S&P 500 that have followed a policy of increasing dividends every year for at least 25 consecutive years) are yielding significantly more. As a result, all or significantly all of the § 7520 rate of return theoretically may be covered by the dividend yield alone.



An important question is whether a non-grantor CLAT or a grantor CLAT will create better results. A grantor CLAT has the obvious benefit of giving the grantor an individual income tax deduction upon contribution. That benefit is offset by the ongoing grantor trust liability. With a concentrated stock position that is not going to be sold, the income tax liability will come from the dividends paid over the term of the CLAT and any capital gains realized by the CLAT to make the charitable payments to charity. As mentioned above, the IRS's current position is that in-kind payments in satisfaction of the charitable annuity will trigger capital gain. Thus, assuming the grantor contributed \$10 million of appreciated stock to a 20 year Shark-Fin CLAT, long-term capital gain would be triggered in the 20th year equal to the \$16 million minus the total dividends paid on the stock and any compounded earnings on

those dividends (assuming one only used enough appreciated stock as is necessary to satisfy the final charitable payment). The \$10 million upfront income tax deduction versus the deferred tax liability (most of which is recognized in the 20th year) at qualified dividend or long-term capital gain rates may be a reasonable trade-off especially considering the amount of wealth that could potentially be transferred to the remainder beneficiaries at the end of the CLAT term. While it is theoretically possible to swap cash for the low basis appreciated stock prior to the payment in-kind to charity under the grantor trust rules and to therefore avoid recognizing capital gain, given the dire penalties for self-dealing (sale or exchange between a private foundation and a disqualified person),¹⁷² that is an impractical planning idea.

A non-grantor CLAT will not create an income tax deduction for the grantor, but because the § 642(c) charitable deduction is not limited by a percentage of contribution base (adjusted gross income), it provides a highly tax-efficient way of offsetting any resulting capital gain tax. With a concentrated stock position, annual payments to charity could be set to approximate the annual dividends with the anticipation that the larger, deferred payments to charity would be satisfied with appreciated shares of stock. The dividends and the resulting capital gain would be fully sheltered by the § 642(c) deduction.

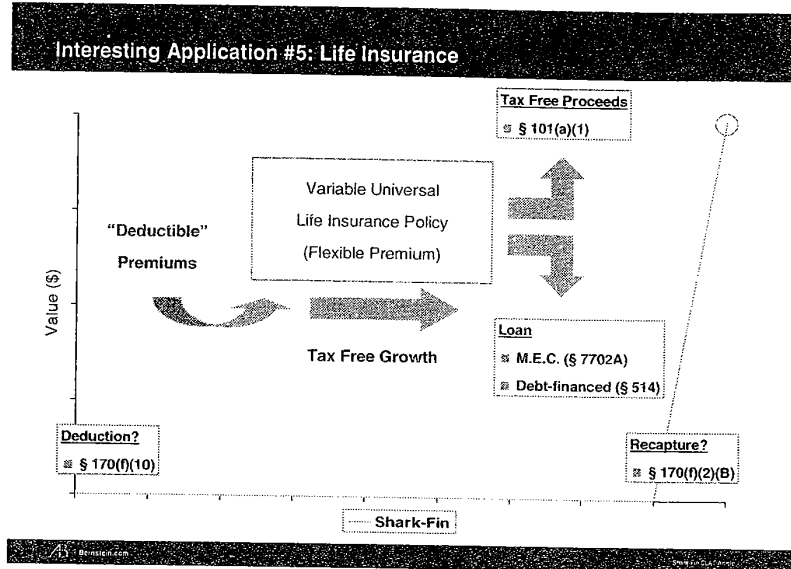
One interesting planning option is to start as a grantor CLAT and then relinquish grantor trust status just prior to the last payment to charity. As mentioned above, the conversion from grantor to non-grantor trust status is not a taxable event unless there is debt in excess of basis. As such, the grantor could retain grantor trust status (as long as the grantor is alive, of course) until the bulk of the payments are payable to charity (in the 20th year, for example). Upon conversion to non-grantor trust status, there would be recapture of the income tax deduction under § 170(f)(2)(B) equal to the original deduction amount minus the discounted value of the dividends declared on the stock and the tax on the reinvestment of the dividends, but as discussed above, recapture is not as detrimental as it might appear at first glance. More importantly, once the CLAT is a non-grantor trust, any resulting gain from the payment in-kind to charity in the last year or years will be fully sheltered by the charitable deduction (\$16 million in the 20th year in the Shark-Fin example).

E. Life Insurance

Because a grantor CLAT provides an income tax deduction to the grantor at the cost of having the grantor taxed on the CLAT's income,

¹⁷² I.R.C. § 4941(d)(1).

an investment inside the grantor CLAT that would not create any income tax liability may be desirable. Life insurance is such an investment, as illustrated in the diagram below. Proponents of the use of life insurance inside a grantor CLAT hope it will provide income tax deduction under § 170(a) to the grantor upon funding of the CLAT, but because all or a portion of the contributed assets will grow tax-free inside the policy there will be little or no income tax liability to the grantor over the term of the CLAT.



However, planners must be wary of a number of technical issues including the modified endowment contract rules under § 7702A, the charitable split-dollar rules under § 170(f)(10), the recapture rules, and the private foundation rules (as discussed in more detail above).

1. Basics of the Plan

In the most extreme, but simplified, version of the plan, the grantor makes a \$10 million cash contribution to a 20 year grantor Shark-Fin CLAT, which generates a \$10 million income tax deduction under § 170(a).

The trustee of the CLAT uses the cash to purchase a variable, universal or whole life insurance policy, paying premiums over 3-7 years (however long it takes to create a paid up policy without causing the policy to be a modified endowment contract under § 7702A). While the

cash is waiting to be paid into the policy in premiums, the trustee invests the assets in something that generates very little or no taxable income to the grantor like municipal bonds.¹⁷³ For purposes of this example, let's assume the premiums purchase \$60 million in death benefit.

The trustee then lets the assets grow inside the policy for the remainder of the 20 year term. Effectively the grantor has created \$10 million of personal income tax deduction, which is equal to the premiums paid, and no grantor trust liability. At the end of the 20 year period, only one of two things has occurred. The grantor, as the insured, is either alive or dead. In the less-likely event the grantor dies during the 20 year period, let's say in year 15, the following occurs:

1. \$60 million of death benefit is paid to the CLAT, tax free under § 101(a)(1), which is more than enough to pay charity the \$16 million it is owed in year 20 and leaving a sizeable amount of wealth transfer to the remainder beneficiaries at the end of the term.
2. There will be recapture of the original income tax deduction under § 170(f)(2)(B) in an amount equal to the deduction on the decedent's last income tax return. However, as noted above, the maximum amount included in income is the original deduction and the grantor has had the time value benefit of that deduction. Furthermore, the tax liability will be deductible for estate tax purposes under § 2053.

In most circumstances, from an economic standpoint, the family is better off if the grantor dies during the term.

In the more likely event that the grantor is still alive at the end of the 20 year term, the following is likely to occur:

1. So that charity can receive its \$16 million, the trustee takes \$16 million out of the life insurance policy, stripping \$10 million of basis out of the policy and then borrowing against the cash value for an additional \$6 million. Both of these are non-taxable from an income tax standpoint because the policy is not a modified endowment contract.¹⁷⁴ Trustee pays charity \$16 million.
2. It is highly likely that even after withdrawing \$16 million of funds from the policy, there will still be significant net cash

¹⁷³ Contributing or exclusively investing in tax exempt bonds does not seem to be a problem with charitable lead trusts. See, e.g., PLR 8427022 (Mar. 30, 1984); PLR 7803041 (Oct. 20, 1977). This is not necessarily the case with charitable remainder trusts. See, e.g., Treas. Reg. § 1.664-1(a)(3); PLR 7802037 (Oct. 14, 1977). But see PLR 8439091 (June 28, 1984).

¹⁷⁴ See I.R.C. § 7702(2)(A).

value in the policy. The assets have been growing tax free, and if those assets are invested in globally diversified equities (through the medium of a variable life insurance policy), the median amount after all payments to charity and after inflation will be \$43.5 million, less the costs of insurance and other policy costs (based upon the forecasted investment results for grantor CLATs described earlier in this article). Of course, one must take into account the reduction in value due to mortality charges, administrative charges, commissions on the policy and other expenses. For purposes of this illustration, let's assume that after all payments to charity, expenses and charges against the funds, this policy still has \$20 million nominally in net cash value (after debt).

This policy now passes to the remainder beneficiaries who can:

1. Cancel the policy and take the \$20 million of net cash value, but this will be a taxable event. However, the tax may be borne by the grantor if the remainder is held in a grantor trust;
2. Continue to maintain the \$60 million death benefit policy for the remainder of the grantor's lifetime, although this would likely require additional premiums to be paid into the policy; or
3. Reduce the death benefit to, say, \$40 million and have a fully paid-up policy on which no additional premiums will be paid.

It is likely that upon termination there is no recapture of the income tax deduction under § 170(f)(2)(B). First, there is the argument that recapture under these circumstances only occurs when the "donor ceases to be treated as the owner of such an interest for purposes of applying section 671."¹⁷⁵ If the term of the grantor CLAT expires and then the trust assets pass to another grantor trust, grantor trust status never ceases. More to the point, however, as mentioned above, the Treasury Regulations provide that as long as charity is paid, recapture has been satisfied.

In all, at least in theory, this plan has created \$10 million of deduction, no grantor trust liability, no recapture of the deduction and a life insurance policy that is out of the estate of the grantor and for which no taxable gifts and annual exclusions were needed.

¹⁷⁵ I.R.C. § 170(f)(2)(B).

Different variations of this basic plan might include changing the term to a lifetime term to match up the termination of the CLAT to the economic event under the policy (death of the insured). Under this construction, the CLAT might purchase (or the insured grantor who is also the measuring life might purchase and then transfer to the CLAT) a single premium guaranteed universal life insurance policy. Any death benefit payable at death (presumably guaranteed) above the final charitable payment would pass to the remainder beneficiaries free of estate taxes. If, taking the lifetime term example from earlier in this article, a \$10 million single premium can purchase \$30 million of death benefit for a 62 year old insured, anything above \$14,061,618 that is payable to charity at death will pass to the remainder beneficiary (ignoring the \$1,000 payment each year).

It is important to note that the IRS is clearly aware of the use of life insurance in the grantor trust context, although perhaps not specifically with "intentionally defective" grantor CLATs. It bears remembering that pursuant to Revenue Procedure 2011-3,¹⁷⁶ the IRS has stated it will not rule on whether:

the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§673 to 677.¹⁷⁷

The IRS has also ruled that under certain circumstances an investment in life insurance will be considered a jeopardy investment under the private foundation rules.¹⁷⁸

¹⁷⁶ Rev. Proc. 2011-3, 2011-1 I.R.B. 111.

¹⁷⁷ *Id.* at § 3.01(54).

¹⁷⁸ Rev. Rul. 80-133, 1980-1 C.B. 258. *But see* PLR 8134114 (May 28, 1981) where the IRS held that insurance policies are not jeopardy investments where there is no outstanding loan on the policy, the donor surrenders all incidents of ownership, and the donor pays the premiums. Presumably this would not be applicable to this technique because the grantor would not be paying any of the premiums, the CLAT would be paying them.

2. Charitable Split-Dollar Rules

One of the primary concerns associated with CLAT-owned life insurance is to what extent the “charitable split-dollar rules” of § 170(f)(10) are deemed to apply under these circumstances. The “charitable split-dollar” rules provide, “no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer,”¹⁷⁹

- “The organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or”¹⁸⁰
- “There is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor.”¹⁸¹

A “personal benefit contract” is

with respect to the transferor, any life insurance, annuity, or endowment contract if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor’s family, or any other person (other than an organization described in subsection (c)) designated by the transferor.¹⁸²

An individual’s family is deemed to include “the individual’s grandparents, the grandparents of such individual’s spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.”¹⁸³

There is an exception for certain life insurance contracts held by charitable remainder trusts but not for CLTs.¹⁸⁴ A CLAT is not an organization described in § 170(c), so § 170(f)(10)(A)(i) is not applicable. Section 170(f)(10)(A)(ii), regarding the existence of an “understanding or expectation,” is more problematic.

The IRS could argue that in the example outlined above, there is an “understanding or expectation” that some “person” (the CLAT) “will directly or indirectly pay” premiums on a personal benefit contract. There are credible arguments to say that this provision does not apply to the example outlined above. For example, it can be argued that the life insurance here is not a “personal benefit contract” as defined above because the beneficiary is the CLAT and the person designating the bene-

¹⁷⁹ I.R.C. § 170(f)(10)(A).

¹⁸⁰ I.R.C. § 170(f)(10)(A)(i).

¹⁸¹ I.R.C. § 170(f)(10)(A)(ii).

¹⁸² I.R.C. § 170(f)(10)(B).

¹⁸³ I.R.C. § 170(f)(10)(H).

¹⁸⁴ I.R.C. § 170(f)(10)(C), (E).

fiary of the contract is the CLAT trustee. Furthermore, it can be argued that, assuming the contract has an internal rate of return equal to the § 7520 rate (an assumption inherent within the calculation of the income tax deduction), no personal benefit is expected to pass to the grantor's family because the contract would only benefit charity (so long as the CLAT is zeroed out). Finally, it seems clear that the charitable split-dollar rules were not intended to apply to this situation. Indeed, the legislative history to § 170(f)(10) indicates that such section was designed to stop charitable split-dollar arrangements that provide little benefit to charity.¹⁸⁵

What is unusual about this provision is that if a grantor had an existing policy that is paid-up (at least by the terms of the current in-force ledger and illustration), the grantor could contribute that existing policy, get an income tax deduction for the value of that contribution, and § 170(f)(10)(A)(ii) would apparently not apply, because there would be no "understanding or expectation" that the CLAT "will" (prospectively) pay any premiums. If an existing life insurance policy is transferred, however, the proceeds of the life insurance will continue to be includible in the estate of the transferor for 3 years following the transfer.¹⁸⁶

Importantly, planners should keep in mind that if the charitable split-dollar rules do apply, not only will the original income tax deduction be disallowed, but the CLAT itself will be subject to an excise tax equal to the premiums paid.¹⁸⁷ The excise tax is imposed upon a § 170(c) organization, but the Code also provides, for purposes of the excise tax, "payments made by any other person pursuant to an understanding or expectation referred to in subparagraph (A) shall be treated as made by the organization."¹⁸⁸ In any case, before planners jump into the deep end on this type of plan, they should carefully consider the charitable split-dollar rules and whether they might or might not apply to their facts and circumstances.

XI. CONCLUSION

The Internal Revenue Code assumes that any asset contributed to a CLAT will have a total return equal to the § 7520 rate. A zeroed-out CLAT is designed to distribute to charity what the government assumes the CLAT will earn and accumulate the excess—which the government assumes will be zero—for eventual distribution to the grantor's non-charitable beneficiaries, usually the grantor's children. Because the gov-

¹⁸⁵ S. REP. NO. 106-120, at 206-07 (1999).

¹⁸⁶ I.R.C. § 2035(a)(2).

¹⁸⁷ I.R.C. § 170(f)(10)(F).

¹⁸⁸ I.R.C. § 170(f)(10)(F)(ii).

ernment assumes the excess accumulation is zero the grantor makes no gift to the children.

The central insight of the Shark-Fin or back-loaded CLAT is that the longer an asset remains in the CLAT the longer it may produce excess earnings for eventual distribution to the children (or other non-charitable beneficiaries). The Internal Revenue Code, Treasury Regulations, and IRS pronouncements have prohibited back-loaded annuities for charitable remainder annuity trusts, limited them for grantor retained annuity trusts, and allowed them for charitable lead annuity trusts; presumably this is because of policy differences that apply to the different types of trusts.

One of the most significant developments that has arisen from the Shark-Fin or back-loaded CLAT is that it opens the door to contributions of certain types of assets that traditionally have not been considered to be good candidates for CLATs. These types of assets are characterized by a lack of liquidity and often very low value at the time of contribution (for example, private equity investments or interests in FLPs holding commercial real property). Shark-Fin CLATs (or other back-loaded annuity CLATs) can ameliorate cash flow concerns so that the charitable payments are matched to when liquidity (and higher value) is expected to occur. Equally as important, from an investment standpoint, the deferred charitable payments allow trustees of CLATs to manage volatility in the portfolio more easily, which could result in higher overall returns over the term of the CLAT.

Concerns about back-loaded CLATs on policy grounds are misplaced. If the § 7520 rate accurately predicted the total return on investments, then a CLAT—regardless of the term—with a zero remainder would in fact produce zero for the non-charitable beneficiaries. To the extent that § 7520 underestimates the actual total return on the CLAT investments, a remainder is created for those beneficiaries. The government could have imposed a floor on the § 7520 rate or otherwise prohibited the use of extremely low rates such as those in effect now, and for the last several years. The government has chosen not to do so and, indeed, mandates use of the low rate. Why some “remainders” should be thought “permissible” and others “abusive” is unclear. Further, even a rate return of 2.4% may not be achieved in certain investment environments even over a long period of time.

Many grantors are troubled by a gift to charity that does not produce an income tax deduction as well as wealth transfer tax benefits. A non-grantor CLAT removes its earnings from the grantor's income tax return—in effect a 100% deduction for the grantor—and to the extent those earnings are paid to charity the trust will receive an income tax deduction. A non-grantor Shark-Fin CLAT will not allow a full income

tax deduction in the trust because the trust will likely not have sufficient income in the year in which the large charitable payment is made. In order to achieve a full income tax deduction a grantor CLAT may be used but at the risk of a mismatch between the income tax rates in effect when the trust is created and those in effect when the annuity payments to charity are made, whether by selling assets or by using appreciated assets directly.

Because the value of the grantor's gift is determined using the § 7520 rate in effect when the CLAT is created, doing so when the rate is low is more efficient than when it is high. Current rates, below 3%, are historically very low. Thus, creating CLATs now rather than waiting until the grantor dies is desirable.

From the point of view of a charity, a stream of payments from a CLAT, or a single payment in the future, has a present value that may be determined by reference to the expected earnings of the charity's endowment. Conceptually, to the charity, a dollar in a CLAT is worth only the dollar increased by the § 7520 rate until the date the charity receives the payment but a dollar in the charity's endowment is worth the actual earnings of the endowment. If those actual earnings are likely to exceed the § 7520 rate the charity may be amenable to selling its future payment or stream of payments for a lump sum. Such a transaction may be beneficial for the purchasers as well.

APPENDIX

NOTES ON THE WEALTH FORECASTING SYSTEM

The Bernstein Wealth Forecasting System uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation; it produces a probability distribution of outcomes, based on Bernstein's estimates of the range of returns for the applicable capital markets over the appropriate time period. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability.

Capital Market Projections

	Median 30-Year Growth Rate	Mean Annual Return	Mean Annual Income	One- Year Volatility	30-Year Annual Equivalent Volatility
Short Term Taxables	4.8	5.1	5.3	1.0	10.0
Int.-Term Diversified Municipals	3.8	4.0	3.8	4.0	7.6
Int.-Term Taxables	4.8	5.1	5.9	4.6	9.2
U.S. Value	9.2	10.7	3.5	16.6	18.1
U.S. Growth	8.8	10.8	2.1	19.1	19.6
Developed International	9.6	11.6	3.5	18.8	19.0
Emerging Markets	7.8	11.7	3.2	27.9	27.6
Inflation	2.9	3.2	n/a	1.1	9.5

Does not represent any past performance and is not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns.
Based on 10,000 simulated trials each consisting of 50-year periods.
Reflects Bernstein's estimates, and the capital market conditions as of March 31, 2011.

 Bernstein.com

Source: ACTEC 2011



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State Regulations Panel

Panelists:

Steven Drutz
Senior Financial Analyst
Washington State Office of
Insurance Commissioner
PO Box 40259
Olympia, WA 98504
P: 360-725-7205
E: steved@oic.wa.gov

Carol Harmon
Senior Staff Counsel
California Department
of Insurance
45 Fremont Street, 24th Floor
San Francisco, CA 94105
P: 415-538-4420
E: harmonc@insurance.ca.gov

Bene' Kyles
Securities Analyst
Alabama Securities
Commission
401 Adams Avenue, Suite 280
Montgomery, AL 36104-4700
P: 334-242-2372
E: bene.kyles@asc.alabama.gov

Moderator:

Edie Matulka
Senior Consultant
PG Calc
115 NE 100th Street, Suite 300
Seattle, WA 98125-8008
P: 206-329-8144
E: ematulka@pgcalc.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

State Regulations Panel

I. Introduction to the Session

The goal of this session is to provide charities with a better understanding of how to comply with state requirements for issuance of gift annuities by providing an opportunity to hear directly from state regulators.

The panelists are:

- Bené Kyles, Securities Analyst, Alabama Securities Commission
- Carol Harmon, Senior Staff Counsel, California Department of Insurance
- Steven Drutz, Senior Financial Analyst, Washington State Office of Insurance Commissioner

The panel will be moderated by Edie Matulka, Senior Consultant, PG Calc Incorporated.

II. Panel Discussion

The panelists will address the registration process, annual filings, and ongoing requirements as they pertain to their state. The focus of the discussion will be on such questions as what the state reviewers are looking for with respect to a charity's filing, the purpose behind requesting certain information, and what issues prompt the most concern with the regulators. Requirements that relate to all three states, as well as those that are unique to a particular state will be part of the discussion. While the panelists' comments will reflect their own state requirements, they are likely to be informative and relevant for other states as well. In addition, as appropriate the moderator may indicate when requirements of the represented states are similar to or different from those of other states.

III. Audience Questions

Rather than having a set Q & A portion of the presentation, questions from the audience may be posed throughout the session by filling out a Panel Question Form available at your seat and passing it to the end of the aisle. Questions will be collected and given to the moderator, and will be posed to the panel at appropriate times during the discussion and/or as time permits at the end.

IV. Further Information

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.

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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

ACGA Rates Luncheon

Presented by:
ACGA Rates Committee Co-Chairs

Cam Morin Kelly

Assistant Vice President for
Principal Gifts Programs
Duke University
Box 90600
Durham, NC 27708-0600
P: 919-613-6296
E: cam.kelly@dev.duke.edu

David A. Libengood

Director, Relationship
Management
Kaspick & Company
One Beacon Street, 8th Floor
Boston, MA 02108
P: 617-788-5875
E: dlibengood@kaspick.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

AMERICAN
COUNCIL ON
GIFT ANNUITIES

Promoting Responsible Philanthropy

**EXPLANATION
of the
ACGA GIFT ANNUITY RATES
Effective January 1, 2012**

ACGA Gift Annuity Rates Committee:

Lindsay Lapole, President, ACGA Board of Directors
Cam Kelly and David Libengood, Co-Chairs of the Rates Committee
Ron Brown, author of the Report
Robert Coffman
David Ely
Susan Gutchess
Rebecca Locke
Michael Mudry
David Wheeler Newman
Kristen Schultz
Jim Soft

INTRODUCTION

One of the primary activities of the American Council on Gift Annuities (“ACGA”) is crafting and publishing a table of suggested maximum charitable gift annuity rates for use by charities and their donors. The Council has published suggested annuity rates as a public service since 1927. Its suggested rates have long been recognized by charities, donors, state insurance departments and the Internal Revenue Service as being actuarially sound and responsive to the best interests of all parties involved.

While the suggested rates are voluntary, 97.3% of the charities responding to the 2009 Gift Annuity Survey reported that they always or usually follow the suggested payment rates. By following the suggested ACGA gift annuity rates, charities are relieved of the expense of hiring an actuary and developing their own rate schedules. Most importantly, when charities follow a common standard and don’t compete with one another on rates, donors are encouraged to make decisions based on the mission of the charities they want to support.

The Rate Review Process

The ACGA Gift Annuity Rates Committee (“Rates Committee”) collects and analyzes information related to the suggested rate tables and the assumptions underlying the rates. ACGA retains an actuarial firm to advise and consult on mortality data and other matters related to rate recommendations.

At least annually, the Rates Committee submits a recommendation to the ACGA Board of Directors on whether or not to change the suggested rates. The Board traditionally reviews and acts on the recommendation at its spring meeting. Any changes in the rates have generally become effective on July 1. However, changes in suggested rates may be made at any time if economic conditions warrant – as they do in the current economic environment.

Rate reviews normally include the following steps:

1. A general re-assessment of the assumptions underlying the rates in light of the best available data regarding the experience of charities issuing gift annuities, current interest rates and investment experience, mortality of annuitants, and expenses incurred in administering a gift annuity program.
2. Occasional consultation with selected financial professionals regarding expected investment returns and expenses for investment management and administration.
3. A review of the current relationship between suggested gift annuity rates and rates for pure-life annuities offered by insurance companies, and how the current relationship between these rates compares to historical relationships between suggested gift annuity and commercial annuity rates.

Because of the Great Recession of 2007-2008, continuing volatility in the economic environment, and the findings of the 2009 Gift Annuity Survey Report, the Rates Committee

conducted a thorough re-examination of its process of calculating suggested gift annuity rates. In the three years leading up to the report for suggested rates beginning in January 2012, ACGA took the following steps:

- Hired a consulting firm to perform a rigorous analysis of the rate recommendation process.
- Commissioned an actuarial firm to conduct the largest-ever mortality study of charitable gift annuitants, involving more than 47,000 gift annuity contracts. The findings of this study led to changes in mortality assumptions.
- Explored a new methodology for setting a target for the charitable residuum (the net amount remaining for use by a charity at termination of a gift annuity contract) based on the discounted present value of the residuum. The new suggested rate table incorporates a minimum present value (PV) target for gift annuities issued at all ages.
- Carefully considered the impact on charitable gift annuity programs of continuing volatility in world investment markets and historically low interest rates. For example, the rates suggested for the period beginning January 1, 2012 were calculated using the IRS CFMR rate of 1.4% from November 2011.

Investment and interest rate considerations led to a more conservative investment return assumption for the rates suggested in July 2011, and a further reduction in investment returns for suggested rates beginning on January 1, 2012.

The ACGA Board of Directors held its semi-annual meeting on November 7, 2011. As part of a continual monitoring process, the board reviewed all the assumptions that underlie the rates schedules. Given the significant changes in the economic environment since April 2011 when rates were last changed, the board approved a new schedule of suggested maximum gift annuity rates which will become effective January 1, 2012.

This paper provides highlights of the thinking behind ACGA's rate assumptions and publishes suggested rate tables that follow from those assumptions.

ACKNOWLEDGMENTS

The Rates Committee is grateful to the following institutions and individuals that have provided counsel and support in various ways as the Committee developed an actuarially sound schedule of suggested gift annuity rates:

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State Street Global Advisors

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HISTORICAL GIFT ANNUITY RATES

The ACGA first issued suggested gift annuity rates in 1927. As might be expected, the suggested rates declined during the Great Depression. They remained at low levels through the 1950s due to continuing low interest rates. In the 1980s they rose sharply in response to the high interest rates that prevailed during that period. In the late 1990s, suggested rates began to decline, as can be seen in the following table:

Historical Percentage Gift Annuity Rates

Age	1927	1931	1934	1939	1955	1965	1971	1974	1977	1980	1983	1992
65	6.8	6.2	5.7	5.1	5.0	5.2	5.6	6.0	6.2	6.6	7.3	7.3
70	7.6	6.7	6.2	5.5	5.5	5.7	6.2	6.6	6.8	7.1	7.8	7.8
75	8.7	7.3	7.0	6.2	6.3	6.5	7.0	7.4	7.7	7.9	8.5	8.5
80	9.0	8.0	8.0	7.0	7.4	7.6	8.2	8.5	9.0	9.2	9.6	9.6
85	9.0	8.0	8.0	7.0	7.4	8.0	9.7	10.0	10.5	11.2	11.4	10.9
90	9.0	8.0	8.0	7.0	7.4	8.0	10.0	10.0	12.0	14.0	14.0	12.0

Age	1994	1997	1998	2001	2003*	2003*	2008	2009	2010	2011
65	6.5	7.2	7.0	6.7	6.3	6.0	5.7	5.3	5.5	5.3
70	6.9	7.7	7.5	7.2	6.7	6.5	6.1	5.7	5.8	5.8
75	7.7	8.4	8.2	7.9	7.3	7.1	6.7	6.3	6.4	6.5
80	8.8	9.4	9.2	8.9	8.3	8.0	7.6	7.1	7.2	7.5
85	10.0	10.5	10.5	10.4	9.7	9.5	8.9	8.1	8.1	8.4
90	11.0	12.0	12.0	12.0	11.5	11.3	10.5	9.5	9.5	9.8

*Rates were changed in both January and July of 2003

ASSUMPTIONS UNDERLYING SUGGESTED GIFT ANNUITY RATES

Following is a summary of the major assumptions on which the suggested January 1, 2012 rates are based.

1. **Target Residuum.** Historically, the ACGA has targeted a residuum (the amount realized by the charity upon termination of an annuity) of 50% of the original contribution for the gift annuity. The new rate schedules retain the 50% target residuum, and continue the requirement first applied for the July 2011 rate schedules that the present value (PV) of the residuum be at least 20% of the original contribution for the annuity.

The 20% minimum PV requirement has the effect of reducing rates for annuitants age 57 and under. It is designed to help charities realize a minimum value from gifts whose residua will not be realized for many years. Rates for younger annuitants (ages 5 to 49) were reduced as necessary to comply with the 10% minimum charitable deduction required under IRC Sec.

514 (c)(5)(A) using the 1.4% CFMR for November 2011. Particularly in low interest rate environments, charities should perform their own deduction calculations and lower their annuity rates if necessary to meet the 10% minimum deduction requirement.

2. **Mortality Assumption.** In calculating suggested rates, all annuitants are assumed to be female and one year younger than their actual ages. The suggested rates use the Annuity 2000 Mortality Tables. The rates also incorporate projections for increasing life expectancies (improvements in mortality) using a scale supplied by our actuary.
3. **Expense Assumption.** Annual expenses for investment and administration are 1.0% of the fair market value of gift annuity reserves. The annual expense assumption is unchanged.
4. **Investment Return Assumption.** The gross annual expected return on immediate gift annuity reserves is 4.25%. This is a decrease from the 5.0% total return assumption used in calculating the July 2011 rates. The gross expected return for deferred annuity reserves is also 4.25%. Both immediate and deferred payment annuity calculations use a net compounding rate of 3.25%.
5. **Payment Assumption.** Annual payments are made in quarterly installments at the end of each period. This assumption is unchanged from the 2011 rate calculations.

The rates for the oldest ages are somewhat lower than the rates that would follow from the above assumptions. Single life rates are capped at 9.0% for annuitants age 90 and above. Single life rates for annuitants between ages 81 and 89 are graduated downward from the rate cap. Two life rates are graduated downward in a similar way.

Additional Assumptions for Deferred Gift Annuities

The annual compound interest rate credited during the deferral period for deferred payment gift annuities is 3.25% (the same investment return assumption as for current gift annuities after subtracting the 1.0% expense assumption). In other words, each dollar contributed for a deferred gift annuity is presumed to grow at an annual compound interest rate of 3.25% between the date of contribution and the annuity starting date.

If payments will be made at the end of the period, which is usually the case, the annuity starting date would be at the beginning of the first period for which a payment is made. For example, if payments will be made quarterly, and the first payment will be made on September 30, 2014, the annuity starting date would be July 1, 2014. If payments will be made semi-annually, the annuity starting date in this case would be April 1, 2014.

Assuming that the annuitant would be nearest age 65 on the annuity starting date, and that the period between the contribution date and the annuity starting date is 10.25 years, the compound interest factor would be $1.0325^{10.25}$ or 1.387948. To determine the deferred gift annuity rate, this factor is multiplied by the immediate gift annuity rate, now in effect, for the nearest age of the annuitant at the time payments begin. In this example, the deferred gift annuity rate would be 1.387948 times 4.7%, or 6.5% (rounded to the nearest tenth of a percent).

The compounding rate during the deferral period is simply the assumed net return (total assumed return of 4.25% less 1.0% for expenses). The compounding rate applies to the entire compounding period, whatever its length. At times in the past, the compounding rate for periods in excess of 20 years was less than the compounding rate for the first 20 years of the deferral period.

In two states, New York and New Jersey, it is sometimes necessary to apply a slightly lower compounding rate when the deferral period is relatively long in order not to exceed those states' maximum allowable deferred gift annuity rates. The ACGA website contains information about New York and New Jersey requirements.

RATIONALE FOR ASSUMPTIONS

Residuum

From its start in 1927, the ACGA has set a residuum target representing a percentage of the face value of the amount funding an annuity contract (originally 70% of the face value, now 50% of the face value of the original amount).

The first assumption is that the target for the residuum (the amount remaining for the charity at the termination of the annuity) will be 50% of the original contribution, assuming that prior to termination expenditures have been limited to annuity payments and to investment and administrative expenses. Obviously, if an organization spends a portion of the contribution for charitable purposes while the annuity is still in force, the residuum will be diminished.

The actual residuum at the termination of any particular annuity could be more or less than 50%, depending on the longevity of the annuitant(s) and the investment returns on gift annuity reserves during the term of the contract. Per the 1999 ACGA survey, which was conducted at the crest of a prolonged bull market, the mean residuum (the share of the contribution actually remaining for charities when annuities terminated) was over 95%. According to the 2004 survey, the mean residuum was 85.5%, and in the 2009 survey the mean residuum was 81.7%. The surveys' data on residua were based on gift annuities that had already terminated. Very few annuities funded just before the onset of the 2008 bear market have terminated. The residua of those contracts are likely to be lower based on the current market value of the reserves of those newer annuities.

The residuum is defined in terms of nominal value, not present value. To say that the residuum for the charity will be 50% means that 50% of the original contribution will remain for the charity. It does not mean that the present value of what the charity will eventually receive is 50% of the contribution.

For a number of years, the Rates Committee has considered moving to a residuum expressed in present value terms because such an approach would mean that—given the investment return, expense, and mortality assumptions—charities would receive similar economic value from gift annuity contracts funded with like dollar amounts, regardless of the age of annuitants. However, the Committee believes that the 50% nominal residuum is an easily understood target that has

appeal in charitable gift annuity fundraising. In order to balance these two objectives, the Committee decided to retain the 50% of nominal value assumption as a starting point, but also require that each contract produce a 20% minimum present value. The 20% minimum present value has the effect of lowering rates for annuities issued at ages 57 and below.

Annuitant Mortality

The ACGA endeavors to base suggested maximum annuity rates on mortality data for individuals as similar as possible to annuitants who will begin receiving payments under contracts to be established in the near future. Because new gifts might involve making payments for three decades or more into the future, effective mortality assumptions for annuitants require continual research and adjustments.

In the fall of 2010, the ACGA commissioned The Hay Group to conduct what we believe to be the largest-ever mortality study of actual gift annuitants: 28 charities furnished mortality data on 47,075 gift annuity contracts over the five-year period of 2005 through 2009. (The most recent prior study, conducted in 2001-2002, examined 24,445 charitable gift annuity contracts.) The results of the study were somewhat surprising: annuitant mortality exceeded what would have been predicted by the mortality assumptions used in suggested maximum gift annuity rates over the past decade. In other words, significantly more individuals from the sample population died during the five-year period of the study than was predicted by the mortality assumptions used over the past decade.

Our actuaries offered two principal reasons for this discrepancy: (1) the proportion of males establishing gift annuities (relative to females) was higher in the current study than in the 2001-2002 study, and (2) the mortality improvement schedule used to estimate how much life expectancy is likely to improve between mortality study periods has recently come to be viewed by the Society of Actuaries (SOA) as too optimistic.

The increasing proportion of annuities being established by men can be seen in the following table of results of ACGA Gift Annuity Surveys conducted over the past 17 years, and the proportion of males in the two mortality studies recently conducted by the ACGA:

Gender	1994 Survey	1999 Survey	2000-01 Mortality Study	2004 Survey	2009 Survey	2010-11 Mortality Study
Male	40%	40%	38%	45%	44%	45%
Female	60%	60%	62%	55%	56%	55%

It is not surprising that the total number of female annuitants is larger than the total number of male annuitants. The ratio of women to men becomes larger as the U.S. population ages. For example, women represented 62.9% and men just 37.1% of the U.S. population age 80-84 in the year 2000. The trend towards more male annuitants runs counter to the widely-held assumption that women are more likely than men to make gifts through charitable annuities.

It is important to note that mortality rates vary by gender, but gift annuity payment rates do not. The ACGA continues to feel that a unisex rate table offers important benefits in terms of simplicity.

The Hay Group has assisted the Rates Committee in evaluating what mortality table assumptions will reasonably and conservatively reflect the actual mortality experience of the annuitants in the 2010-11 study.¹ Therefore, the ACGA's 2012 rate recommendations assume the use of the Annuity 2000 mortality table with all annuitants assumed to be female and one year younger than their actual ages. Also, following the advice of the Society of Actuaries and The Hay Group, ACGA will use mortality improvement Projection Scale AA instead of Projection Scale G to update its rates until the next gift annuitant mortality study is conducted. Projection Scale AA assumes a slower rate of mortality improvement than Projection Scale G, which as noted above, has come to be viewed as overly optimistic.

Expenses

The annual expenses for administering gift annuities are assumed to be 1% per year. These expenses include investment and custodial fees, the costs of making payments and filing federal tax forms, and the costs of submitting reports in regulated states. They do not include the costs of marketing or stewardship, which are presumed to be covered in a charity's general budget for the development office.

For large charities with economies of scale, and for charities that do not operate in heavily regulated states, 1% might be slightly high. However, charities with smaller and mid-sized programs, and those that operate in regulated states that require annual filings, actuarial reports, and sometimes a fee for each annuity written, 1% appears reasonable.

Average Investment Return

Perhaps the most difficult assumption to make is the average total investment return on gift annuity reserves. First is the challenge of determining the appropriate asset allocation to use in the return calculation. Next is the task of extrapolating from historic and current returns on various asset allocations to arrive at a reasonable projected return on each asset class.

ACGA surveys have provided valuable information about the asset allocations charities are actually using. In the 2009 Survey, charities reported the actual investment allocation for their gift annuity reserve funds. They were asked to report on the investment of their required annuity reserve funds, and other gift annuity funds used to invest the charitable or "surplus" amounts related to annuity gifts. Below is a chart from the 2009 Survey Report showing the number of charities where a particular asset class (shown in the rows) constituted a particular percentage (shown in the columns) of the overall asset allocation of their gift annuity.

¹ New mortality tables for very large numbers of annuitants are produced from time to time by the Society of Actuaries (SOA) for use by life insurance companies that issue commercial annuities. In 1996 the National Association of Insurance Commissioners asked the SOA to update its mortality tables to reflect recent experience. Later that same year (1996), SOA produced the Annuity 2000 Mortality Tables, which are the current industry standard.

Asset Allocation for Gift Annuity Investments (2009 Survey Report)

	0-19%	20-39%	40-59%	60-79%	80-100%
Cash	373	70	17	11	16
Government Bonds	290	110	52	17	6
Corporate Bonds	258	149	45	15	4
Stocks/Mutual Funds	82	104	167	99	17
Real Estate/REITs	465	8	6	2	1
Other Assets	444	18	8	1	4

From time to time, the Rates Committee receives guidance from highly-regarded financial advisors, as well as from sponsors' own business offices, regarding the use of current and past performance of various asset classes to estimate future returns. Finally, the Committee notes current state restrictions on the investment of gift annuity reserves.

Taking into consideration all of these factors, the Rates Committee used the following asset allocation and benchmarks for calculating the weighted average return assumption on which gift annuity rates, effective January 1, 2012, are based.

Asset Allocation and Benchmarks

The rates effective on January 1, 2012 assume a portfolio consisting of:

- 40% equities
- 55% 10-year Treasury bonds, and
- 5% cash and equivalents.

The following benchmarks are used to determine the average annual total return for each component of the portfolio:

- For *equities*, the approximate average annual *total return* for the period 1926 – 2010 *less 2.0%*.

The Standard and Poor's 500 Index return for the period 1926 – 2010 is approximately 10% per year. This number is then reduced by 2.0%, resulting in 8.0% as the assumed total return on the equity portion of the portfolio. After careful consideration and consultation with a number of investment professionals at sponsor institutions and investment management firms, the historical return used to calculate the suggested rate schedules for July 2011 and for January 2012 was reduced by 2.0%, instead of the previous reduction of 1.0%. This

reflects the generally more conservative assumptions for economic growth and equity returns in the coming decade.

- For *bonds*, the average *current yield* for the last three months on the 10-year U.S. Treasury bond.
- For *cash*, the average *current yield* for the last three months on the 3-month U.S. Treasury Bill.

The weighted average total return on a portfolio of 40% equities, 55% bonds, and 5% cash is rounded down to the nearest 0.25% using ACGA's current guidelines. The Committee reserves the right to exercise its judgment in rounding the expected return, taking into account current economic conditions, forward-looking projections, recent rate change history, and other practical issues.

Importance of the Asset Allocation Assumption

History has shown that, in well-diversified portfolios, asset allocation (not investment manager selection or individual security selection) is the primary driver of investment return. Because returns from equity asset classes historically have outpaced returns from fixed income and cash allocations, many investment professionals believe that allocations emphasizing higher percentages of equity asset classes are likely to have a higher expected return than those emphasizing fixed income allocations.

However, risk is also a very important element of the portfolio management decision. Equity asset classes have significantly greater variability in returns and much greater downside risk than fixed income asset classes. A large investment market decline (such as we experienced in 2008) can quickly turn a gift annuity contract paying the annuitant 7% of its initial gift value into one that is paying 10% (or more) of its current value. Sustained poor investment markets raise the possibility of a gift annuity contract running out of money, requiring the charity to make payments on the contract from other sources.

As shown above, charities differ significantly on the asset allocations chosen for the investment of gift annuity assets. Some institutions invest charitable gift annuities in their endowments. In many cases these endowments have aggressive asset allocations that approach an allocation of 85% to 90% in equity asset classes (or alternative asset classes designed to produce equity-like returns). Other charities invest their gift annuity assets predominantly or wholly in bonds, or choose to reinsure some or all of their gift annuity contracts.

The ACGA believes the 40% equity/55% fixed income/5% cash allocation used in the derivation of its rate schedule is a reasonable allocation that is achievable by virtually all charities, although not all charities will choose this particular asset allocation. (In the past, investment restrictions in states such as California and Wisconsin made a 40% equity allocation difficult or impossible, depending upon the mix of contracts in a particular charity's program.) ***However, it is very important that charities and their investment advisors select an asset allocation that is appropriate for the unique circumstances and preferences of the institution and its gift***

annuity program. For some institutions, it might be appropriate to invest the gift annuity assets more aggressively than the 40%/55%/5% allocation; for other institutions it can be equally appropriate to invest in a more conservative allocation. What's important to note is that the ACGA rate schedule is based on the 40%/55%/5% model portfolio.

The following chart provides some historical perspective as to how the asset allocation of a gift annuity pool affects the residuum.

How Asset Allocation Affects the Residuum				
Assumptions:				
<ul style="list-style-type: none"> • \$10,000 contribution • ACGA rates • One-life annuity, female age 70 • Annual expenses equal to 1.0% of reserves 				
<u>Date of Contribution</u>	<u>Annuity Rate</u>	<u>Duration of Annuity</u>	<u>Amount of Residuum</u>	
			<u>Investment A (50% Stocks/ 50% Bonds)</u>	<u>Investment B (10% Stocks/ 90% Bonds)</u>
12/31/1971	6.2%	18 years	\$16,432	\$12,822
12/31/1979	7.1	18 years	44,246	24,652
12/31/1988	7.3	18 years	20,204	11,418
12/31/1999	7.5	10 years	4,000	7,100

Notes: (1) Investment A: 50% S&P 500 / 50% bonds.
(2) Investment B: 10% S&P 500 / 90% bonds.
(3) Results are calculated on quarterly returns and assume that payments and expenses are taken out at the end of each quarter.

The S&P 500 is the composite series calculated by Wilshire Associates. The bond series is 75% Intermediate Government Bonds and 25% Long-Term Government Bonds as reported by Ibbotson Associates, Inc.

The Rates Committee believes that most investment professionals will consider the following factors in selecting an asset allocation for a charity's gift annuity assets:

- The desired expected investment return
- The risk tolerance of the institution
- The availability of unrestricted assets to make payments on any contracts that might run out of money
- The value of the existing pool of gift annuity assets and the dollar amounts of annuity payments that must be made pursuant to those contracts
- The expertise of its staff or advisors to create, access, and manage well-diversified investment portfolios at reasonable costs
- Whether most gift annuity contracts have unrestricted or restricted gift purposes

- The existence of an institutional assessment against each annuity to build a reserve for making payments on contracts that run out of money.

For more information on implementing the asset allocation decision please refer to ACGA's Gift Annuity Best Practices, which may be found on the ACGA's web site at http://www.acga-web.org/best_practices.html

Historical Assumed Returns

Prior to 1997, charities issuing gift annuities were assumed to set aside 5% of the initial amount transferred for expenses, and to invest the remaining 95% at the assumed total rate of return. It is not certain when the 5% expense assumption began to be factored into the rates. In the chart below, the total net return shown below assumes that a 5% expense load applied from 1927-1996. Therefore the total net return shown is 95% of the assumed total return.

Beginning in 1997, an annual expense assumption replaced the front-end load in the calculations. From 1997 through 2001, annual expenses were assumed to be 0.75%. In 2002, they were increased to 1.0% where they have remained. Thus, for years 1997 and later, total net return is total return minus the annual expense assumption.

	<u>Total Return</u>	<u>Total Net Return</u> (Total return minus expense deduction)
1927-31	4.5%	4.275%
1934	4.0	3.80
1939	3.0	2.85
1955-65	3.5	3.325
1971	4.0	3.80
1974	4.5	4.275
1977	5.0%	4.75%
1980	5.5	5.225
1983-92	6.5	6.175
1994	5.5	5.225
1997	7.0	6.25
1998-2000	6.75	6.0
2001	6.5	5.75
2002	6.75	5.75
1/1/2003	6.25	5.25
7/1/2003-05	6.0	5.0
2006-07	6.25	5.25
7/1/2008	5.75	4.75

Historical Assumed Returns		
	<u>Total Return</u>	<u>Total Net Return</u>
2/1/2009	5.25	4.25
7/1/2010	5.5	4.5
7/1/2011	5.0	4.0
1/1/2012	4.25	3.25

COMPARISON OF GIFT ANNUITY AND COMMERCIAL ANNUITY RATES

The process of reviewing gift annuity rates includes a comparison of them with the pure-life annuity rates offered by highly rated representative insurance companies. Since gift annuities provide for a charitable gift element, the rates are not intended to be competitive with insurance company rates. A narrowing differential between gift annuity and commercial rates would be one factor to suggest that gift annuity rates should perhaps be reduced, while a widening differential would be one indicator that gift annuity rates should possibly be increased. Below is a comparison of ACGA rates and commercial rates in November 2011. It is important to note that commercial gift annuity rates can change almost daily, an approach which is impractical for charitable gift annuity rates. Therefore, comparisons between the ACGA's schedule of suggested maximum charitable gift annuity rates and commercial rates necessary represents only a "snapshot" at a particular point in time.

Comparison of ACGA Rates Effective 1/1/12 with Commercial Rates*			
One-Life Annuity – Female Annuitant			
<u>Age</u>	<u>ACGA Rate</u>	<u>Average Commercial⁽¹⁾ Rate</u>	<u>ACGA Rate as % of Commercial Rate</u>
65	4.7%	6.30 %	74.6%
70	5.1	7.15	71.3
75	5.8	8.39	69.1
80	6.8	10.15	67.0
85	7.8	12.83	60.8
90	9.0	16.73	53.8

**Comparison of ACGA Rates Effective 1/1/12
with Commercial Rates***

One-Life Annuity – Male Annuitant

<u>Age</u>	<u>ACGA Rate</u>	<u>Average Commercial ⁽¹⁾ Rate</u>	<u>ACGA Rate as % of Commercial Rate</u>
65	4.7%	6.80%	69.1%
70	5.1	7.74	65.9
75	5.8	9.11	63.7
80	6.8	10.95	62.1
85	7.8	13.64	57.2
90	9.0	17.55	51.3

* Commercial rate quotations obtained November 14, 2011.

Commercial Rate Footnotes:

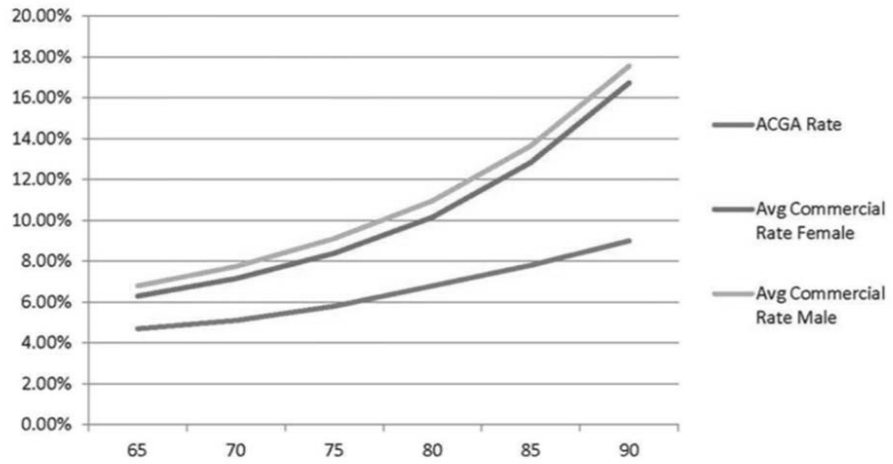
⁽¹⁾Quotations were obtained from between seventeen and eighteen insurance companies, and these are averages of the rates provided by the insurance companies.

The following table gives an historical sense of how ACGA rates have compared with commercial rates since 2009.

**ACGA Rates as a % of Commercial Annuity Rates
2009, 2010, 2011, 2012**

	2009	2009	2010	2010	Jan 2011	Jan 2011	Nov 2011	Nov 2011
Age	Male	Female	Male	Female	Male	Female	Male	Female
65	67.9%	72.8%	74.3%	79.6%	73.9%	78.9%	69.1%	74.6%
70	64.3	70.0	69.0	74.8	71.3	76.9	65.9	71.3
75	61.2	66.8	65.3	71.0	68.6	74.2	63.7	69.1
80	58.4	63.5	61.6	66.7	66.5	71.6	62.1	67.0
85	54.0	57.6	56.6	60.0	60.3	63.8	57.2	60.8
90	49.2	51.4	52.8	54.5	55.7	58.0	51.3	53.8

**Comparison of 1-Life ACGA Rates Effective 1/1/2012 with
Commercial Annuity Rates**



THE FINANCIAL RISK OF ISSUING GIFT ANNUITIES

When a charity issues a gift annuity, it incurs a financial risk because the annuity payments are a general liability of that charity. If the contribution for a gift annuity is entirely consumed because of the longevity of the annuitant(s) and/or poor investment performance, the charity must make payments from its general assets. Thus, there is the possibility that the charity could lose money on any one gift annuity, or even on its entire gift annuity program.

The annuitant also assumes a risk because if the charity that issues the annuity becomes insolvent, payments cease. If a charity, pursuant to state requirements, maintains a segregated reserve fund with sufficient assets to back outstanding annuities, the annuitant has a greater degree of protection. Still, there is the possibility that the segregated fund could be exhausted or, in the case of insolvency, that the assets within the segregated fund might not be insulated from the charity's other creditors. Unlike a bank deposit or a commercial annuity, a gift annuity is not backed by a guaranty association. Fortunately, default on gift annuities is rare, but it could happen if the issuing charity has limited financial resources or is not managed well.

The ACGA rates are designed to manage the risks both to charities and donors. They are intended to be high enough to be attractive to donors, but low enough to result in a significant residuum for the charity under normal conditions. If a charity develops and executes a well-diversified investment portfolio with an asset allocation appropriate for its unique situation, it should derive meaningful financial value from its gift annuity program over time. However, this does not mean an individual gift annuity contract can never run out of money. If a charity issues gift annuities in sufficient quantity over time, one or more contracts are likely to run out of money because the annuitant significantly outlives life expectancy at the time of the gift and/or the gift annuity assets suffer a bear market in the early years of the contract.

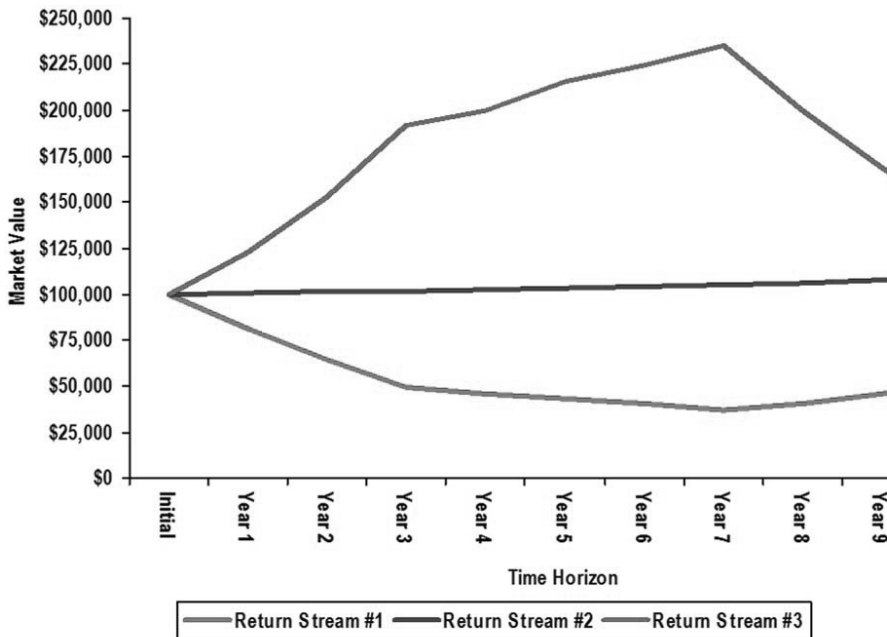
Finally, it is important to consider that the timing of investment returns has a very significant impact on the value of a gift annuity contract at termination. This fact is sometimes overlooked when, for simplicity's sake, one uses average annual returns to estimate the value of a contract to the charity. For purposes of illustration, consider the three series of returns in the chart below. All three series have the same average annual return of 7.6%, yet the average return is achieved in three completely different ways. The first series has significant negative returns of -12% in the first three years, and significant positive returns in the final three years. The second series has constant returns of 7.6%. The third series is a mirror image of the first series. It has significant up returns in the first three years followed by significant down returns in the final years.

Year	Return Stream 1	Return Stream 2	Return Stream 3
1	-12.00%	7.60%	30.00%
2	-12.00%	7.60%	30.00%
3	-12.00%	7.60%	30.00%
4	7.60%	7.60%	7.60%
5	7.60%	7.60%	11.54%
6	11.54%	7.60%	7.60%
7	7.60%	7.60%	7.60%
8	30.00%	7.60%	-12.00%
9	30.00%	7.60%	-12.00%
10	30.00%	7.60%	-12.00%

Average Annual Compound Return 7.60% 7.60% 7.60%

The line graph below depicts the value of a \$100,000, 7% gift annuity contract established on January 1 of Year 1 and making an annual payment on December 31 of each year. (The calculations are gross of fees.) Also note that these returns are hypothetical and used for illustrative purposes only. They do not represent performance of any specific investment.

The Sequence of Investment Returns Matters



Note that by the end of Year 10, Return Stream #3, which experienced the positive returns in the early years, is worth almost three times as much as Return Stream #1, which experienced negative returns immediately after the gift was established. Return Stream #3 is also worth 30% more than Return Stream #2 in which the gift achieved a constant investment return of 7.6%. The outcome of Return Stream #2 is more than double the poor outcome generated under Return Stream #1.

While the results may seem counterintuitive, the math is relatively simple. If a gift started at \$100,000 and declined by 30% to \$70,000, it would take more than a 30% move upward to bring the contract market value back to \$100,000. In fact, the gift would have to improve by \$30,000 divided by \$70,000—or nearly 43%—to get back to break even. Factor in a constant payment to the income beneficiary and it is easy to understand why bear markets in the early years of a gift annuity contract are so damaging to its value.

Appendix: **Present Value Calculations and Charitable Gift Annuities**

Definition of Present Value

Present value is simply the value in today’s dollars for an amount that will be received in the future. The key concept is that \$1 today is worth more than \$1 received in the future. A simple example is a one-year calculation based on an expected return. If you currently have \$100 and can earn 5% in one year, at the end of year one you will have a projected \$105 in future value. Suppose someone said “I will give you \$105 in one year, how much will you give me today?” You would simply discount the future by the assumed rate of return of 5% and you would end up with a present value of \$100. As you can see by this example, a person can calculate a future value based on assumptions (\$105) and a current present value (\$100), and then can calculate a present value based on assumptions (\$100) and a future value (\$105). This illustrates the time value of money and can be easily calculated using spreadsheet applications or financial calculators.

Historically, the ACGA has recommended charitable gift annuity rates based on an assumption that the nominal or future value of the contract at its termination would be 50% of its original funding amount. For an example, for a \$10,000 gift made by a 60-year old would be worth \$5,000 at the contract termination if all of the assumptions were precisely realized. By using an assumed net rate of return as the discount rate—for example, 4.75%—and a financial calculator, we can derive a present value of \$1,378.26 for the eventual \$5,000 to be received. So the present value to the charity is 13.78% of the original gift annuity contribution. What follows is a table that provides the calculations at various ages for hypothetical gift annuity contracts funded with \$10,000.

Age	Present Value at Issue Date of a \$5,000 Residuum	Present Value as a Percentage of the \$10,000 Original Gift
60	\$1,378.26	13.78%
65	1,689.01	16.89%
70	2,246.63	22.47%
75	2,457.74	24.57%
80	2,893.91	28.94%
85	3,327.19	33.27%
90	3,719.24	37.19%

The above table is simply for illustration purposes only. It does not address differing life expectancies for male and female annuitants; differences between ACGA rate committee assumptions and actual realized results for the variables of expenses, investment returns or payment frequency; or the appropriateness of a particular discount rate.

SUGGESTED CHARITABLE GIFT ANNUITY RATES
Approved by the American Council on Gift Annuities
November 7, 2011
Effective January 1, 2012

SINGLE LIFE

Age	Rate	Age	Rate
5-10	2.0	68	4.9
11-15	2.1	69	5.0
16-19	2.2	70	5.1
20-23	2.3	71	5.3
24-26	2.4	72	5.4
27-29	2.5	73	5.5
30-32	2.6	74	5.7
33-34	2.7	75	5.8
35-36	2.8	76	6.0
37-38	2.9	77	6.2
39-40	3.0	78	6.4
41-42	3.1	79	6.6
43	3.2	80	6.8
44-45	3.3	81	7.0
46	3.4	82	7.2
47	3.5	83	7.4
48-49	3.6	84	7.6
50	3.7	85	7.8
51-52	3.8	86	8.0
53-54	3.9	87	8.2
55	4.0	88	8.4
56-57	4.1	89	8.7
58	4.2	90+	9.0
59	4.3		
60-61	4.4		
62-63	4.5		
64	4.6		
65	4.7		
66-67	4.8		

NOTES:

1. The rates are for ages at the nearest birthday.
2. For immediate gift annuities, these rates will result in a charitable deduction of more than 10% if the CFMR is 1.4% or higher, whatever the payment frequency. If the CFMR is less than 1.4%, the deduction will be less than 10% when annuitants are below certain ages.
3. For deferred gift annuities with longer deferral periods, the rates may not pass the 10% test when the CFMR is low.
4. To avoid adverse tax consequences, the charity should reduce the gift annuity rate to whatever level is necessary to generate a charitable deduction in excess of 10%.

SUGGESTED CHARITABLE GIFT ANNUITY RATES
 Approved by the American Council on Gift Annuities
 November 7, 2011
 Effective January 1, 2012

TWO LIVES – JOINT & SURVIVOR

Younger Age	Older Age	Rate
5	5-95+	1.8
6	6-95+	1.8
7	7-95+	1.8
8	8-95+	1.8
9	9-95+	1.8
10	10-95+	1.8
11	11-95+	1.9
12	12-95+	1.9
13	13-95+	1.9
14	14-95+	1.9
15	15-95+	1.9
16	16-95+	2.0
17	17-95+	2.0
18	18-95+	2.0
19	19-95+	2.0
20	20-95+	2.1
21	21-95+	2.1
22	22-95+	2.1
23	23-95+	2.1
24	24-95+	2.1
25	25-95+	2.2
26	26-95+	2.2
27	27-95+	2.2
28	28-95+	2.2
29	29-95+	2.3
30	30-95+	2.3
31	31-95+	2.3
32	32-95+	2.3
33	33-95+	2.4
34	34-95+	2.4
35	35-95+	2.4
36	36-95+	2.5
37	37-95+	2.5
38	38-95+	2.5
39	39-95+	2.6
40	40-95+	2.6
41	41-95+	2.7
42	42-95+	2.7
43	43-95+	2.8
44	44-95+	2.8
45	45-95+	2.9
46	46-95+	2.9
47	47-50	3.0
47	51-95+	3.1
48	48	3.0

Younger Age	Older Age	Rate
48	49-95+	3.1
49	49-51	3.1
49	52-95+	3.2
50	50	3.1
50	51-53	3.2
50	54-95+	3.3
51	51-52	3.2
51	53-55	3.3
51	56-95+	3.4
52	52-54	3.3
52	55-95+	3.4
53	53-55	3.4
53	56-58	3.5
53	59-95+	3.6
54	54	3.4
54	55-57	3.5
54	58-95+	3.6
55	55	3.5
55	56-58	3.6
55	59-61	3.7
55	62-95+	3.8
56	56-57	3.6
56	58-59	3.7
56	60-62	3.8
56	63-95+	3.9
57	57-58	3.7
57	59-63	3.8
57	64-95+	3.9
58	58-61	3.8
58	62-65	3.9
58	66-95+	4.0
59	59-60	3.8
59	61-63	3.9
59	64-68	4.0
59	69-95+	4.1
60	60-62	3.9
60	63-66	4.0
60	67-70	4.1
60	71-95+	4.2
61	61	3.9
61	62-64	4.0
61	65-68	4.1
61	69-95+	4.2
62	62-63	4.0
62	64-66	4.1

Younger Age	Older Age	Rate
62	67-69	4.2
62	70-95+	4.3
63	63-64	4.1
63	65-67	4.2
63	68-95+	4.3
64	64-66	4.2
64	67-70	4.3
64	71-95+	4.4
65	65	4.2
65	66-68	4.3
65	69-72	4.4
65	73-95+	4.5
66	66-67	4.3
66	68-71	4.4
66	72-75	4.5
66	76-95+	4.6
67	67-69	4.4
67	70-73	4.5
67	74-95+	4.6
68	68	4.4
68	69-71	4.5
68	72-75	4.6
68	76-95+	4.7
69	69-70	4.5
69	71-73	4.6
69	74-76	4.7
69	77-95+	4.8
70	70-71	4.6
70	72-74	4.7
70	75-78	4.8
70	79-95+	4.9
71	71-73	4.7
71	74-75	4.8
71	76-79	4.9
71	80-82	5.0
71	83-95+	5.1
72	72	4.7
72	73-74	4.8
72	75-76	4.9
72	77-79	5.0
72	80-83	5.1
72	84-95+	5.2
73	73	4.8
73	74-75	4.9
73	76-77	5.0
73	78-80	5.1

SUGGESTED CHARITABLE GIFT ANNUITY RATES
 Approved by the American Council on Gift Annuities
 November 7, 2011
 Effective January 1, 2012

TWO LIVES – JOINT & SURVIVOR (cont.)

Younger Age	Older Age	Rate
73	81-83	5.2
73	84-95+	5.3
74	74	4.9
74	75-76	5.0
74	77-78	5.1
74	79-80	5.2
74	81-83	5.3
74	84-87	5.4
74	88-95+	5.5
75	75	5.0
75	76-77	5.1
75	78	5.2
75	79-81	5.3
75	82-83	5.4
75	84-86	5.5
75	87-95+	5.6
76	76-77	5.2
76	78-79	5.3
76	80-81	5.4
76	82-83	5.5
76	84-85	5.6
76	86-88	5.7
76	89-95+	5.8
77	77-78	5.3
77	79	5.4
77	80-81	5.5
77	82-83	5.6
77	84-85	5.7
77	86-87	5.8
77	88-91	5.9
77	92-95+	6.0
78	78	5.4
78	79	5.5
78	80-81	5.6
78	82-83	5.7
78	84	5.8
78	85-86	5.9
78	87-89	6.0
78	90-92	6.1
78	93-95+	6.2
79	79-80	5.6

Younger Age	Older Age	Rate
79	81	5.7
79	82	5.8
79	83-84	5.9
79	85-86	6.0
79	87-88	6.1
79	89-90	6.2
79	91-93	6.3
79	94-95+	6.4
80	80	5.7
80	81	5.8
80	82	5.9
80	83-84	6.0
80	85	6.1
80	86-87	6.2
80	88-89	6.3
80	90-91	6.4
80	92-93	6.5
80	94-95+	6.6
81	81	5.9
81	82	6.0
81	83	6.1
81	84-85	6.2
81	86	6.3
81	87-88	6.4
81	89	6.5
81	90-91	6.6
81	92-94	6.7
81	95+	6.8
82	82	6.1
82	83	6.2
82	84	6.3
82	85-86	6.4
82	87	6.5
82	88	6.6
82	89-90	6.7
82	91	6.8
82	92-93	6.9
82	94-95+	7.0
83	83	6.3
83	84	6.4
83	85	6.5

Younger Age	Older Age	Rate
83	86	6.6
83	87	6.7
83	88-89	6.8
83	90	6.9
83	91	7.0
83	92-93	7.1
83	94-95+	7.2
84	84	6.5
84	85	6.6
84	86	6.7
84	87	6.8
84	88	6.9
84	89	7.0
84	90	7.1
84	91	7.2
84	92-93	7.3
84	94-95+	7.4
85	85	6.7
85	86	6.9
85	87	7.0
85	88	7.1
85	89	7.2
85	90	7.3
85	91	7.4
85	92	7.5
85	93-95+	7.6
86	86	7.0
86	87	7.1
86	88	7.3
86	89	7.4
86	90	7.5
86	91	7.6
86	92	7.7
86	93-95+	7.8
87	87	7.3
87	88	7.4
87	89	7.5
87	90	7.7
87	91	7.8
87	92	7.9
87	93-95+	8.0

SUGGESTED CHARITABLE GIFT ANNUITY RATES
Approved by the American Council on Gift Annuities
November 7, 2011
Effective January 1, 2012

TWO LIVES – JOINT & SURVIVOR (cont.)

Younger Age	Older Age	Rate
88	88	7.6
88	89	7.7
88	90	7.9
88	91	8.0
88	92	8.1
88	93-95+	8.2
89	89	7.9
89	90	8.0
89	91	8.2
89	92	8.3
89	93-95+	8.5
90	90	8.2
90	91	8.4
90	92	8.5
90	93	8.7
90	94-95+	8.8
91	91	8.6
91	92	8.7
91	93-95+	8.8
92	92-95+	8.8
93	93-95+	8.8
94	94-95+	8.8
95	95+	8.8

Procedure for Calculating Suggested Deferred Gift Annuity Rates

Approved by the American Council on Gift Annuities

Effective January 1, 2012

1. Determine the annuity starting date, which is:

One year before the first payment, if payments are made annually.

Six months before the first payment, if payments are made semi-annually.

Three months before the first payment, if payments are made quarterly.

One month before the first payment, if payments are made monthly.

2. Determine the number of whole and fractional years from the date of the contribution to the annuity starting date (the deferral period). Express the fractional year as a decimal of four numbers.
3. For a deferral period of any length, use the following formula to determine the compound interest factor:

$$F = 1.0325^d, \text{ where}$$

F is the compound interest factor and

d is the deferral period

Example: If the period between the contribution date and the annuity starting date is 14.5760 years, the compound interest factor would be $1.0325^{14.576} = 1.593902$

4. Multiply the compound interest factor (F) by the immediate gift annuity rate for the nearest age or ages of a person or persons at the annuity starting date.

Example: If the sole annuitant will be nearest age 65 on the annuity starting date and the compound interest factor is 1.593902, the deferred gift annuity rate would be 1.593902 times 4.7%, or 7.5% (rounded to the nearest tenth of a percent).

Comments:

- The annuity starting date for purposes of calculating the deferred gift annuity rate will be the same as the annuity starting date for calculating the charitable deduction, if payments are at the end of the period (which is usually the case). This was not true with the pre-July 1, 2001 methodology.
- An annuitant is credited with compound interest for the entire period from the date of contribution to the annuity starting date. Under the pre-July, 2001 methodology, compound interest was credited only for the number of whole years between the two dates.
- Charities issuing deferred gift annuities in New York and New Jersey may need to use a slightly lower compounding rate depending on the deferral period (see page 27). Information regarding this subject will be posted on the ACGA website (www.acga-web.org) and on the new gift annuity rate sheets.

**Note to Charities Issuing Deferred Gift Annuities
in New York and New Jersey***
Approved by the American Council on Gift Annuities on November 7, 2011
Effective January 1, 2012

Through August of 2012 the following compound interest factors during the deferral period noted will satisfy the requirements of New York and New Jersey:

For all deferral periods:

Single-life and two-life annuities, whatever the gender of the annuitants, a compound interest factor of 3.25%.

Information about the maximum compound interest factors for these two states are posted on the ACGA website. See www.acga-web.org.

*New York and New Jersey are the two states known at this time that may require different interest factors for deferred gift annuities with longer deferral periods.




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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Accounting 101 for Charitable Gifts

Presented by:

Vera Bennett

Chief Financial and
Administrative Officer
Silicon Valley Community
Foundation
2440 West El Camino Real, Suite 300
Mountain View, CA 94040
P: 650-450-5412
E: vlbennett@siliconvalleycf.org

Kristine L. Caratan, CPA

Partner—Retired
Moss Adams, LLP
722 47th Avenue
San Francisco, CA 94121
P: 415-385-1821
E: kristinecaratan@yahoo.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

Understanding the Accounting, Finance, and Tax Rules of Long-Term Giving – or
"why you really need to talk to the finance department"

30th ACGA Conference
 April 20, 2012

Vera Bennett, Chief Financial and Administrative Officer, Silicon Valley Community Foundation
 Kristine L. Caratan, CPA – Partner (Retired) Moss Adams LLP

Presentation Objectives

- Understanding of the accounting rules for planned and split interest gifts
- Basic understanding the tax reporting rules
- Interdepartmental communications - Finance and Development
- What information the auditors will want
- What the tax preparer will want
- When to ask a question or two

2

Caveat

Vera and Tina are not a tax specialists –
 We can address your tax questions to a point and we can get back to you on any matter that we do not have the expertise to address.

3

What the Auditors/Finance Department Has to Deal With

- Chapter 6 of the AICPA Audit and Accounting Guide
- Investments – Including Fair Value Accounting
- Beneficial interest rules

4

Types of Gifts

- We will concentrate on:
 - Bequests
 - Annuities
 - Charitable Remainder Trusts
- If there is time:
 - Charitable Lead Trusts
 - Pooled Income Funds

5

Bequests

- Obtain critical information
 - Copy of will or trust
 - Contact information for trustee, accountant, legal counsel
 - Family members
 - Type of gift
 - Unusual assets
 - Gift restrictions
 - Residual or specific gift

6

Bequests

- Valuation
 - Inventory
 - Formal accounting
 - Explanation of how expenses are allocated
 - Liquidation and distribution
- Avoid being trustee or executor

7

Bequests – Gift Procedures

- Assign a point person
- Review GAP – get approval
- Keep a checklist
- Monitor progress/update status
- Document all conversations
- Keep finance informed
- Consult with legal counsel
- Don't sign release until gift is complete

8

Bequests

- Interdepartmental communication is essential
- Development Department might not be as forthcoming as they should be
- Finance might not explain everything in a language Development might understand
- Rule – if an annual major donor dies, chances are they have left a bequest
- Examples

9

Bequests

- When does the Organization record the revenue?
 - Unconditional anticipation that funds will be received
- What does the Organization record?
 - Discount rules apply if time for payment delayed
 - Tax difference
- Accounting policy is essential

10

Annuities

- Benefits to donors
 - People living longer
 - Unwilling to make a large outright gift
 - Increase income while making gift to charity
 - Market volatility and income insecurity
 - Low interest rates
 - Property – asset rich/cash poor
 - Term CGAs

11

Determining Rate

- ACGA rates are conservative
 - Designed to protect charity and beneficiaries
- Offering different rates:
 - Consult State regulations
 - Why offer a higher or lower rate?
 - Requires disclosure
 - Rates can differ by gift and within a pool

12

Managing Risk

- Two primary types of risk
 - Mortality Risk
 - Investment Risk
- Re-insurance
 - When to consider it
 - Cost

13

Annuities – Year of Contribution

Accounting entries

- Dr – Investments (FMV)
 - Cr – Annuity Payable
 - Cr – Change in Split Interest Gift Income
- Annuity payable should be computed based on the actuarial PV of the annuity payments

JE provided not to make you accountants but to provide an explanation why reportable numbers are different

14

Annuities – Intervening Years

- Since the liability represents the FV of the expected stream of payments – when a payment is made it will reduce the liability
- Since the assets are invested to earn sufficient income (hopefully) to fund the payment, the increase in investments will increase the liability
- At the end of the year, the assets will be adjusted to FV and the liability will be recomputed – any difference goes to gain/loss
- Under the accounting standards, the assets and associated liabilities are not considered restricted unless state law requires segregation

15

Reserves

- Check State requirements
- CA DOI – must have a reserve fund
 - 50% of liability
 - Legally and physically segregated
 - Trust account - charity can self trustee
 - No more than 50% in equities or mutual funds
- Funding reserves
 - Pre-fund with unrestricted gifts
 - Fund with a % of matured annuities
- www.pgresources.com/regs.html

16

Annuities – Year of Termination

- Development needs to communicate annuity terminations to finance/accounting
- What happens when neither finance/accounting or development knows of an annuitants death?
- The remaining liability is taken into income
- The associated assets are reclassified to general investments

17

Annuities - Things to be Mindful About

- Due to abuse in the early years (1970's and 1980's) it is next to impossible to create a CGA with a payout rate that will ultimately leave the charity without reserved funds to pay from
- Most states are requiring some sort of segregation – State laws follow the donor's place of residence
- Be mindful of permanently restricted CGA's

18

Charitable Remainder Trusts

- **First rule** – there is no difference in the accounting for the various types of CRTs
- **Second rule** – there is a difference in the accounting if the charity is the trustee or if an related party is the trustee
- **Third rule** – all CRTs are TRNA unless they are permanently restricted by the donor at gift
- **Fourth rule** – Lack of consistent and open interdepartmental communication may result in a lack of information on both sides

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Types of Charitable Remainder Trusts

- CRUT
 - % payout of FMV at end of year
- CRAT
 - % payout of beginning value
- Net Income
- Flip
 - From net income to CRUT at date certain or event
- Deferred
 - Through estate or at inception of event/date

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Charitable Remainder Trusts

- To trustee or not to trustee
 - Fees/costs
 - Minimums
 - Irrevocability
 - Endowment building
 - Flexibility for donor - remainder beneficiaries
 - Unusual assets
 - Donor self trustees
 - Control
 - Co-trustee issues/cautions
- Annual accounting if not trustee

21

Charitable Remainder Trusts - Year of Contribution

Charity is the trustee:

Dr – Investments (FMV)
 Cr – CRT liability
 Cr – Change in Split Interest
 Gift Income

I could bore you to tears about how the finance department is to compute the CRT liability, but suffice to say it is based on FV rules

22

Charitable Remainder Trusts Contribution

Charity is not the trustee:
 Year of contribution (if you know about it)

Dr – CRT receivable
 Cr – Change in Split Interest
 Gift Income

Receivable is recorded based on the actuarial PV of the FMV of the assets contributed

23

Charitable Remainder Trusts (Trustee) Intervening Years

- Since the liability represents the FV of the expected stream of payments – when a payment is made it will reduce the liability
- Since the assets are invested to earn sufficient (hopefully) amounts to fund the payment, the increase in investments will increase the liability
- At the end of the year, the assets will be adjusted to FV and the liability will be recomputed – any difference goes to change in SIGs
- Accounting rules are very similar to CGAs

24

Charitable Remainder Trusts (Not Trustee) – Intervening Years

- Since the Organization doesn't hold the assets or make the payments, the only entry needed is to adjust the receivable and take the offset to change in SIGs

25

Charitable Remainder Trusts (Trustee) - Termination Year

- The remaining liability is taken into income
- The associated assets are reclassified to general investments

26

Charitable Remainder Trusts (Not Trustee) – Termination Year

- The assets are received from the Trustee
- The receivable is reduced to zero
- Any difference goes to income

27

Charitable Remainder Trusts - Things to be Mindful About

- If a net income trust, does the Trust have an income flow?
- What is the asset funding the Trust?
- If the Organization is not the Trustee, when is the last time someone within the Organization has contacted the Trustee/donor?
- How do you record something you don't know exists?

28

Charitable Remainder Trusts - More Things to be Mindful About

- Follow through – annual communication with beneficiaries
- Follow up on SS notifications
 - Set up Yahoo/Google alerts
 - People searches
- Recover any payments cashed by others

29

Hiring 3rd Party Administrator

- What to look for:
 - Investment expertise
 - Tax preparation – timely k-1s
 - Annual report to beneficiaries
 - Payout calculation – CRUT
 - Donor stewardship
- Cost benefit analysis
 - Internal capacity
 - Options – bank trust depts., big firms

30

Public Disclosure

- Tax return – disclosure - new for 2010
 - Schedule R – Part IV
- Communicate disclosure requirements to donors
- Efforts underway to exempt charitable trusts

31

Copy of Schedule R

32

Charitable Lead Trusts

- To trustee or not to trustee
 - Issues
- CLTs are similar to long term pledges
 - Subject to discount
 - Need to consider uncollectible risk

33

Pooled Income Funds

- Accounting is no different than other split interest gifts
- Rule 4 from above applies

34

Pooled Income Funds

Contribution of assets

- Dr – Assets of Pooled Income Fund
- Cr – Contribution revenue
- Cr – Discount for future interest

35

Pooled Income Funds

Term of the agreement

- Dr – Assets of Pooled Income Fund
- Cr – Liability to Life Beneficiary
- Dr – Liability to Life Beneficiary
- Cr – Assets of Pooled Income Fund

Income earned and subsequent payment thereof to beneficiary

36

Pooled Income Funds

Termination of agreement

- Dr – Discount for Future Interest
- Cr – Change in Split interest Gift Income
- Dr – General Investments
- Cr – Assets of Pooled Income Fund

37

Why Finance Asks Development SO Many Questions

- The rules for valuing investments and other assets/liabilities subject to fair value are long and cumbersome
- While it is development's job to expand the resources of the Organization, accepting anything is not wise
- An unusual planned gift should be subject to going through gift acceptance

38

Policies

- Good GAPs
 - Define unusual gifts
 - Committee review and approval
 - Document, document, document
- Solid accounting policies
 - Revenue Recognition
 - Internal Controls

39

Auditors and Tax Preparers

- The reporting rules are different so the questions being asked will be different
- Documentation is key
- Controls are key
- Don't hide behind board members
- The auditors and the tax preparers are the organization's friends!

40

Auditors will Want

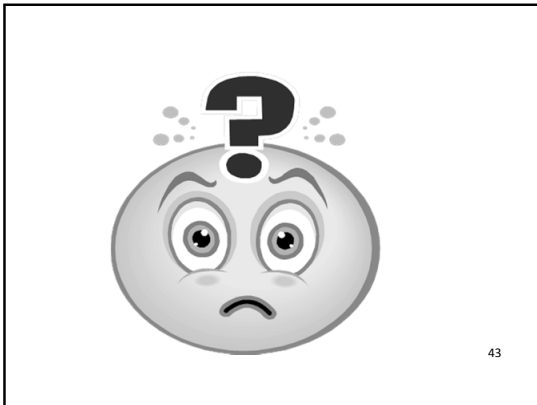
- Bequests
 - Communications between finance and development
 - Understanding of the controls
 - Any and all documentation obtained from estate
- Split interest gifts
 - Trust documents
 - Understanding of the controls

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Summary

- Continuous evaluation of process
 - Change procedures as organization grows
- Understand accounting rules
 - Development
 - GAAP
- Working together for the same goal
 - Accounting is not there to say "NO"
- Organizational reputation

42



Contact Information

Vera Bennett Chief Financial and Administrative Officer – Silicon Valley Community Foundation vlbennett@siliconvalleycf.org 650-450-5412	Kristine ("Tina") Caratan, CPA Partner (retired) – Moss Adams LLP Adjunct Professor – SFSU kcaratan@sfsu.edu 415-385-1821
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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Charitable Remainder Trust Basics

Presented by:

Pamela J. Davidson, J.D.
Charitable Gift Planner and Consultant
Davidson Gift Design, Thompson & Associates
3940 Walcott Lane
Bloomington, IN 47404
P: 812-876-8646
E: pj davidson@giftplanners.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

CHARITABLE REMAINDER TRUSTS

THE BASICS,

PROFILES OF LIKELY USERS,

HOW CHARITY CAN PROMOTE

THE 30TH AMERICAN COUNCIL ON GIFT ANNUITIES CONFERENCE

San Francisco, California

April 19, 2012

PAMELA JONES DAVIDSON, J.D.

Thompson & Associates

Pamela@ceplan.com

www.ceplan.com

Davidson Gift Design

Charitable Gift Planning and Consulting

pj davidson@giftplanners.com

www.giftplanners.com

PAMELA JONES DAVIDSON, J.D.

Pamela Jones Davidson, J.D., is a Vice President for **THOMPSON & ASSOCIATES**, offering estate planning services to nonprofits. She is also President of **DAVIDSON GIFT DESIGN**, Bloomington, Indiana, a consulting firm specializing in gift planning, planned giving program design and implementation, and training.

Before forming Davidson Gift Design in 1999, she was a charitable gift planner and consultant for three years with Laura Hansen Dean and Associates, Indianapolis, Indiana. From 1985 through 1996, she was with Indiana University Foundation, most as its (Executive) Director of Planned Giving and Associate Counsel.

Ms. Davidson received her undergraduate degree from Indiana University in 1975, and graduated *magna cum laude* from the Indiana University School of Law at Indianapolis in 1979. She has previously been an examiner in the Estate and Gift Tax Division of the Internal Revenue Service, and later practiced business, corporate and probate law with the Indianapolis law firm of Bingham, Summers, Welsh & Spilman (now, Bingham McHale) before joining the nonprofit sector in 1985.

Ms. Davidson was the 1999 President (now, Chair) of the National Committee on Planned Giving (now, Partnership for Philanthropic Planning, PPP), and served NCPG in various capacities during her six years on the Board, in 1995 as Education Chair, in 1996 as Secretary, and as President Elect in 1998. She served as NCPG's 2000 Nominating Committee Chair and is a past member and chair of its Ethics Committee.

Ms. Davidson is on the Editorial Board of the Planned Giving Design Center, and past faculty of The College of William and Mary's National Planned Giving Institute. She is a past board member and past treasurer of the Indiana Chapter of the National Society of Fund Raising Executives (now, Association of Fundraising Professionals, AFP), and a past board member and president of the Planned Giving Group of Indiana. She is a past president of the Network of Career Women, and a Leadership Bloomington alumna. She is on the Boards of her local Edgewood Choral Foundation and Buskirk-Chumley Theater, and on the Board and past President of Middle Way House, her community's nationally recognized women's shelter. She serves on the Community Advisory Boards of both her local public radio and television stations.

In her twenty-seven years in the gift planning profession, Ms. Davidson has made countless presentations throughout the state of Indiana and nationally to development professionals, planned giving councils, estate and tax attorneys, accountants and financial planners, and to prospects and donors about planned giving and charitable giving techniques. She is known for her pragmatic and practical presentations, designed to empower and motivate many individuals to understand there is an understandable gift plan that will work in their circumstances that can further personal planning goals and philanthropy both.

3940 W. Walcott Lane, Bloomington, IN 47404-9339
812/876-8646 voice 812/322-3495 cell
Pamela@ceplan.com pj davidson@giftplanners.com

Charitable Remainder Trusts

The Technical Rules

- I. Charitable Trusts are an Important (and underutilized) Estate and Tax Planning Tool.
 - A. Benefits to a grantor (or donor) of a Charitable Remainder Trust may include:
 1. Avoiding or reducing current income taxes.
 2. Providing the donor with a “tax-free” investment vehicle in which assets can be sold and traded freely.
 3. Generating more income from the same assets versus selling and reinvesting outside of the trust.
 4. Redirecting the donor’s “social capital” to reduce estate taxes and fund other charitable interests.
 - B. Two Key Types of Charitable Trusts:
 1. ***The Charitable Remainder Trust (“CRT”)***. The CRT is a trust in which one or more noncharitable beneficiaries receive the trust income for a certain period, followed by one or more charitable beneficiaries as remaindermen. The CRT has several variations that are covered later in this material, and is by far the more popular of the two types of trusts.
 2. ***The Charitable Lead Trust (“CLT”)***. The CLT provides an income stream during its terms to one or more charitable

beneficiaries, and then leaves the corpus of the trust to one or more noncharitable beneficiaries.

II. The ABCs of CRTs.

A. Specific potential benefits available by using a CRT are:

1. **Avoiding capital gains tax.** Upon the sale of a capital asset by a CRT, no capital gains tax is immediately due because of the charitable nature of the trust.
2. **Increasing an income stream.** Because the trustee will have more net proceeds to invest after the sale of an asset than the donor would if he or she sold the same asset outside of the trust, a larger income stream can be generated from the same asset.
3. **Saving other income taxes.** The donor receives a current charitable income tax deduction for the present value of the remainder interest that will pass to charity. This can be used to offset other income on Schedule A and save the donor additional current income taxes.
4. **Saving estate taxes.** The effect of a CRT is to remove the value of any asset owned by the trust from the donor's estate, thereby reducing the donor's estate tax liability.
5. **Furthering charitable interests.** By leaving the corpus of the CRT to charity at the end of the trust term, the donor can

further his or her charitable interests while also meeting current income needs of the donor or other beneficiaries.

- B. There are two basic types of CRTs:
1. ***The Charitable Remainder Unitrust (“CRUT”)***. In a CRUT, the income beneficiaries receive an income stream based upon the assets owned in the trust valued annually. The income each year, then, will rise or fall with the investment performance of the trust.
 2. ***The Charitable Remainder Annuity Trust (“CRAT”)***. In a CRAT, the income is a set amount based upon a stated dollar amount or a percentage of the assets invested at inception of the trust.
- C. There are some basic requirements under IRC § 664 (and the applicable Treasury Regulations, Revenue Rulings, and revenue Procedures) that apply to **both** CRUTs and CRATs. To qualify as either type, a trust must:
1. Be an irrevocable trust valid under state law (see Treas. Regs. § 1.664-1(a)(1)(i)).
 2. Provide for the payment of an annuity or a unitrust amount (see Treas. Regs. § 1.664-1(a)(2)), which must comply with the 5% minimum and 50% maximum rules described below for each type of trust (see *infra* Section II.D.2).

3. Pay income to at least one noncharitable beneficiary in annual or more frequent installments (see IRC §§ 664(d)(1)(A), 664(d)(2)(A)).
4. Prohibit payments to any person of any amount other than the annuity or unitrust payments and the charitable remainder interest (see IRC §§ 664(d)(1)(B), 664(d)(2)(B)).
5. Transfer to or apply for the benefit of only charitable organizations described in IRC Section 170(c) the remainder interest at the expiration of the annuity or unitrust term (see IRC §§ 664(d)(1)(C), 664(d)(2)(C)).
6. Not restrict the investment options of the trustee in the governing instrument (see Treas. Regs. § 1.664-1(a)(3)).
7. Function exclusively as a CRT from its date or creation (see Treas. Regs. § 1.664-1(a)(4)).
8. Provide in its governing instrument for proration of the annuity or unitrust amount for any short year based upon the actual number of days (see Treas. Regs. §§ 1.664-2(a)(1)(iv)(a), 1.664-3(a)(1)(iv)(a)).
9. Require in the governing instrument payment of the annuity or unitrust amount for a period beginning with the first year of the trust and continuing (i) for the life or lives of a named individual or individuals living at the creation of the trust, or

(ii) for a term of years not to exceed twenty (20) (see IRC §§ 664(d)(1)(A), 664(d)(2)(A)). A combination of the two may be used, but the trust will not qualify if the payment period may extend beyond (i) the lives of the beneficiaries living at the creation of the trust and (ii) twenty (20) years.

Two permissible examples are:

Example 1: An otherwise qualified CRUT provides for a unitrust payable to Beneficiary (“B”) for the shorter of B’s life or 20 years.

Example 2: An otherwise qualified CRAT provides for payment of the annuity to B for life and then to Successor (“S”) for the shorter of S’s life or 20 years. This is permissible if both B and S were alive at the time the trust was created.

D. A couple of the basic rules differ between a CRAT and a CRUT.

More specifically, these rules apply to the following:

1. **Additions to trust.** No additional contributions may be made to a CRAT (Treas. Regs. § 1.664-2(b)); however, CRUTs may receive subsequent, additional contributions of property (Treas. Regs. § 1.664-3(b)). The CRAT instrument must explicitly prohibit additions to the trust, and the CRUT instrument must either prohibit additions to the trust or provide special rules for valuing unitrust payments in the event additional assets are transferred to the trust.

2. **Payment amount to income beneficiaries.** Both CRATs and CRUTs must provide for payments to the income beneficiaries that are 5% and 50% of the value of assets in the trust. Under IRC Section 664(d)(1)(A), a CRAT must pay a sum certain that is at least 5% and not more than 50% of “the initial net fair market value of all property placed in the trust.” IRC Section 664(d)(2)(A), requires a CRUT to pay a “fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually.”
- E. Permissible annuity or unitrust payment beneficiaries.
1. **Named “persons.”** Annuity or unitrust amount must be payable to or for the benefit of at least one named person other than a Section 170(c) organization. §§ 664(d)(1)(A), 664(d)(2)(A). A “person” may be an individual, trust, estate, association, company, corporation, or partnership.
 2. **Pets.** A pet is not a permissible beneficiary. See Rev. Rul. 78-105 (concluding that three instances in which a unitrust provided for a pet with the remainder to charity did not qualify as a CRUT).
 3. **Named Classes.** The regulations define “named person or persons” to include members of a named class (Treas. Reg.

§§ 1.664-2(a)(3)(i), 1.664-3(a)(3)(i)). If the payment to a class is for the lives of a class of individuals, then all of the individuals must be alive and ascertainable at the inception of the trust. *Id.* If, however, the period to a class is for a term of years, it may include afterborn members of that class. Treas. Reg. §§ 1.664-2(a)(5)(i), 1.664-3(a)(5)(i).

4. **Charitable organizations.** An IRC Section 170(c) organization may be a recipient of trust income, either as a party named in the trust instrument or by a sprinkle power given to the trustee. The trust will still qualify as a CRT if at least one beneficiary is not a Section 170(c) organization. Treas. Regs. §§ 1.664-2(a)(3)(i), 1.664-3(a)(3)(i). The donor will not receive any additional charitable deduction for the income given to a charity or charities.

F. Remainder beneficiaries.

1. **Only charitable beneficiaries permitted.** The trust instrument must provide that after the termination of the annuity or unitrust period, the entire remainder of the trust will be “irrevocably transferred, in whole or in part, to or for the use of one or more organizations described in section 170(c) or retained, in whole or in part, for such use.” Treas. Regs. §§ 1.664-2(a)(6)(i), 1.664-3(a)(6)(i).

2. **Multiple beneficiaries.** If more than one charity is named as a remainder beneficiary, their interests may be successive or concurrent. Treas. Regs. §§ 1.664-2(a)(6)(iii), 1.664-3(a)(6)(iii).
3. **Alternative remaindermen.** The trust instrument must provide for the selection of an alternative remainder beneficiary upon the failure of the designated remaindermen. Treas. Regs. §§ 1.664-2(a)(6)(iv), 1.664-3(a)(6)(iv). The alternative remainder beneficiary or beneficiaries may be selected in any manner set forth in the trust instrument, although any such alternative beneficiary must be an IRC Section 170(c) charitable organization. *Id.*
4. **Donor authority to change remaindermen.** The donor of an inter vivos CRT may retain the right to change the remaindermen, provided that any substitute remainder beneficiary must also be a Section 170(c) charitable organization. See Rev. Rul. 76-8, 1976-1 C.B. 179.
5. **Required value of remainder interest.** Although the annuity or unitrust amount payable to the income beneficiary may be as high as 50%, there is also a required minimum value for the remainder interest. IRC Sections 664(d)(1)(D) and 664(d)(2)(D) were added by the Taxpayer Relief Act of

1997, and require that the present value of the remainder interest be equal to at least 10% of the net fair market value of assets contributed to the trust. This provision limits the use of CRTs for young donors or for multiple life beneficiaries.

G. Permissible and impermissible contributions.

1. **No specific restrictions.** IRC Section 664 and the regulations under it have no specific prohibitions on the types of property that may be contributed to a CRT. Restrictions arise as a result of the interplay between Section 664 and other tax provisions (e.g., private foundation rules applicable to CRTs, grantor trust rules, and unrelated business income tax provisions).
2. **Capital assets.** The vast majority of inter vivos CRTs are funded with capital assets that have a taxable gain awaiting recognized if the donor sells the asset. This is because the donor can transfer the asset to the CRT without recognition of the gain, and the trust can sell the asset without paying tax on the gain. This allows the donor to receive more income from the same asset versus selling the asset outright for reinvestment.

Example 3: Donor (“D”) has a \$250,000 rental property with a basis of \$50,000. D faces a combined federal and state

capital gains tax rate of 20%. D plans to sell the property and reinvest the proceeds for a retirement income, from which he anticipates an average annual return of 8%. If D sells the property himself for reinvestment, he will have \$210,000 for reinvestment, generating an anticipated income of \$16,800 per year. If D instead transfers the property to a CRT and the trustee sells the property, the entire \$250,000 will remain for reinvestment. Using an 8% CRAT or CRUT, the income to D on the same asset will be \$20,000 per year.

3. **Cash.** With the exception of seed money to get a trust started, most CRT donors will not fund their trusts with cash. This is because the donor does not receive the same tax-savings leverage he or she does in funding the trust with a capital asset.
4. **IRD assets.** Assets that contact “income in respect of a decedent” (“IRD”) under IRC Section 691 may be a good choice for funding testamentary CRTs. The CRT will not be required to pay tax on the IRD asset, and can keep 100% of the funds to generate a higher return for the income beneficiaries. The income beneficiaries will be taxed on the IRD only as it is distributed to them. See, e.g., PLR 9634019.
5. **Encumbered property.** Encumbered property may be transferred to a CRT only if (i) the donor is released from any personal liability on the debt or (ii) the encumbrance is removed from the property prior to its transfer. Treas. Regs.

§ 1.664-1(a)(4). The application of self-dealing rules under IRC Section 4941 and the debt-financed income rules under IRC Section 514(a) also make it advisable not to use encumbered property to fund a CRT.

6. ***Homestead or other personal use property.*** Unless the donor plans to sell an asset without retaining any control or use rights, the property should not be used to fund a CRT. As noted *supra* at Section II.C.6, the trust will not qualify if the trustee is restricted from selling and reinvesting the trust corpus. Retention of any life estate or other use rights by the donor will disqualify the trust as a CRT. In addition, self-dealing rules will prohibit the donor from leasing the property from the trust because the donor is a “disqualified person.”
7. ***Closely held stock.*** A CRT may not own S corporation stock because it will disqualify the corporation from subchapter S treatment. See Rev. Rul. 92-48, 1992-1 C.B. 301. Otherwise, a CRT may take title to other closely held business interests, and may even sell them to the donor or other family members if proper precautions are followed to avoid self-dealing.

III. Distribution and Tax Matters.

- A. Nature of and taxation of income distributions. *Note that what follows is a very simplified, brief summary of just a couple of the tax issues involved. An exhaustive or even more extensive discussion of tax issues is beyond the scope of this presentation.*
1. IRC Section 664(b) (and its regulations) requires a four-tier accounting system for income and distributions of that income. Income is to be accounted for separately by tier and distributions are deemed to be taken in the following priority:
 - a. Ordinary income (IRC Section 664(b)(1)).
 - b. Capital gains (IRC Section 664(b)(2)).
 - c. Other income (e.g., tax-free bonds) (IRC Section 664(b)(3)).
 - d. Trust Corpus (IRC Section 664(b)(4)).
 2. If distributions are made to a Section 170(c) organization, the order set forth under Section 664(b) is reversed. Treas. Regs. § 1.664-1(e)(1).
 3. The distributions in the hands of the beneficiary will have the same character as the tier to which they were attributed and taxed accordingly. The income will be deemed to have been distributed on the last day of the year in which the trust required to be distributed. Treas. Regs. § 1.664(d)(4)(i).

- B. Income tax charitable deduction for donor.
1. The donor receives a charitable income tax deduction for the present value of the remainder interest that will ultimately pass to charity under the CRT. In addition to complying with other income tax deduction rules, the donor of a CRT must attach to his or her income tax return a statement setting forth the computation of the present value of the remainder interest. Treas. Regs. §§ 1.664-2(d), 1.664-4(c). For unmarketable assets, a qualified appraisal is now required per IRC Section 170(f)(11)(C), which was added by the Pension Protection Act of 2006.
 2. Valuing the remainder interest is governed by IRC Section 7520. That section requires the use of IRS actuarial tables with mortality data that are updated every ten years and a discount rate equal to 120% of the applicable federal rate (“AFR”) for midterm obligations under IRC Section 1274(d), compounded annually and rounded to the nearest 0.2%. The donor may use the rate in effect for the month of the transfer or for either of the two months preceding the transfer. IRS Notice 89-24 provides guidelines (including a formula) for valuing interests under Section 7520.

3. The Treasury Regulations prescribe the procedures to be followed to elect the Section 7520 rate (see Treas. Regs. §§ 1.7520-2(a)(4), 1.7520-2(b); 20.7520-2(a)(4), 20.7520-2(b); and 25.7520-2(a)(4), 25.7520-2(b)). Information must be attached to the first return on which the deduction is being claimed containing:
 - a. A statement that a Section 7520 election is being made;
 - b. A description of the interest being valued;
 - c. The applicable valuation date;
 - d. The names and tax numbers of the trust beneficiaries;
 - e. The names, birthdates, and any other relevant information (e.g., terminal illness) of any measuring lives; and
 - f. A computation of the deduction.

4. The donor will receive a charitable income tax deduction for the value of the remainder interest (which equal to at least 10% of the net fair market value of the assets transferred into the trust, *see supra* Section II.F.5). In accordance with other income tax charitable deduction rules, this deduction may be used on Form 1040 Schedule A to offset other income, and it may be carried forward for up to five years.

C. Gift taxes.

1. Gift taxes are not normally a major concern with inter vivos CRTs because the income recipient is generally the donor, and they are obviously not a concern with testamentary CRTs because the transfer occurs at death.
2. Gift tax concerns arise only in the context of inter vivos CRTs where an individual other than the grantor is a designated recipient of the annuity or unitrust amount. Note, however, that even where no gift tax is implicated, the donor must still file a gift tax return. IRC § 6019.
3. In simplified terms, the value of the gift where a donor creates a CRT and names another individual as the sole recipient of the annuity or unitrust interest will be the net fair market value of the assets transferred to trust minus the present value of the remainder interest determined under IRC Section 7520.

D. Estate taxes.

1. Since a qualified CRT is a charitable instrument, the donor's will normally receive a charitable deduction under IRC Section 2055(a). The deduction under Section 2055(a) is the value of the property included in the estate and transferred to charity.

2. In the case of an inter vivos CRT with the term expiring at the death of the donor, the effect will be to remove the value of the asset from the estate completely.
3. In the case of testamentary CRT, the deduction to the estate will be the present value of the remainder interest valued at the time of the trust's inception (generally held to be the date of death).

IV. Examples and Illustrations to demonstrate the Variations on the CRUT.

A. Assumptions/Fact Pattern:

1. Husband ("H") and Wife ("W") are ages 64 and 62, respectively.
2. H and W have worked together operating H's independent medical practice, and H is planning to retire at age 65.
3. The practice was conducted from a building owned by H and W next to the local hospital. H had the building appraised at \$500,000, and their basis in the building is \$100,000.
4. The hospital is interested in acquiring the building and is willing to pay the appraised value, although no agreement has been reached for the sale.
5. H and W's combined federal and state marginal income tax rate is 35%.

6. The combined federal and state capital gains tax rate faced by H and W if they sell the building is 20%, which would result in a capital gain tax of \$80,000.
 7. H and W's estate is also large enough that the survivor's estate will owe federal estate tax unless the survivor of them dies in 2010.
 8. We will assume that the current estate tax law does not change and that both H and W live to exactly their life expectancies under the IRS mortality tables (i.e., they have 24 years left). They will face a 55% estate tax rate on these assets at death.
 9. We will also assume that the net investment performance of the CRT created by H and W matches exactly to the unitrust amount paid to them each year.
 10. The date of creation of each CRT in the illustrations and the funding of the CRT were January 1, 2008.
 11. Each CRT also provides a unitrust amount to be paid to H and W jointly during their lives and then solely to the survivor for his or her lifetime.
 12. The unitrust rate for each CRT is 8% per year to be paid annually at the end of each year.
- B. Standard Charitable Remainder Unitrust ("SCRUT").

1. H and W create an SCRUT with the specified 8% unitrust amount.
2. H and W fund the trust with the \$500,000 building used in their medical practice.
3. The present value of the remainder interest is \$89,775 under the applicable IRS tables and AFR.
4. From the charitable deduction, H and W save up to \$31,421 in other income taxes (i.e., [$\$89,775$ deduction] x [35% marginal rate]).
5. The trustee of the SCRUT sells the building, free of capital gains tax, and invests all \$500,000 of the proceeds.
6. H and W receive \$40,000 from the SCRUT annually. Investment of the \$420,000 of net proceeds without the trust would yield only \$33,600 annually at 8%.
7. Upon the death of the survivor of H and W, the remaining proceeds pass to one or more charities selected by them free of federal estate tax.
8. Benefits H and W derived by using the SCRUT:
 - a. Ordinary income taxes saved: \$ 31,421
 - b. Capital gains taxes saved: \$ 80,000
 - c. Additional lifetime income (24 years): \$153,600
 - d. Estate tax saved: \$275,000

e. **Total Dollars Saved** **\$540,021**

C. Net Income Only Charitable Remainder Unitrust (“NICRUT”).

1. The Concern: The asset used to fund the trust may not sell as anticipated and the trustee would be required to distribute back to the unitrust amount beneficiary portions of the principal to meet payout requirements. Doing so will reduce the principle of the trust and lower future unitrust payouts to be used for retirement income.
2. The Solution: The NICRUT, based in IRC § 664(d)(3)(A) and its regulations, allows a CRT to pay the beneficiary the lesser of trust income or the unitrust amount each year.
3. Additional Assumptions: Same assumptions as in Section IV.A, with the following modifications. The deal with the hospital never materializes and the trust is unable to sell the building until early 2009, but the sale is still for \$500,000. During the year 2009, the trust’s net income is only 6.6% (income of \$33,000), but it earns the expected 8% thereafter. H and W plan to retire when H reaches age 67 rather than age 65, so not receiving income from the trust right away is not a major problem.
4. The Variations from the SCRUT: The steps will follow the same ones as the SCRUT with the following differences:

- a. H and W receive no income distributions in 2008.
 - b. H and W receive income of only \$33,000 in 2009.
5. Benefits H and W derived by using the NICRUT:
- a. Ordinary income taxes saved: \$ 31,421
 - b. Capital gains taxes saved: \$ 80,000
 - c. Additional lifetime income (24 years): \$106,600
 - d. Estate tax saved: \$275,000
 - e. **Total Dollars Saved** **\$493,021**

D. Net Income with Makeup Charitable Remainder Unitrust (“NIMCRUT”).

1. The Concern: While the donors may be able to delay receipt of some of the income by relying on other assets more heavily at retirement, they ultimately need the full 8% payout as part of their retirement income. A delay in the sale is acceptable if there is some way to replenish the other assets depleted while waiting for the sale.
2. The Solution: The NIMCRUT, based in IRC § 664(d)(3)(B) and its regulations, allows a trust instrument to pay the beneficiary the lesser of trust income or the unitrust amount each year, to track the deficiencies in the amounts paid to the beneficiary, and then to make larger distributions in future years to “makeup” the deficiency.

3. Additional Assumptions: Same assumptions as in Section IV.A, with the following modifications. The deal with the hospital never materializes and the trust is unable to sell the building until early 2009, but the sale is still for \$500,000. During the year 2009, the trust's net income is only 6.6% (annual income of \$33,000). In the year 2010, the trust has a very good investment year and earns 17.4% (annual income of \$87,000). Thereafter the trust earns only the expected 8% annually. H and W still plan to retire when H reaches age 65, but they have other liquid assets on which they can rely for income until the sale is completed, provided that they will be able to replenish those assets to produce the intended income for the future.
4. The Variations from the SCRUT: The steps will follow the same ones as the SCRUT with the following differences:
 - a. H and W receive no income distributions in 2008 making a unitrust deficit of \$40,000.
 - b. H and W receive income of only \$33,000 in 2009, making the unitrust deficit accrue to \$47,000.
 - c. H and W receive all of the trust income of \$87,000 in 2010, which pays the unitrust deficit in full and makes the regular payment for 2010.

- d. H and W receive annual payments of 8% (i.e., \$40,000) thereafter.
5. Benefits H and W derived by using the SCRUT:
- a. Ordinary income taxes saved: \$ 31,421
 - b. Capital gains taxes saved: \$ 80,000
 - c. Additional lifetime income (24 years): \$153,600
 - d. Estate tax saved: \$275,000
 - e. **Total Dollars Saved** **\$540,021**
- E. Flip Charitable Remainder Unitrust (“FLIPCRUT”).
1. The Concern: The donors may want to establish a CRUT for the capital gains tax advantages now, but they may not need the income to start until some future event such as retirement. The donors are not comfortable with the NICRUT or the NIMCRUT because they will be relying on specified unitrust amount and are willing to trade the risk of slightly lower payouts due to depletion of trust principal rather than taking a large hit in any year when the trust has poor investment performance.
 2. The Solution: The FLIPCRUT, based in Treas. Regs. § 1.664-3(a)(1) and other IRS rulings, allows a trust instrument to start out as a NICRUT or a NIMCRUT, and then convert to an SCRUT for purposes of determining the

unitrust amount after the occurrence of a triggering event.

This is a one-time conversion event only, and the triggering event must be outside the control of the trustee or any other persons. That being said, permissible triggering events are marriage, divorce, death, divorce, and the sale of an unmarketable asset (such as real estate). Treas. Regs. §§ 1.664-3(a)(1)(i)(c), 1.664-3(a)(1)(i)(c).

3. Additional Assumptions: Same assumptions as in Section IV.A, with the following modifications. H does not plan to retire for 5-10 years, but will be joining the hospital's practice group. The deal with the hospital is consummated at the appraised value of \$500,000 in January of 2008 and the trust earns 8% on its investments each year. H and W would prefer to wait until H retires to start drawing income from the trust.
4. Use of the FLIPCRUT: The steps will follow the same ones as the SCRUT with the following differences:
 - a. The trustee invests the assets of the trust to produce only principal growth, no income. Thus, H and W do not receive any distributions from the trust and the corpus continues to grow at 8% per year.

- b. By the end of 2012, the principal (growing at 8% per year) equals \$714,257.
 - c. H retires at the end of 2012 (the triggering event) and the trust begins distributing the unitrust amount to H and W in 2013.
 - d. H and W receive annual payments of 8% (i.e., \$57,141) thereafter for their remaining 19 years (per the IRS mortality tables).
5. Benefits H and W derived by using the SCRUT:
- a. Ordinary income taxes saved: \$ 31,421
 - b. Capital gains taxes saved: \$ 80,000
 - c. Additional lifetime income (24 years): \$279,279
 - d. Estate tax saved: \$275,000
 - e. **Total Dollars Saved** **\$655,700**

NOTE:

Specimen forms for CRTs and CLTs are available from the IRS.

They may also be accessed at the Thompson & Associates web site at the following URL:

<http://ceplan.com/gen/pfdlyn1.aspx?p1=1839&p2=1840&p3=1841>

Foregoing analysis & materials presented courtesy of:

William R. Gustoff, JD
Executive Vice President
Thompson & Associates
BGustoff@ceplan.com

ATTRIBUTES OF CHARITABLE REMAINDER TRUSTS AND PROFILES OF THEIR MOST LIKELY USERS

CHARITABLE REMAINDER TRUSTS

Benefits:

1. Most flexibility in amount and timing of receipt of lifetime income. Both fixed (annuity trust) and variable (unitrust) income possible. Possible to defer some or all income through use of a "net-income with make-up provisions" unitrust invested to defer income and maximize growth. So-called "retirement unitrusts" very popular; have been considered by IRS for possible revisions in regulations, but no adverse current position nor forewarned.

2. Use of the net-income unitrust allows for funding with an asset not currently producing income and allows for sale of the contributed asset by the trust at other than "fire-sale" price. With issuance of final regulations, "flip" unitrusts are possible under some conditions, with June 8, 1999 the applicable date for some "flips" to be finalized. In "flip" unitrusts, the trust operates as a net-income trust until most or all of the nonliquid assets are sold, then flips to a regular payout unitrust after the sale. After the sale, any accumulated deficiencies cannot be made up.

3. Variable income from a unitrust offers better chance of keeping up with inflation and maintaining the purchase price of the lifetime income. As value of trust assets increases, fixed percentage payout produces more dollars. Likelihood of keeping up with inflation much greater if 5% payout chosen, then both excess income and growth in value maximize the growth of the value of the trust assets.

4. For individuals who want a larger payout percentage than realistic in current economy (5 to 6%) who believe interest rates will increase in the near future and don't mind reducing the charitable value for deduction purposes, using a net-income unitrust with a higher payout percentage (6, 7, 8%) may be attractive (of course charitable value will be less).
5. Flexibility in length of trust term. Trusts may last for the lifetime of one or more individuals, with either joint or consecutive payments. Trusts may last for a term of years, not to exceed 20 years. The trust term can also be a combination of lives and a term of years, e.g. parents for life then children or grandchildren for term.
6. Term of years trusts have been used to provide cash flow for college years, or to provide some cash flow to income beneficiaries while maximizing charitable value for income tax or gift/estate tax deduction purposes.
7. Tax character of distributions to life income beneficiaries based on four-tier system. Possible to receive tax-favored income (long-term capital gain income, tax-exempt income, or tax-free return of corpus). Possible to receive only tax-exempt income if fund with cash or tax-exempt holdings and trust only invests in tax-exempt investments.
8. Maximum donor involvement of all the charitable life income plans. Trusts can be established without any involvement by a charitable organization. No federal requirement to notify charities named as irrevocable beneficiaries. Donor can be his or her own trustee, but at one time needed independent trustee with hard-to-value assets. Under final regulations, independent trustee is not needed, only qualified appraisal of hard-to-value assets. Donor can retain the right to change which charities take the trust assets at the end of

the trust term and in which proportion.

9. Can provide that payouts to income beneficiaries cease upon the occurrence of a qualified contingency (divorce, remarriage, for example).
10. Charitable remainder annuity trust produces the same high charitable value for deduction purposes as charitable gift annuities.
11. Can do all charitable giving in one vehicle because multiple charities can be named to divide the trust assets at the end of the trust term.
12. When contribute appreciated asset to a fund, long-term capital gain never recognized, so no long-term capital gains tax paid, either by donor or trust.

Disadvantages:

1. If corporate trustee used, usually not economically feasible at less than \$300,000 or so, even more.
2. Costs to establish the trust or for legal review can be substantial (although should be less due to issuance of IRS sample documents).
3. Complicated accounting required and annual trust tax return which can increase trustee fees or annual costs when donor is the trustee.
4. Trusts can end before the end of the trust term if trust assets consumed.
5. Setting payout percentage above 5% increases the likelihood of use of corpus

to make annual distributions. In a unitrust, use of corpus to make current payouts also reduces future payouts. In an annuity trust, use of the corpus can cause the corpus to be eroded before end of the trust term.

6. Under 1997 tax act, payout rate may not exceed 50% and if the present value of the charitable interest is less than 10% when funded (in both charitable remainder annuity trusts and charitable remainder unitrusts), the trust is not a qualified charitable remainder trust, so no charitable deductions and treated as a taxable trust. This provision also affects additions to current unitrusts, which must meet these tests as well.
7. In unitrusts, fairly slight variations in investment performance as compared to investment illustrations can cause substantial differences in lifetime performance of the trust. Donors don't always understand the subtle impacts or are frustrated when less than optimum results are achieved.

Charitable Remainder Trusts Donor Profiles

Annuity Trusts (Fixed Income):

1. 75+ year old donors who could afford to make an outright gift, but are concerned about future income needs and want something they can "count on."
2. Donors who want a life income plan where all the income will be tax-exempt interest; may fund initially with cash or municipal bond holdings. Normally are either highly compensated or have a large amount of taxable income from

other sources.

3. Donors who want a nominal income they can "count on" and budget for; charitable gift annuities not available or the donor does not trust the charity and wants a Trustee to manage the process; or donors who want to retain the right to change the charitable remaindermen.
4. Donors who want income they can "count on" and want the larger immediate income tax deduction generated by the CRAT as opposed to the charitable remainder unitrust. Especially attractive if the donor names older parents as the trust's income beneficiary(ies) to assist in their support (gift tax implications possible).
5. Donors who simply want to replace a fixed income (such as income from a Certificate of Deposit) and make a future charitable contribution at the same time.
6. Donors with low-yield appreciated assets who want higher current income without incurring long-term capital gains taxes. Typically a large, one-time transfer to fund the trust.

Unitrusts (Variable, Market-Driven Income):

1. Younger (50's/60's) donors who could afford to make an outright gift, but are concerned about future income needs and want something that can keep up with inflation.
2. Donors with low-yield appreciated assets who want higher current income

without incurring long-term capital gains taxes. Typically fund the trust with a large transfer, but like the idea that additional assets can be added during lifetime, or can be "poured over" from the estate of the first spouse to die for additional income for the surviving spouse without management responsibilities.

3. Older donors who want a variable, market-driven income.
4. Donors who want a higher payout rate than economically feasible at present (net-income unitrust or net-income unitrust with make-up provision).
5. Donors who want a variable, market-driven income, but want to preserve the trust corpus for the charitable remaindermen (net-income unitrust).
6. Donors who want to fund a charitable remainder trust with an asset not currently producing an income (net-income unitrust or net-income unitrust with make-up provision to give the Trustee time to produce income for distribution; avoids distribution of the corpus when no income has been earned.)
7. Donors who still enjoy the excitement of stock and bond market deviations and have higher risk tolerance.
8. Donors who want to assist with a "younger" (60s) parent's support but want a variable, market-driven income for the parent.
9. Donors who want to "defer" the income until later (around the time of retirement).

Note: It is possible to invest charitable remainder unitrusts so there is only income distributed when the income beneficiary requests it and none distributed in other years. This allows for total deferral until some point in the future, such as retirement. The charitable remainder unitrust assets are invested in a special type of growth investment or occasionally, in deferred variable annuities. The IRS has reviewed whether such "retirement" unitrusts are abusive, but has taken no formal regulatory position on these particular vehicles.

The IRS recently released eight new sample charitable remainder unitrust forms replacing those issued in 1990. In this article, St. Louis attorney Lawrence P. Katzenstein, writing for Leimberg Information Services, offers his "first impressions" commentary on the sample CRUT forms with an eye for changes practitioners will want to make in the forms for use with clients.

EXECUTIVE SUMMARY:

In Revenue Procedures 2005-52 through 2005-59, the Internal Revenue Service has issued sample charitable remainder unitrust forms replacing the sample forms issued in 1990. As with the annuity trust forms issued in 2003, the new forms are a significant improvement over the prior forms and the explanatory material and annotations provided by the Internal Revenue Service are very useful.

FACTS:

The specific forms issued are as follows:

1. Inter vivos charitable remainder unitrust (CRUT) for one measuring life - Rev. Proc. 2005-52.
2. Inter vivos CRAT for a term of years - Rev. Proc. 2005-53.
3. Inter vivos CRUT with consecutive interests for two measuring lives - Rev. Proc. 2005-54.
4. Inter vivos CRUT for concurrent and consecutive interests for two measuring lives - Rev. Proc. 2005-55.
5. Testamentary CRUT for one measuring life - Rev. Proc. 2005-56.
6. Testamentary CRUT for a term of years - Rev. proc. 2005-57.
7. Testamentary CRUT with consecutive interests for two measuring lives - Rev. Proc. 2005-58.

8. Testamentary CRUT with concurrent and consecutive interests for two measuring lives - Rev. Proc. 2005-59.

WHAT'S NEW AND DIFFERENT?

The forms are more complicated than the annuity trust forms, of course, because there are more flavors of unitrusts: regular unitrusts, income-only with makeup, income-only without makeup, and flip unitrusts (referred to by the Service as "combination of methods unitrusts").

The forms track closely the annuity trust forms issued in 2003 and many of the comments one could make about the forms were also true of the annuity trust forms.

But a number of the items are specific to unitrusts:

The annotations note that if an additional contribution is made to an existing charitable remainder unitrust and the contribution does not satisfy the 10% test of section 664(d)(2)(D) the contribution is treated as a transfer to a separate trust under section 664(d)(4).

The annotations also include information and language regarding unitrusts with more than one valuation date. It will be rare when more than one valuation date will be desirable, because of the considerable complexities such a provision entails.

The annotations also include alternate language for testamentary additions to unitrusts and alternate methods of computing the deferred payments.

The annotations to the income-only variants take into account changes in state law definitions of income and provide that proceeds of sales of assets may be allocated

to income under the terms of the governing instrument if not prohibited by applicable local law. Further, a discretionary power to make the allocation may be granted to the trustee to the extent that the applicable estate statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially. One assumes that prior IRS pronouncements prohibiting allocation of pre-gift gain to income still govern.

The annotations to the flip unitrust-which can make a one time change from an income only (with or without makeup) to a regular unitrust-note that the change may not be discretionary with or in the control of the trustees or any other persons. However, the usual trigger will be the sale of unproductive property which is, of course, within the control of the trustees.

I suppose what the Service is really saying is that only events of dependent significance count. There is something new in the flip unitrust forms: separate and detailed language regarding pro-ration of the unitrust amount in years both before and after the effective date of the triggering event.

BEWARE: NO MENTION OF NEW WAIVER REQUIREMENTS IN TWO LIFE TRUSTS!

Interestingly, and perhaps even bizarrely, the two life trusts, which will almost always be for husband and wife, say nothing about the waiver requirements of Revenue Procedure 2005-24 (The tax trap covered by Larry Katzenstein, Charles Schultz, and Conrad Teitell in Charitable Planning Newsletters 73, 74, and 76 at <http://www.leimbergservices.com>) .

The forms include no sample waiver language for a spousal interest and the annotations do not even mention the existence of the necessity imposed by

Revenue Procedure 2005-24.

Has the Service had a change of heart, or are they merely punting on the exact requirements? Or maybe spousal waivers is some else's department.

HANDLE WITH CARE!

The trust language itself is straightforward and to the point, and each form includes alternate provisions. As with the prior forms, the new forms must be used with care, although the thorough annotations provided by the Service will prevent many more inadvertent errors than the previous versions.

IRS PROVIDED ALTERNATIVES:

Examples of the kinds of alternatives provided by the Service, as well as explanatory cautions in the explanatory material, are the following:

1. The annotations point out that if the trust is funded with unmarketable assets, the annual or more frequent fair market value determination must be made by an independent trustee or must be determined by a qualified appraisal from a qualified appraiser as defined in the regulations.
2. The old IRS unitrust forms included language to the effect that the charitable remainder beneficiary must be an organization described in Code section 170(c). This was a trap for many, because section 170(c) includes private foundations, which have lower income tax percentage limitations.

In addition, the deduction for gifts of appreciated property other than marketable securities is limited to basis if the charity is a private foundation. The explanatory annotations include a warning and alternative language for the case (which is the usual one) where the donor wishes the charitable beneficiary to be a public

charity.T

3. The annotations point out that the unitrust amount may be payable to members of a named class in a term of years trust even if the members of the class are not living or ascertainable at the creation of the trust. The annotations also point out that sprinkling powers cannot be held by certain persons without causing the trust to be treated as a grantor trust for income tax purposes.
4. The forms point out that the unitrust amount may be paid in equal or unequal installments throughout the year. Unequal installments create complexities of valuation, and most practitioners will want to avoid unequal payments.
5. The annotations point out that generally the unitrust amount must be paid before the close of the taxable year in which it is due, and refer the reader to the regulations under section 664 which were adopted to prevent abuses related to the 2-year, high pay out charitable remainder trust.
6. The annotations point out that the trust may provide for an amount other than the unitrust amount to be paid in the discretion of the trustee to a charitable organization, and further point out that if distribution is made in kind, the adjusted basis of distributed property must be fairly representative of adjusted basis of property in the trust.
7. The annotations point out that the charitable remainder beneficiary may be selected by the trustee or some other person, or that the power to name the charitable beneficiary may be retained by the donor. In that case the gift will be incomplete for gift tax purposes, but the charitable income tax deduction will still be available. The forms also include alternate provisions in which the donor retains the right to substitute the charitable remainderman.

8. Another interesting provision referred to in the annotation is the qualified contingency provision of section 664(f) which permits a trust to end early upon the happening of any contingency, whether or not the actuarial value of the contingency can be determined. The qualified contingency is ignored for valuation purposes, but it will not disqualify the trust.

PLANNING MODIFICATIONS YOU'LL WANT TO MAKE TO THE FORMS:

There are several changes most practitioners will want to make in the forms.

1. First, the forms provide as the default that the final payment will be prorated. In many cases this necessitates a payment of the stub period payment to the beneficiary's estate for the period after the last payment and until the beneficiary's death. Most practitioners will want to provide that the final payment will be the regular payment preceding the beneficiary's death.
2. As noted above, most practitioners will want to limit the charitable remainder beneficiary to public charities described in section 170(b)(1)(A), as provided in the alternative language.
3. Most practitioners will want to include a spendthrift provision, at least where the beneficiary is not the donor. The advisability and effect of a spendthrift provision will depend on state law. 4. In the two-life trusts, the forms have much simpler language regarding payment of taxes on the first death than were used in some of the prior IRS pronouncements. The two-life trust form does not include as a default provision a retained testamentary power to revoke the interest of the

successor beneficiary so as to prevent a gift for gift tax purposes.

Most practitioners will want to include that provision, even in the case of trusts for spouses. Where the donor has retained the right to change the charitable remainder beneficiary, including a power to revoke the survivorship interest of the spouse will avoid the necessity for filing a gift tax return. Note that this power must be testamentary rather than a lifetime power to avoid grantor trust treatment. (By contrast, the power to designate a different charitable remainder beneficiary may be an inter vivos or a testamentary power.)

NITS AND LICE:

In one respect, the generally useful forms are unnecessarily nitpicking. The explanatory material accompanying the term of years trust states that the term of a term of years trust must not exceed 20 years, and then includes the following sentence:

"Thus, for example, the unitrust period of a CRAT for a term of 20 years will end on the date preceding the 20th anniversary of the date the trust was created."

But surely a trust ending on the 20th anniversary date of the trust should qualify.

Requiring that the term end one day before the 20th anniversary seems unnecessarily nitpicking and undoubtedly many trusts have been written calling for the trust to terminate on the 20th anniversary date. Do all of these fail to qualify? Actually, now that we have a required 10% minimum actuarial value for both CRATs and CRUTs, the term limitation is really unnecessary. But it will be up to Congress to change that.

Steve Leimberg's Charitable Planning Newsletter # 80 (August 22, 2005) at

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CHARITABLE REMAINDER TRUSTS - TWO CASE STUDIES

CASE ONE:

FACTS AND DONOR OBJECTIVES:

Prospect contacts Gift Planner about an appreciated asset, a home that she and her husband left in Atlanta when he was transferred to a new job to Texas. They have since held that principal residence longer than two years, and, under the former tax law, would be paying capital gains taxes on its appreciation if they personally sold it. They had passed the point, under former law, in which they had to reinvest the sale proceeds from their principal residence within two years to avoid reporting and paying capital gains tax on the appreciation.

Prospect tells Gift Planner she has three goals for this property:

- a) she would like a tax deduction if she gives it to charity,
- b) she doesn't want to pay capital gains taxes on the property, and
- c) she wants to use the property for the college education of her children, currently ages 4 and 7.

HURDLES:

The very young ages of Prospect's children pose significant problems for an income stream. There would be virtually no deduction for any lifetime interests for such young beneficiaries.

SOLUTION:

Gift Planner suggests a charitable remainder unitrust for these two young beneficiaries, for a term of years not to exceed 20 years. A twenty year period

would provide income for both children through college and probably even graduate school, too, an expressed goal of Prospect for the transaction. A 5% payout with a twenty year term also meets another of Prospect's goal, to receive an itemizable charitable income tax deduction for her gift.

Funding a charitable remainder trust with the home, the appreciated property itself by a deed transfer, meets Prospect's second goal, not to pay capital gains tax on the property. And, the trust would then be funded with the full fair market value of the property (though that value would be recomputed on the trust's first anniversary date, at which time any real estate commission and other selling expenses would be deducted from its portfolio value), producing a higher value investment against which to earn income and invest from the trust's very inception.

Gift Planner suggests the net income only variation of the unitrust, the NIMCRUT, because the trust could be invested for growth in the first years, perhaps even for 11 years, of the trust when income was not really needed. Then, when the older child reached age 17, by investment strategy, the trust could begin producing more income. The Prospect could even choose a make-up option, so that in later years, income due but not paid out in the early years of the trust could be "made up" to its two young income beneficiaries.

At the end of the trust term, the trust would terminate and the trust portfolio value distributed outright to charity, to fund a charitable use of Prospect's own choosing. This would remove this asset from the family. However, all of the Prospect's three goals were met and even exceeded by this gift plan.

CONSIDER CHARITABLE REMAINDER TRUSTS also for the exercise of a stock redemption, the CRT can be funded, the stock given to the trustee, which exercises the redemption within the stated period.

CASE TWO:

FACTS AND DONOR OBJECTIVES:

Donor, a retired military officer living on the East Coast, chose to invest over the years in rental real estate. He is an active manager and overseer of his rental property, and his units are well-maintained and have appreciated significantly in value over the years. He believes that the properties are marketable and most could be sold relatively quickly.

Donor and his wife have one child, a daughter, who has an advanced degree and who is employed with a good job. She is married to a neurologist, and they plan not to have children. They engage in very adventuresome hobbies and vacations that could pose significant personal danger to them.

Donor wants to avoid recognizing capital gains tax on the appreciation in his rental units. He is also concerned about recapturing depreciation as ordinary income when he ultimately disposes of those properties. His wife is anxious for him to get out of the rental business since she is growing weary of tenant calls and matters that intrude daily upon their private life. Those demands have also meant less travel, which she would like to do more of now that her husband is retired.

HURDLES:

Donor's wife would also like for these rental properties to eventually benefit their only child, even though Donor feels that their daughter is and will be well taken

care of. He also wonders if he should make many long-term provisions for his daughter when she engages in activities that could pose a threat to a long life.

SOLUTIONS:

Gift Planner suggests a charitable remainder unitrust at a 5% payout rate with Donor and spouse as its income beneficiaries. The trust could be funded initially with one of the rental properties, and no capital gains tax would be recognized from the transfer of the appreciated property itself, by deed, into the trust. The trust would be funded with the full fair market value of the rental property, against which balance the Donor and his spouse would receive income (until the first revaluation date, after which expenses of sale would reduce the portfolio value). The initial trust value would not be reduced by capital gains taxes, meaning the trust would produce greater income for the Donor and spouse from its inception.

Gift Planner suggests a 5% payout because of Donor and his spouse's relatively young age, in trust terms, each only 71 years old. The 5% with a unitrust allows the reinvestment of excess income feature to really work, hopefully meaning greater payments over the many years of the trust for the couple as they age and inflation means a costlier lifestyle. The 5% payout also yields the greatest charitable income tax deduction for the couple.

Donor's wife wants to include their daughter as an income beneficiary of the trust, which can be legally accomplished but which diminishes many of the favorable aspects of the trust. There would be inclusion, perhaps significant, in Donor's estate for a portion of this trust if it contains an income interest to the daughter that survives Donor and spouse. The charitable remainder unitrust would be revalued as of Donor's date of death, and the charitable deduction recomputed depending then on the ages of his surviving spouse and daughter.

But, the marital deduction that would have been available if the trust provided only for the Donor and spouse and, together with the charitable deduction would have meant no estate tax effect, is lost when the daughter is added as an income beneficiary. Upon reflection, the Donor decided not to add his daughter because he can provide for her in other ways plus her lifestyle indicates to him that she does not need their support.

Donor is so pleased with the operation of the unitrust, that he embarks upon a plan to add a piece of rental real estate to it each year, meaning a new itemizable charitable income tax deduction every time he adds to the trust. He is careful to work with his accountant to ensure that, given his other income, he can fully use the deduction each year. Additionally, there is no depreciation recapture to Donor since he used a straight-line approach and he is transferring the properties to into the charitable trust.

Donor's spouse appreciates this arrangement since, over time, it will divest her husband of his duties as landlord while converting those appreciated properties into a more liquid source of income, which will allow the couple additional income to travel and to enjoy their retirement years. Donor would not have believed it originally, but the couple now feel that could ultimately transfer up to \$1,000,000 over time into this trust, meaning a much significant gift for their favorite charity than they ever would have thought possible. They remark to the Gift Planner that this arrangement has allowed them to truly become philanthropists.

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Diving Into Endowments: UPMIFA and More

Presented by:

Erik Dryburgh

Principal

Alder & Colvin

235 Montgomery Street, Suite 1220

San Francisco, CA 94104

P: 415-421-7555

E: Dryburgh@aldercolvin.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

**DIVING INTO ENDOWMENTS:
UPMIFA and More**

ACGA CONFERENCE – ON TRACK FOR TOMORROW

Erik Dryburgh

April 19, 2012

The Law of Endowments (The Uniform Prudent Management of Institutional Funds Act)

Erik Dryburgh

I. WHAT IS AN ENDOWMENT?

- A. To a donor, an endowment is a sum of money given to a charity for charitable purposes, with only the “income” being spent and “principal” being preserved.
- B. To an accountant, it is a fund which is “permanently restricted”.
- C. To a lawyer, it is an institutional fund not wholly expendable on a current basis under the terms of the gift instrument.
- D. Thus, a “true” endowment is one established or created by the donor. A board-restricted endowment (or “quasi-endowment”) is created when the Board takes unrestricted funds and imposes a spending restriction.

II. WHAT WAS UMIFA AND WHY WAS IT ADOPTED?

The Uniform Management of Institutional Funds Act (UMIFA) is a uniform law which provides rules regarding how much of an endowment a charity can spend, for what purpose, and how the charity should invest the endowment funds. UMIFA was the governing law in California through December 31, 2008. It was adopted because charities and their lawyers were unsure how to define “income” in the context of an endowment. Many looked to trust law, which generally defines “income” as including interest, dividends and the like, but defines gains as “principal”. Thus, charities invested endowments in bonds and high-dividend stocks, but passed by investments with favorable growth prospects if they had a low current yield. Consequently, long-term yield suffered. The drafters of UMIFA thought charities should be able to spend a prudent portion of the gains earned by an endowment.

III. SO WHAT IS UPMIFA?

- A. UMIFA is thought to be out of date, particularly as to management, investment, and spending issues. In particular, the post-dot.com “down” market resulted in

many “underwater” endowments, exposing the flaws in the UMIFA spending rules.

- B. UPMIFA was approved by the National Conference of Commissioners on Uniform State Laws in July 2006, and has been adopted by approximately one-half of the states.
- C. California adopted UPMIFA (Senate Bill 1329) effective January 1, 2009. It applies to funds created after that date, and to decisions made after that date for existing endowments (i.e., it will be “retroactive”).

IV. HOW DOES AN ENDOWMENT GET CREATED?

- A. An endowment fund is a fund not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument. UPMIFA makes it clear that the term “endowment fund” does not include funds that the charity designates as endowment (these are “quasi-endowment” funds).
- B. UPMIFA defines a gift instrument as being a “record” – information inscribed on a tangible medium or stored electronically – including an institutional solicitation, under which property is given. UPMIFA thus makes it clear that a gift instrument must be in writing, but expands the definition to include email. Governance documents, such as Bylaws, may be part of the gift instrument. A record is part of the gift instrument, however, only if the donor and the charity were, or should have been, aware of its terms.

V. HOW SHOULD A CHARITY INVEST ITS ENDOWMENT?

- A. Investment is a matter of state law. In California, the Board is subject to the rules on prudent investments as set forth in both the Corporations Code and UPMIFA (which unfortunately are not entirely consistent).
- B. The Corporations Code provides that in making investments, a Board must “avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of funds.” This is an “old fashioned” and fairly conservative statement of the prudent investor rule.
- C. UPMIFA articulates a standard of care for both managing and investing an endowment. It requires the charity to consider the charitable purposes of the charity, and the purposes of the endowment fund. It requires the Board (and others responsible for managing and investing) to act in good faith and with the care of an ordinary prudent person, and notes that the charity may incur only appropriate and reasonable costs.

The charity must consider:

1. General economic conditions,
 2. Effects of inflation and deflation,
 3. Tax consequences,
 4. The role of each investment in the overall portfolio,
 5. Expected total return from income and appreciation,
 6. The charity's other resources, and
 7. The needs of the charity and the fund to make distributions and preserve capital.
- D.** UPMIFA provides that an individual investment must be analyzed in the context of the total portfolio and the overall risk-reward objectives, and that a charity can invest in any kind of property that is not inconsistent with the standard of care.
- E.** UPMIFA imposes a duty to diversify.

VI. HOW MUCH OF AN ENDOWMENT CAN A CHARITY SPEND?

- A.** UMIFA provided that “The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, both realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent”

Net appreciation includes realized gains and unrealized gains.

Historic dollar value is “the aggregate fair value in dollars of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the endowment fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the endowment fund.”

Although UMIFA did not explicitly so state, most attorneys concluded that “income” (e.g., interest and dividends) could be spent as well (even with an “underwater” endowment).

- B.** UPMIFA makes a radical change and does away with the concept of “historic dollar value”. UPMIFA allows a charity to appropriate for expenditure, or

accumulate, so much of an endowment fund as the charity determines is prudent for the purposes for which the fund was established.

The charity must consider:

1. The duration and preservation of the endowment fund,
 2. The purposes of the charity and the fund,
 3. General economic conditions,
 4. Effects of inflation and deflation,
 5. Expected total return from income and appreciation,
 6. The charity's other resources, and
 7. The charity's investment policy.
- C. California's UPMIFA includes the optional provision stating that an appropriation of greater than 7% of the average FMV of an endowment (averaged over the last three years) is be presumptively imprudent.

VII. WHAT ABOUT DELEGATION?

UPMIFA allows a charity to delegate management and/or investment decisions to agents. The charity must act prudently in selecting the agent, establishing the scope of the delegation, and reviewing the agent's actions. A charity that does so is not liable for the actions of the agent. However, the agent is held to a "reasonable care" standard and is expressly made subject to appropriate court jurisdiction.

VIII. WHAT ABOUT CHANGING A RESTRICTION?

- A. UPMIFA allows a charity to release or modify a restriction regarding management, investment, or purpose of a fund if the donor consents in writing.
- B. If a purpose or use restriction becomes unlawful, impracticable, impossible to achieve, or wasteful, the court may modify the restriction in a manner consistent with the donor's intent. The Attorney General must be notified.
- C. The court can modify a management or investment restriction if it has become impracticable or wasteful, impairs the management or investment of the fund, or (if due to unforeseen circumstances) the release would further the purposes of the fund. The Attorney General must be notified.

- D. If a fund is less than \$100,000 in value and over 20 years old, and the charity determines that a restriction on the management, investment, or use of the fund is unlawful, impracticable, impossible to achieve, or wasteful, the charity can (after notice to the Attorney General) release or modify the restriction. It must thereafter use the funds in a manner consistent with the donor's charitable purposes.

IX. WHAT ABOUT ENFORCING SPENDING OR PURPOSE RESTRICTIONS?

- A. The Attorney General can bring an action to enforce the terms of a restricted gift. Depending on the law governing the internal affairs of the charity, an officer, director, or even a voting member may be able to challenge a breach of trust. *See, e.g., Cal. Corp. Code §5142* (for California nonprofit public benefit corporations).
- B. What if the donor believes the institution is violating the use restriction? Some states have held that unless the donor reserves a right to enforce in the gift instrument, only the state Attorney General has legal standing (*Carl Herzog Foundation v. University of Bridgeport*, 699 A.2d 995 (1997)). Other states have concluded that a donor may have standing (*LB Research and Education Foundation v. UCLA Foundation*, 130 CalApp 4th 171 (2005); *Smithers v. St. Luke's Roosevelt Hospital Center*, 723 N.Y.S.2d 426 (2001)).
- C. A donor may consider building donor standing into the gift instrument. A power of reversion is likely to render the gift incomplete and non-deductible for income tax purposes; consider including a power to redirect the gift to another charity willing to abide by the restrictions in the event of default.

X. WHAT ABOUT THOSE ACCOUNTANTS?

- A. In general, for accounting purposes, funds received as "true" endowments are classified as permanently restricted. Funds subject to a restriction that the Board can satisfy – such as a timing restriction or purpose restriction – are classified as temporarily restricted. Funds received with no donor-imposed restrictions are classified as unrestricted.
- B. FASB Staff Position 117-1 sets forth guidelines for reporting endowments governed by UPMIFA. It states that a charity should classify "all or a portion" of an endowment as permanently restricted net assets, based upon explicit donor restrictions (if any) or what the Board determines must be retained permanently. For example, a Board could determine that UPMIFA requires it to maintain the "historic dollar value" of its endowments. The value of an endowment in excess of the amount reported as permanently restricted is to be reported as temporarily restricted, until such time as some amount is "appropriated for expenditure", at

which time that amount becomes unrestricted. FASB Staff is not encouraging charities to report as permanently restricted the purchasing power of an endowment (e.g., initial value increased by the rate of inflation, not reduced for losses or expenditures). FSP 117-1 also requires more disclosure, including information regarding a charity's spending policy and investment policy.

- C. FASB 124 requires that distributions from the endowment, and losses suffered by the endowment, be taken from the endowment portion of the temporarily restricted asset class first (until it goes to zero), then from the unrestricted asset class. Put another way, the amount reported as permanently restricted funds would not change if there is a significant investment loss; the loss would reduce the temporarily restricted and the unrestricted asset classes.

The Uniform Prudent Management of Institutional Funds Act: What We Have Learned So Far...

Erik Dryburgh

I. Review the Gift Instruments

Review for specific spending language – beyond “spend income, interest and dividends, don’t spend principal”

Three categories of endowments:

- Those with a specific spending limitation
- Those governed by the UPMIFA spending rule
- Quasi-endowment

Need to review:

- Donor gift letters and instruments
- Charity solicitations
- Perhaps charity governing documents

May need to consult:

- An attorney regarding gift instrument language – there is lots of “gray” between “spend income” and “don’t spend per UPMIFA”
- The donor to discuss on the “interpretation” of his/her gift language
- The Attorney General’s Office

II. Decide Spending Approach

Endowments with a specific spending rule:

- Abide by the rule
- Segregate and track gift separately

Endowments subject to UPMIFA:

- Remember it is a default rule of construction
- General rule – spend that which is “prudent”, considering 7 factors
- 7% of fair market value “cap”

Process:

- Board to review the UPMIFA factors
- Board to review facts and circumstances of each fund
- Document decision process
- Goal is to demonstrate Board met its standard of care
- Note this should be an annual process

Possible options:

- Continue to spend per past policy
- Decrease spending
- Don't invade "historic dollar value"
- Spend more during time of need, less when flush
- Different spending amounts for different funds?

III. Accounting Issues

Board to decide the amount that "must be retained permanently consistent with relevant law" (which is classified as Permanently Restricted)

Board to review what to disclose on Financial Statements

IV. Review endowment policy

Update for UPMIFA

Re-visit dollar-minimums for:

- Naming rights
- Restricted purpose
- Separately negotiated fund agreement

V. Review Investment Policy

Update for revised UPMIFA prudent investor rules

Focus on meeting standard of care, and Board's ability to rely on experts

VI. Review Gift Acceptance Policy

IRS Form 990 now inquires about GAP for "nonstandard" gifts

VII. Disclose Endowment Terms to Donors

Take the opportunity to contact donors

Put the endowment policy on the web

Offer sample bequest language: "I leave \$_____ to Charity X, to be held and administered per the terms of The Charity X Endowment Fund"

VIII. Release of Restrictions

Address funds with unwanted/unworkable restrictions:

- Release or modify with donor consent
- Secure Probate Court order modifying purpose/use restrictions
- Secure Probate Court order modifying management or investment restrictions
- Release or modify restrictions on "old and small" funds

ENDOWMENT ALTERNATIVES FOR RELUCTANT DONORS

Erik Dryburgh

The Virtual Endowment

Attractive to a donor who wants to make an endowed gift now, has high current income, but doesn't have the necessary principal amount.

Essentially a binding pledge for the desired endowment principal amount (payable in a specified number of years or even at death) coupled with a binding pledge to pay (for example) 5% of the principal amount every year until the principal is paid.

The Mortgage Endowment

The donor essentially pays his endowment amount over time. Using the endowment principal amount, a payment term, and an interest rate, you can calculate the required annual payment using a mortgage amortization program.

Revocable Endowment

Essentially, a Grantor Reversionary term-of-years CLT. Donor gets an upfront income tax deduction, charity gets an annual annuity payment for the term-of-years, and at the end – the donor can either roll the gift over into a new CLT or take the funds back.

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doesn't raise their hand.



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James Preston
The University of Missouri, Columbia
(Mizzou)

FOR MORE INFORMATION CONTACT:



Timothy D. Logan, ACFRE
Senior Vice President and Senior Consultant
Planned Giving Services
timothy.logan@ruffalocody.com
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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

The Impact of “Philanthropic Planning” On Your Career

Presented by:

Brian M. Sagrestano, JD, CFRE
President & CEO

Gift Planning Development, LLC
100 Chestnut Place

New Hartford, NY 13413

P: 315-292-1335

E: brian@giftplanningdevelopment.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

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 100 Chestnut Place
 New Hartford, NY 13413

P: 315.292.1335 • F: 315.292.7001 • M: 315.292.2384

brian@giftplanningdevelopment.com

www.giftplanningdevelopment.com



GIFT PLANNING
 DEVELOPMENT

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Introduction

- Defining Donor-Centered “Philanthropic Planning”
- Understanding Generational Cohorts
- How Changing Generational Cohorts Led to the Need for Philanthropic Planning
- Impact of Philanthropic Planning on Advancement Hiring and Training
- Impact of Philanthropic Planning on Professional Advisors

Defining Donor-Centered Philanthropic Planning

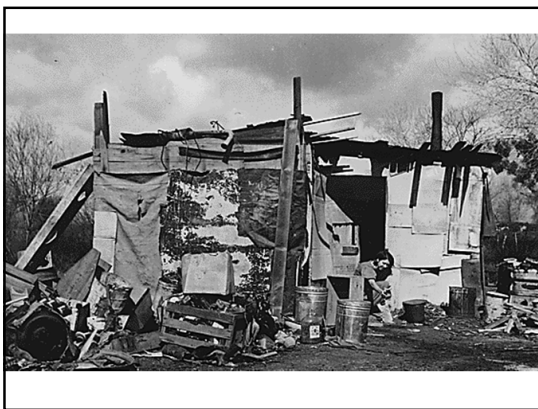
- Emerging Model for Working with Philanthropists
- Asks What the Philanthropist Needs to Accomplish For:
 - Self
 - Family
 - Future
- Charities Believe In/Legacies Want to Create
- Integrates Those Goals into Tax, Estate and Financial Planning

Generational Cohorts

- Identifying Cohorts
- Defining Moments
- Shared Values
- Traditionalists (Born Pre-1946)
- New Philanthropists (Born 1946-Present)

Generation Name	Birth Years
Depression	1912-1921
World War II	1922-1927
Post-War	1928-1945
Leading Boomers	1946-1954
Younger Boomers	1955-1964
Generation X	1965-1976
Millennials	1977-1984?
Great Recession	1985-?

**Depression
 1912-1921**



- Depression (1912-1921)**
- Bequests to Charity's Rainy Day Fund
 - Trust
 - Face to Face (Visual Presentation)
 - Kids Will Be Involved

World War II
1922-1927

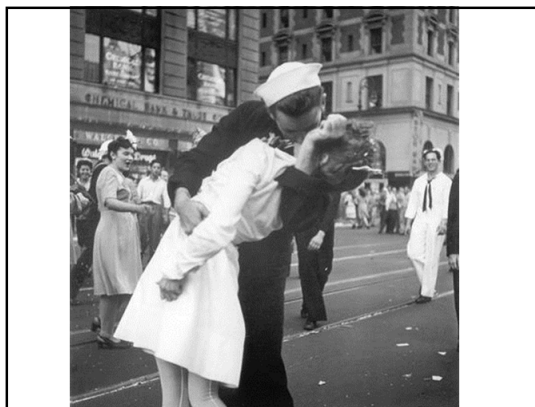
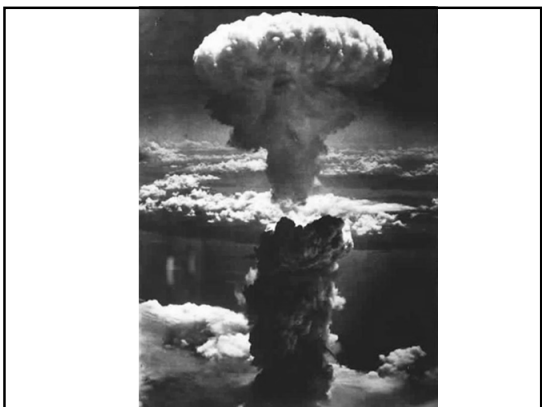


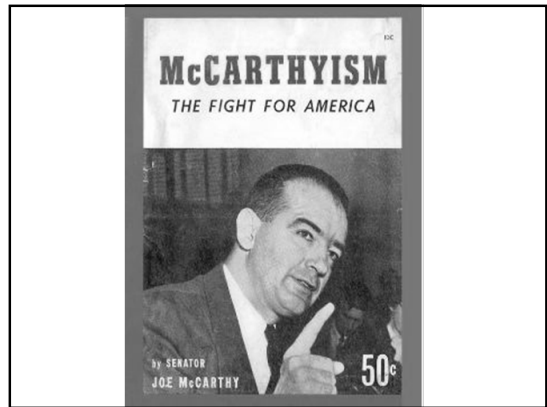


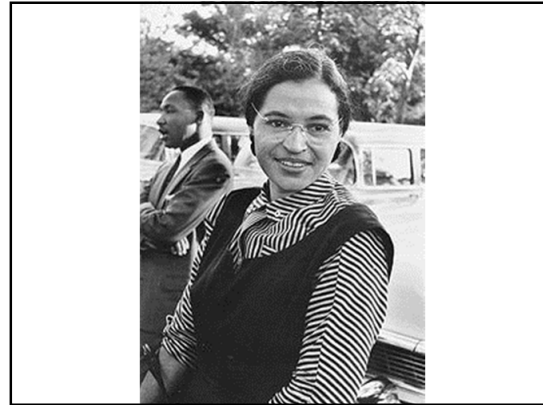
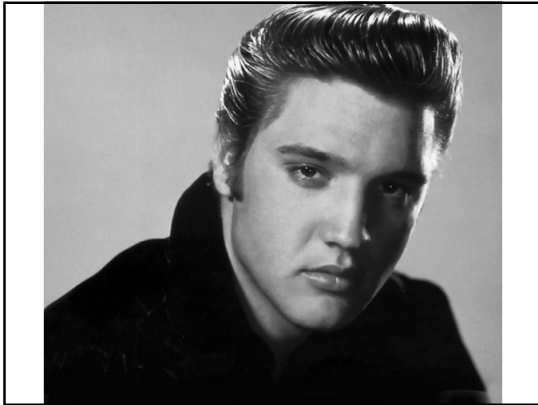
World War II (1922-1927)

- Common Good
- Public Service
- Trust
- Bequest and Current Gifts
- Matching Gifts
- Referrals
- Immortality

Post War 1928-1945







- Post War (1928-1945)**
- Shared Experiences
 - Significant Resources
 - Trust
 - Giving Clubs
 - Gift Annuities
 - Paying for Grandkids Education
 - Passing on Values

Leading Boomers 1946-1954



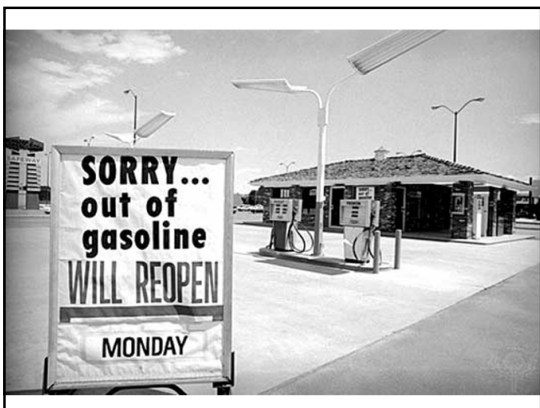


Leading Boomers (1946-1954)

- Balancing Act
- Lack Trust
- Social Justice and Changing the World
- Most Generous of All Cohorts
- Low Savings
- No Inheritance for Kids
- “What’s In It for Me”
- Assets Other Than Cash
- Focus on Youth

**Younger Boomers
1955-1964**

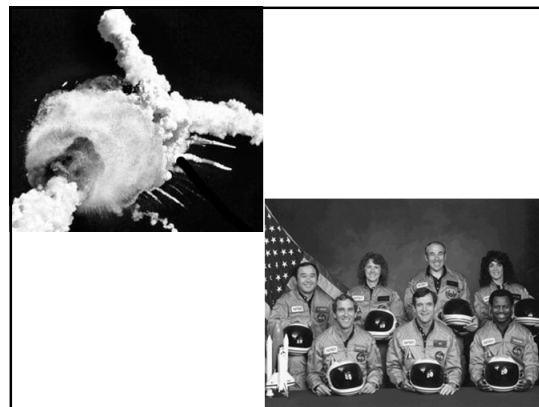


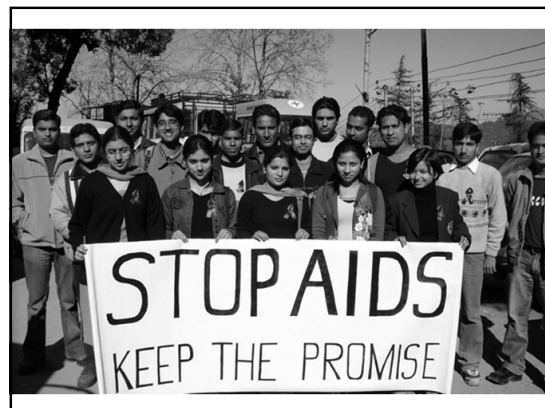
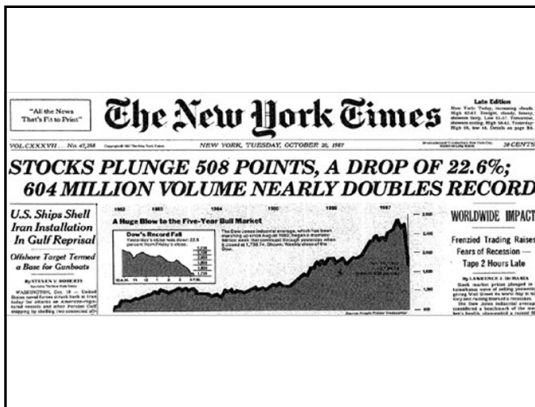


Younger Boomers (1955-1964)

- Promised the Moon...Cynicism
- Missed Youth
- Competitive
- Lack Trust
- Control Freaks
- Retreat to the Home
- Impact
- Make Giving Easy

Generation X
1965-1976





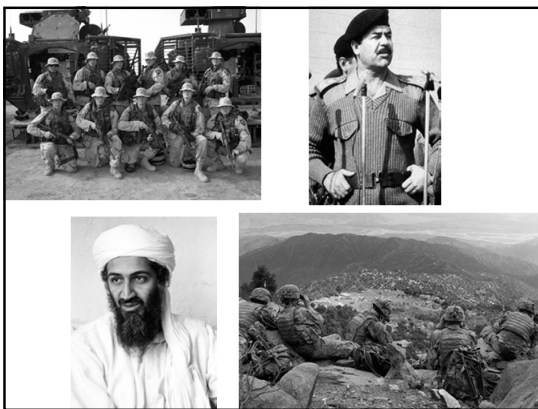
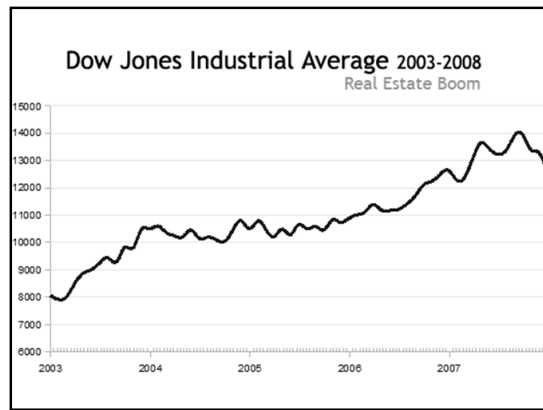
- Gen X (1965-1976)**
- Self-Interest
 - Work-Life Balance
 - Entrepreneurial
 - Less Likely to Marry
 - Friends First/Trust Peers Not Others
 - Environmental
 - No Traditional Stewardship Events
 - Lack Brand Loyalty
 - Change is Bad

**Millennials
1977-1984?**



On April 20, 1999, in a senseless act of violence, twelve students and one teacher were killed, and many others injured at Columbine High School. It was a tragic event that shook the Columbine and metro Denver communities, horrified and saddened the nation, and changed forever our perceptions of the safety and security within a school typical of so many across America.

Over time, Columbine parents, students, faculty, and community leaders designed and constructed this Columbine Memorial to remember those killed and injured that day and honor their lives. This Memorial is dedicated to those innocent victims, so that they are "never forgotten".



Millennials (1977-1984?)

- Economic Promise
- Careful Dealing with Others
- Don't Trust Authority
- Hopeful, Idealistic, Social Justice
- Change is Good
- Failure to Launch
- What Corporate Ladder?
- More Traditional Values
- Brand Loyal
- Keep it Fresh

Great Recession 1985-???



Times They Are A Changin’

- Traditionalists
 - 18% of total population
- New Philanthropists
 - 82% of population

New Philanthropists

- Do not trust charities
- Will not make gifts unless they can see:
 - Impact
 - Long-term outcomes
 - Verifiability
 - Accountability
 - Real volunteer opportunities
 - “Get out of the way”

New Philanthropists

- Use Donor-Centered Philanthropic Planning
 - Mission of the charity
 - Long-term goals of the donor/family
 - Relationship with the charity, not your needs
 - Impact and outcomes (robust stewardship)
 - Allow more restricted gifts
 - Partnerships with professional advisors

Impact of Philanthropic Planning on Advancement Hiring

- Gift planning specialist positions are being eliminated in favor of generalists
 - PPP Gift Planner Profile in 2007 showed
 - A marked reduction in full-time gift planners
 - A marked reduction in the time full-time gift planners spent on gift planning
 - PPP membership down over 50% from its all-time high

Impact of Philanthropic Planning on Advancement Training

- All gift officers are now expected to have a basic knowledge of gift planning
- Gift planning training is becoming part of most major gift training programs
- Charities are “renting” gift planning expertise when they need a true expert

Impact of Philanthropic Planning on Careers

- Gift planning expertise is shifting from the non-profit sector to the for-profit sector (except for the largest and most sophisticated charities)
- Donors trust their advisors more than non-profits to provide technical gift planning advice
- Advisors have a better understanding of donors’ financial situation

Impact of Philanthropic Planning on Careers-Gift Planners

- Gift planning specialists will become harder and harder to come by-which makes them more valuable
- Dedicated gift planning positions will become more difficult to find
- Expert gift planners will shift into principal gift positions to work with high net worth donors
- Collaboration with professional advisors is vital to success

Impact of Philanthropic Planning on Careers-Development Officers

- Role needs to shift to services only the charity can provide
 - MISSION
 - Gift agreement/Gift acceptance*
 - Ensuring donors’ charitable goals are achieved by the gift, whether it is a current or future gift
- Need to build relationships with professional advisors serving your donors

* For a sample gift acceptance policy: www.plannedgiving.com/brian

Impact of Philanthropic Planning on Careers-Professional Advisors

- Advisors need to
 - Drive the process
 - Not rely on charities for gift planning expertise
 - Become more knowledgeable about charitable methods to meet personal planning goals
 - Bring charities to the table for mission and gift terms discussion

Summary

- Aging generational cohorts have altered the fundraising landscape
- Donor-centered philanthropic planning techniques are required to reach the majority of donors in their peak earning years and younger
- Professional advisors, development officers and gift planners must **COLLABORATE** to help donors achieve their personal planning and philanthropic goals

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Brian M. Sagrestano, JD, CFRE
100 Chestnut Place
New Hartford, NY 13413

P: 315.292.1335 • F: 315.292.7001 • M: 315.292.2384

brian@giftplanningdevelopment.com

www.giftplanningdevelopment.com

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Overview of Gift Annuities

Presented by:

Frank Minton
Frank Minton Consulting, LLC
16538 Beach Drive, NE
Lake Forest Park, WA 98155
P: 206-362-7641
E: FDMinton@gmail.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

OVERVIEW OF GIFT ANNUITIES

American Council on Gift Annuities

2012 Conference

San Francisco, California

April 19, 2012

Presented by:

Frank Minton
16538 Beach Drive N.E.
Lake Forest Park, WA 98155
Tel: 206-365-5154
E-mail address: FDMinton@gmail.com

Introduction

The charitable bequest is the most popular planned gift, and for most charities it has been, and probably always will be, the centerpiece of the planned giving program. The next most popular instrument, at least for charities with a full-service planned giving program, is the gift annuity. While the total dollars contributed for charitable remainder trusts exceed the amount contributed for gift annuities, the number of gift annuities is larger than the number of charitable remainder trusts.

The gift annuity appeals to a charity's oldest donors. According to a recent survey conducted by the American Council on Gift Annuities ("ACGA"), the average age of an annuitant of an immediate gift annuity is 78. However, younger donors sometimes establish gift annuities as a supplemental retirement plan. Thus, there are two markets for this instrument: the largest market being older individuals looking for the security of fixed payments, and a smaller market consisting of individuals who want to accumulate more for retirement. In both cases, philanthropic intent is presupposed, for a gift annuity should be viewed as a means of making a gift and not simply as an investment.

Although large amounts are sometimes contributed for a gift annuity, the average contribution according to the ACGA survey is about \$43,000, and many gift annuities are established with gifts of \$10,000 or even less. These data indicate that most donors for gift annuities do not have high-net-worth. Those who create charitable remainder trusts and charitable lead trusts tend to have greater wealth.

While gift annuities and charitable remainder trusts have some things in common, they are quite different. For instance a gift annuity is not a trust, and with a gift annuity, unlike a charitable remainder trust, the charity assumes financial risk. (See the Appendix for a detailed comparison of gift annuities and charitable remainder trusts.)

This paper focuses on gift annuities considering in turn a description of gift annuities, the tax aspects, how rates are determined, state regulations, sample applications, and some marketing suggestions.

I. Understanding the Essentials

A. Description of a Gift Annuity

A gift annuity is a contract under which a charity, in return for a transfer of cash or other property, agrees to pay a fixed sum of money for a period measured by one or two lives. A person who receives payments is called an "annuitant" or "beneficiary." The contributed property becomes part of the charity's assets, and the payments are a general obligation of the charity. The annuity is backed by all of the charity's assets, not just by the property contributed.

The charity may spend a portion of the contribution immediately, provided it retains sufficient reserves to satisfy the requirements of applicable states in which gift annuities are regulated. Most charities, however, keep the entire contribution (increased by earnings and decreased by annuity payments and expenses) in reserve until the sole or surviving annuitant dies. The remaining portion of the contribution is called the “residuum.

B. Types of Gift Annuities

Immediate Gift Annuity

With an immediate gift annuity the annuitant(s) start(s) receiving payments at the end (or beginning) of the payment period immediately following the contribution. Payments can be made monthly, quarterly, semi-annually, or annually. The most common arrangement is quarterly payments at the end of the quarter. The first payment is customarily prorated from the date of the contribution to the end of the first period, and thus is smaller than subsequent payments, but it is possible to stipulate that the first payment be for the full amount. All of these factors have some effect on the charitable deduction.

The annual annuity is determined by multiplying the amount contributed by the annuity rate. For example, if a person, age 65, contributes \$10,000 and the charity follows the American Council on Gift Annuities (ACGA) suggested rate of 4.7 percent, the annual annuity would be $\$10,000 \times 4.7\% = \470 . If quarterly payments have been selected, the annuitant would receive \$117.50 for each full quarter.

Deferred Gift Annuity

With a deferred gift annuity the annuitant(s) start(s) receiving payments at a future time, which must be more than one year after the date of the contribution. As with immediate gift annuities, payments can be made monthly, quarterly, semi-annually, or annually.

C. Tax Aspects of Gift Annuities

1. Allowance of Charitable Deduction

A gift annuity is a form of bargain sale, for the present value of the annuity is less than the value of the property transferred to the charity. The donor is entitled to an income tax, gift tax, and/or estate tax charitable deduction for the difference or "overpayment." [See Reg. Secs. 1.170A-1(d)(1) and 20.2055-2(f).]

2. Determination of the Charitable Deduction
(Immediate Annuities)

The amount of the deduction or "overpayment" is determined as follows:

- a. Multiply the applicable annuity rate by the amount transferred to the charity. This is the annual amount paid to the annuitant(s).
- b. Multiply this result by the value of a \$1 annual annuity based on the appropriate table (S for a single life, R(2) for two lives) for the age(s) of the annuitant(s), and for the Charitable Midterm Federal Rate ("CMFR")*. These tables are found in IRS Publication 1457.

*Some planned giving publications refer to this rate as the Section 7520 rate since it is described in that section of the Code. In this paper the term "CMFR" is used throughout.

- c. Multiply this result by the adjustment-for-payment-frequency factor, also found in Publication 1457. (Use the adjustment factor in Table K for payments made at the end of the period, Table J for payments made at the beginning of the period.)
- d. The result, after completing steps a-c, is the present value of the annuity. The amount of the charitable gift, or deduction, is determined by subtracting the present value of the annuity from the value of the property transferred.

The CMFR referred to above is 120 percent of the annually compounded Applicable Federal Rate (AFR) for mid-term obligations, rounded to the nearest .2 percent. The donor has the option of using the CMFR for the current month or either of the two preceding months. [See IRC Sec. 7520.] The higher the applicable rate, the larger the charitable deduction. On the other hand, a lower rate results in more of the annuity payment being tax-free.

The Regulations dealing with determination of the present value of the annuity are Reg. Secs. 1.170A-1(d)(2), 1.101-2(e)(1)(iii)(b)(2), and 20.2031-7.

3. Determination of the Charitable Deduction
(Deferred Annuities)

For deferred gift annuities, as well as for immediate gift annuities, the charitable deduction is the amount by which the contribution exceeds the present value of the future payments. However, the method for determining that present value is more complicated for deferred annuities because both earnings during the deferral period and the probability of death occurring prior to the first payment must be taken into consideration.

This entails the use of additional tables from IRS Publication 1457, namely Table H for Dx factors and Table 90CN for Lx factors.

4. Gifts Resulting in a Reduced Deduction

If either ordinary income property or unrelated-use tangible personal property is contributed for a gift annuity, the charitable deduction will be limited to the cost basis of the gift portion. [See IRC Sec. 170(e).]

As used here, *ordinary income property* is property which, if sold, would not result in long-term capital gain. It includes:

- Short-term capital gain property (for example, securities owned one year or less),
- Inventory held for sale to customers in the ordinary course of business,
- Recaptured gain, which arises from the sale of certain types of property that has been depreciated, and
- Various other types of property (accounts receivable, certain intellectual property created by the owner, etc.)

Unrelated-use tangible personal property refers to property not related to the purpose that constitutes a charity's basis for exemption. A gift of a painting to an art museum is a related use because the museum's purpose is to display art. However, a gift of the painting to a food bank, which immediately sells it, would be unrelated to the charity's purpose.

The following is an example of a gift resulting in a reduced deduction:

Jose contributes for a gift annuity technology stock which he purchased eight months ago for \$20,000, and which is now valued at \$100,000. If he had held the stock for more than one year, the charitable deduction, considering all relevant factors, would have been \$40,000.

In this instance, however, his charitable deduction is only \$8,000, which is the cost basis of the gift element [$(\$40,000 \div 100,000) \times 20,000 = \$8,000$].

5. Taxation of Annuity Payments

a. Contribution of Cash

When cash is contributed, the portion of the annuity payments that represents a return of the donor's investment in the contract (present value of the annuity) will be tax-free. That portion is determined as follows:

- i. Determine the "expected return" by multiplying the life expectancy(ies) of the annuitant(s) by the annual annuity. [Use Table V of Reg. Sec. 1.72-9 for a single life, Table VI of Reg. Sec. 1.72-9 for two lives, and make adjustments if payments are made less frequently than monthly or if the first payment will cover a partial period per Reg. Sec. 1.72-5(a)(2)(i).]
- ii. Divide the present value of the annuity by this "expected return." This yields the "exclusion ratio."
- iii. Multiply the annual annuity by the exclusion ratio. The result is the tax-free portion of each payment. The balance is taxable as ordinary income.

Example: On February 1, 2012 Jasmine, whose date of birth is December 15, 1936, contributed \$100,000 cash for a gift annuity. The charity to which she made the gift offered the ACGA rate of 5.8 percent, and the applicable CMFR was 1.4%. The annual payment was \$5,800.

\$100,000 Gift Annuity (Cash)

<p style="text-align: center;">Present Value of Annuity = \$58,140</p> <p>This is the present value of the annuity based on the IRS mortality tables and discount rate. This is the capital that is returned tax free.</p>	<p style="text-align: center;">Gift Value = \$41,860</p> <p>This is the amount by which the contribution (\$100,000) exceeds the present value of the annuity. This "excess" is the charitable deduction.</p>
---	--

Annual payment \$5,800

Jasmine's life expectancy, per the IRS Expected Return Multiple Tables, is 12.4 years. Thus, total payments over her life expectancy would be $\$5,800 \times 12.4 = \$71,920$, a number known as the "expected return."

The present value of the annuity (also known as the "investment in the contract") divided by the expected return ($\$58,140 \div 71,920 = .808$) is the portion of each payment that is excluded from taxation during life expectancy because it is a return of capital. This decimal is known as the "exclusion ratio." The exclusion ratio multiplied by the annual payment ($.808 \times \$5,800 = \$4,686.40$) is the portion of each full-year's payment that is tax-free.

Jasmine will be taxed on her Social Security payments if her income exceeds a certain threshold amount. Fortunately, the tax-free portion of each payment is not added to income. Thus, for some donors a gift annuity is a way to increase cash flow without increasing the portion of Social Security payments subject to taxation.

The return multiple (life expectancy) is from Table V of Reg. Sec. 1-72-9. In the case of an immediate gift annuity, use the return multiple in effect at the time the annuity is funded in order to calculate the exclusion ratio (tax-free portion of each payment). In the case of a deferred gift annuity, the exclusion ratio will be based on the return multiple in effect at the time payments begin. This cannot be known in advance because the return multiple tables may change between the time the annuity is funded and payments begin. A charity may wish to tell an annuitant how payments from a deferred gift annuity would be taxed under existing tables, but with the caveat that the taxation of payments will have to be recalculated if the tables change before payments begin, and the old return multiple tables are not grandfathered for existing deferred gift annuities.

Some gift planners believe that the return multiple tables in effect when the contribution for a deferred gift annuity was made should be used to calculate the exclusion ratio, even if those tables change before payments actually start. We disagree with their position for the following reasons: IRC Sec. 72(c)(4) says that for purposes of calculating the exclusion ratio, the annuity starting date is “the first day of the first period for which an amount is received as an annuity under the contract.” Thus, if the first payment were June 30, 2013, the annuity starting date (in the event payments are quarterly at the end of the period) would be April 1, 2013. Private Letter Ruling 7401290510A, a clarification of Private Letter Ruling 7309280510A, supports this analysis. It states, “The exclusion ratio for a donor who enters into a deferred payment gift annuity contract shall be computed at the time the payments start based on the life expectancy at the time payments are to commence.”

If new return multiple tables are issued and the old tables are not grandfathered for existing deferred gift annuities, the return of capital (whether on a tax-free basis or as capital gain) will be the amount originally calculated. It will simply be returned over a different period of time. For example, if the return multiple had been 15.0 and changed to 16.5, the return of capital would be reported ratably over 16.5 years.

In the case of a joint and survivor deferred gift annuity where the annuitants are husband and wife, who funded the annuity with jointly-owned or community property, the taxation of payments would definitely have to be recalculated in the event that (1) one of the spouses dies before the annuity starting date or (2) pursuant to a divorce decree, the annuity is divided into two annuities or one spouse is awarded the entire annuity payment. The recalculation would be based on the return multiple for one life in effect on the annuity starting date (or on the one-life table in effect when the annuity was funded, in the event that the tables have changed in the meantime and the old tables were grandfathered for existing deferred gift annuities.)

If the sole annuitant of a one-life annuity or the survivor annuitant of a two-life annuity dies before the end of his/her life expectancy, he/she gets a posthumous income tax deduction for the amount of capital not returned (i.e., for the total unpaid tax-free amounts). See IRC Sec. 72(b)(3)(A). The annuitant is entitled to this deduction for use on the final income tax return regardless of whether the annuitant or another person funded

the annuity. See IRC Sec. 72(b)(3)(B). For the 2010 Form 1040, the deduction was reported on Line 28 of Schedule A.

Note: The immediately-preceding paragraphs apply to a gift annuity, the annuity starting date of which occurs after 1986—even if the contribution was made in 1986 or earlier. If an annuitant began receiving payments before 1987, the tax-free portion of the annual payments will continue to be tax-free no matter how long the annuitant lives. However, if the annuitant dies before the end of life expectancy, no income tax deduction will be allowed on his or her final income tax return. This change was brought about by the Tax Reform Act of 1986.

6. Contribution of Long-term Capital Gain Property

The contribution of any property for a charitable gift annuity is deemed to be a bargain sale of that property. See Reg. Secs. 1.170A-1(d)(3) and 1.1011-2(a)(4)(i). The donor is subject to tax on the gain attributable to the present value of the annuity. The taxable gain is determined by subtracting the basis allocated to the present value of the annuity from the present value.

If the following conditions are met, that gain need not be recognized in the year of the gift but can be reported ratably over the life expectancy(ies) of the annuitant(s). See Reg. Sec. 1.1011-2(a)(4)(ii).

- The annuity is non-assignable except to the charity.
- The donor is the sole annuitant or is the initial annuitant in a two-life annuity.

If the annuity payments are made to someone other than the donor, then the taxable gain (computed under the bargain sale rules) is all reportable in the year property is transferred for the annuity. To the extent the annuity was funded with property held one year or less, or with other property with ordinary gain, the gain reported in the year of transfer will be taxed as ordinary income.

If the annuity is funded with the donor's separate property, but is payable to the donor and then to another, the gain is reported over the donor's life expectancy only. However, any gain not reported by the time the donor dies must be reported by the surviving annuitant. The amount reported each year by the surviving annuitant will be the same as the donor was reporting, and will continue to be reported for the duration of the donor's life expectancy, determined at the time payments began. Sometimes it will be impossible to report all of the gain over the donor's life expectancy. When that is the case, planned giving software programs show the remaining gain continuing to be

reported ratably by the successor annuitant for however many years it takes to report it completely.

If the annuity is funded with jointly-owned or community property, and payments are payable to both owners and then to the survivor, the gain can be reported ratably over their joint life expectancy.

Any gain unreported at the death of the sole or surviving annuitant is not taxed because it is part of the residuum that belongs to the charity. See Figure 2.5.

When gain is reported ratably, annuity payments usually consist of three elements: ordinary income, capital gain, and tax-free return of capital. The amount of ordinary income will be the same as it would have been had an equivalent amount of cash been contributed. The tax-free portion of the payments will be reduced by the amount of gain reportable. When property with a very low basis is contributed, there may be no tax-free portion.

Finally, if a donor contributes long-term capital gain property but elects under IRC Sec. 170(b)(1)(c)(iii) to have the income tax charitable deduction be calculated with respect to the property's cost basis rather than with respect to its fair market value, the gain will still be reported as long-term capital gain.

The foregoing specifically applies to an immediate gift annuity, but the same method of reporting gain apparently also applies to deferred gift annuities. The capital gain would not be reported until the payments begin, and then would be reported ratably over the donor's remaining life expectancy.

Example: *Instead of contributing \$100,000 cash for the gift annuity, Jasmine contributes stock with a fair market value of \$100,000 and a cost basis of \$40,000.*

PRESENT VALUE OF ANNUITY \$58,140

GIFT VALUE \$41,860*

\$23,256	\$34,884	\$16,744	\$25,116
This is the cost basis of the present value of the annuity. It is the capital that is returned tax free.	This is the capital gain allocated to the present value of the annuity. Since Jasmine is the annuitant, it is reported ratably over her life expectancy.	This is the cost basis allocated to the charitable gift (the deductible portion of the contribution).	This is the capital gain allocated to the charitable gift, and it is not taxed.

* *This is the amount by which the contribution (\$100,000) exceeds the value of the annuity. This “excess” is the charitable deduction.*

For the duration of her life expectancy, Jasmine’s payments will be taxed as follows:

Tax-free return of capital	\$23,256 ÷ 12.4**	=	\$1,875.48
Capital gain	\$34,884 ÷ 12.4**	=	\$2,813.23
Ordinary income (the balance of the payment)			<u>\$1,111.29</u>
			\$5,800.00

The numbers generated by a computer program may vary from these numbers by a few cents because of rounding. The portion of the payments taxed as ordinary income is the same whether \$100,000 of cash or \$100,000 of long-term appreciated stock is contributed.

At the end of her life expectancy the entire capital will have been returned, and the entire taxable gain will have been reported. Thereafter, the annuity payments are fully taxable as ordinary income.

If Jasmine dies prior to the end of her actuarial life expectancy—i.e., before 12.4 years—the unreturned capital can be taken as an income tax deduction on her final income tax return. (Again, this applies to a gift annuity, the annuity starting date of which occurs after 1986—even if the contribution was made in 1986 or earlier.) As indicated, any unreported capital gain will not be taxed.

If she were the donor and another person—her brother, for example—were the successor annuitant, the taxable capital gain (\$34,884) would be reported ratably over her life only. However, if she were to die before the end of her actuarial life expectancy, her brother would continue the ratable reporting of gain until it has all been reported.

** *As noted earlier, this is the expected return multiple (life expectancy) in effect now, and it should be used for an immediate gift annuity. However, in the case of a deferred gift annuity, both the tax-free portion of payments and the amount of payments taxable as capital gain will have to be recalculated if the return multiple tables change prior to the starting date of the annuity, and the old return multiple tables are not grandfathered for existing deferred gift annuities.*

7. Gift and Estate Tax Implications

A donor who funds a gift annuity and names an annuitant in addition to, or instead of, himself or herself makes two gifts: one to the charity and one to the annuitant. Depending on the circumstances, the gifts may or may not be reportable and taxable.

For example, if a donor establishes an immediate-payment one-life annuity and names someone else as annuitant, the donor makes a present interest gift to the charity of the gift value and a present interest gift to the annuitant of the present value of the annuity. Each of these gifts must be reported on Form 709 if it exceeds the gift tax annual exclusion. The former is fully deductible, but the latter is a taxable gift to the extent it exceeds the annual exclusion.

A donor can avoid making a current taxable gift by reserving the right during life, or by testamentary instrument, to revoke the annuitant's right to payments.

II. Gift Annuity Rates

The ACGA Board annually publishes suggested rates, which most charities follow. Charities that adopt these rates do not have to hire an actuary to develop their own rate schedule, and they do not compete with each other on rates. By offering uniform rates they encourage individuals to base their decision on which charity they want to support, rather than on which charity offers the highest rates.

A. Guidelines

In recommending gift annuity rates, the ACGA is guided by these four considerations:

1. A gift should usually result in a significant residuum, and the risk to the charity should be minimal.
2. Gift annuity rates should be lower than commercial rates. (Charities represented to Congress and to state regulators that gift annuities do not compete with commercial annuities.)
3. Gift annuity rates should be high enough to attract donors.
4. ACGA rates should have credibility so that most charities will continue to follow them.

B. Assumptions Underlying the ACGA Suggested Rates That Became Effective January 1, 2012.

1. The residuum (amount of the contribution remaining at the death of the annuitant) will be 50 percent, but the present value of that residuum (discounted at 3.25 percent) must be at least 20 percent of the amount contributed.

2. Life expectancies are based on the Annuity 2000 Tables, assuming all annuitants are female and are 1.0 years younger than their actual ages. The new rates take into consideration projected increases in life expectancy per Projection Scale AA since those tables were published.
3. The charity's expenses for investing gift annuity reserves and administering gift annuities total 100 basis points.
4. The total return on gift annuity reserves for immediate gift annuities is 4.25 percent, or 3.25 percent net of expenses. This return assumption is based on an assumed portfolio consisting of 40 percent equities, 55 percent 10-year Treasury bonds, and 5 percent cash equivalents, using the historical average minus 2.0 percents on large-cap equities and current yields on the bonds and cash.

Note: The rates for certain older and younger annuitants are lower than the rates that would follow from these assumptions. The lower rates for older annuitants result from the fact that rates are capped, and there is a gradation into the cap. The lower rates for younger annuitants is necessary to produce rates that result in a charitable deduction of more than 10 percent, which is required for a gift annuity to qualify for favorable tax treatment under the Internal Revenue Code and Regulations.

5. The interest credited during the deferral period for deferred gift annuities is 3.25 percent.

III. State Regulations

At the present time:

- 12 states require a segregated reserve fund, annual reporting, and/or a detailed application. (Four additional states that exempt charities from most regulations require a reserve fund.)
- 15 states exempt gift annuities from regulation but require a notification to the state of an intent to issue gift annuities. All but one of these states require certain disclosure language in the gift annuity agreement.
- 19 states exempt gift annuities from regulation and do not require notification to the state. Six of these states require disclosure language in the gift annuity agreement.
- 4 states and the District of Columbia either do not address gift annuities or have determined that they are not subject to insurance regulation.

A. Segregated Reserve Fund

Sixteen states require a charity to establish an annuity reserve fund: Alabama, Arkansas, California, Florida, Hawaii, Maryland, Montana, New Hampshire, New Jersey, New York, North Dakota, Oregon, Pennsylvania, Tennessee, Washington, and Wisconsin. The fund is to be segregated, held separate and distinct from other assets of the organization, and its assets may not be used to pay any obligations other than annuity payments. The amount required to be held in the fund is generally calculated based on an actuarial methodology, utilizing mortality tables and interest rates that can vary from state to state. Some states require a surplus, most often an additional 10 percent of the calculated reserve. However, in Hawaii, New Jersey and Wisconsin the surplus is the greater of 10 percent or \$100,000. (Thus, until a charity's calculated reserves exceed \$1 million, the required surplus will be \$100,000.) For a charity just launching a gift annuity program that includes any of these three states, this in effect creates a minimum fund balance requirement of \$100,000. Arkansas and New York also have minimum fund balance requirements of \$50,000 and \$100,000, respectively.

New York is among the states that require a charity to hold 110% of the calculated reserve, although a higher amount (125%) is required if a charity is able to claim the exemption from annual filing that is available when reserves are less than \$500,000. In addition, unless a charity prepares and files an Actuarial Opinion and Memorandum that involves an asset adequacy analysis, there is an additional surplus a charity must maintain. This second surplus has been phased in over a three year period (2008-2010). Now, fully implemented as of December 31, 2010, a charity registered in New York needs to hold 126.5% of calculated reserves to meet the layered surplus requirement – or 137.5% if it is in the exempt period.

B. Restrictions on Investment of Reserve Fund

California and Florida both place specific limitations on how the segregated reserve fund is invested. In general, the investment limitations imposed are:

- government bonds allowed without limit;
- corporate bonds generally limited only as to percent in any one company, except in California where they are included in limit on publicly-traded securities;
- stock limited to 50 percent of required reserve assets;
- mutual fund limitations include a 10-percent limit in any one fund (Florida), or inclusion as part of the stock limitation, regardless of the underlying assets in the mutual fund (California);
- real estate is not permitted as a reserve investment in California, and is limited to 5 percent by Florida.

As California requires a “California only” reserve fund, the restrictions apply only to reserves held for California residents. Florida and Wisconsin allow a charity the option of creating a state-specific fund. The Florida restrictions apply just to the Florida reserves, whether they are held in a Florida-only fund or in an “all states” fund. However, insuring that the Florida restrictions are met within an all states fund may be problematic.

Eight other states — Hawaii, Maryland, New Hampshire, New Jersey, New York, Tennessee, Washington, and Wisconsin — have statutes or regulations that specifically mention investment of reserve fund assets, with each requiring investment in accordance with a “prudent investor” standard.

C. Annual Reporting

Certain states (Arkansas, California, Hawaii, Maryland, New Jersey, New York, Tennessee, Washington, and Wisconsin) have a detailed annual reporting requirement, involving either use of a specific state form or a statement from a CPA (either in the audited financial statements or separate). Washington and Wisconsin specifically require an actuary to verify the reserve requirement as part of the annual filing.

IV. Applications of Gift Annuities

A. Gift Annuity to Increase Cash Flow.

Example: Sarah, age 76, receives pension income, Social Security payments, dividends from a few stocks, and interest from CDs. Her cash flow has been declining as interest rates have fallen. In fact, her CDs are now yielding only 2.0 percent. To increase her cash flow and provide a gift to her university she contributes \$50,000 from a maturing CD for a gift annuity. Here is how her situation changes. (The figures are based on a CMFR of 1.4 percent.)

Prior to the gift

Invested in CD	\$50,000
Interest	1,000
Income tax on interest (33 percent rate)	<u>330</u>
Net spendable	\$670

After the gift

Contributed for gift annuity	\$50,000
Annual payment	3,000
Ordinary income	573
Tax-free	2,427
Income tax (33% x 573)	189
Net spendable	\$2,811

The cash flow from the gift annuity is almost three times that from the CD. However, with the CD Sarah retains her capital while it is irrevocably committed in the case of the gift annuity. It should also be noted that if Sarah lives beyond her actuarial life expectancy, the gift annuity payments are fully taxable as ordinary income.

In addition to significantly increasing her cash flow, Sarah receives an income tax charitable deduction of \$21,369, which results in tax savings of \$7,052.

B. Gift Annuity for Someone Other Than the Donor

Sometimes it makes sense for a donor to establish a gift annuity for someone else. This means that younger individuals – for example, those who must help support an aged parent and those who want to assist a friend or provide for a retiring domestic worker – could be prospects. Often, such assistance is paid with after-tax dollars, which can be quite costly for the donor. For example, a person subject to a 35-percent tax rate must earn \$769 in order to provide a \$500 monthly check. It could be advantageous to transfer capital for a gift annuity and name as the annuitant the person whom the donor desires to help. The donor receives an income tax deduction, and the tax paid by the annuitant will probably be minimal because a portion of the annuity payments will likely be tax-free for a number of years, and the taxable portion of the payments will be taxed at a low rate.

Example

In February of 2012, Chris contributed stock having a fair market value of \$100,000 and a cost basis of \$40,000 for a gift annuity and named his mother as annuitant, reserving no power to revoke her interest. His mother, age 82, will receive \$7,200 per year (\$1,800 per quarter) based on the ACGA rate of 7.2 percent. The deduction and taxation of payments are based on the February CMFR of 1.4 percent.

Chris will recognize the capital gain allocated to the present value of the annuity, which is \$29,950. However, his charitable deduction of \$50,083 will offset the taxable gain and reduce taxes on other income somewhat, assuming he is able to use the deduction.

Since Chris will already have recognized the taxable gain, no part of his mother's payments will consist of capital gain. For the balance of her life expectancy, \$6,012 will be tax-free, and only \$1,188 will be ordinary income. The payments to her will be taxed the same as they would have been if Chris had contributed \$100,000 cash.

Chris made a gift to his mother of \$49,917 (the present value of her annuity payments). As a present-interest gift, it qualified for the gift tax annual exclusion of \$13,000. Thus, assuming he made no other gifts to her in the year he established the gift annuity, the taxable gift to his mother was \$36,917 (\$49,917 – 13,000). He could have avoided making any taxable gift by retaining in the gift annuity agreement the right, during his life or upon his death, to revoke his mother's annuity interest. Then he will have made no completed gifts to his mother until she actually receives the annuity payments, and since each year's payments are under \$13,000, they will be covered by the gift tax annual exclusion.

However, some legal advisors are concerned that if an individual sets up an income stream payable to a third person and retains control over that stream (e.g., is able to terminate it), the income will be taxable to the person who created it. They note that although the applicable statute (IRC Sec. 674) pertains to trusts, the principle might be broad enough to apply to gift annuities as well. Other authorities take the position that there is no basis for concluding that a statute applicable to a trust should also apply to a gift annuity, which is not a trust. They note as well that the payments would not be taxable under the assignment of income doctrine because assignment of income arises only when the right to receive income has matured in the hands of the assignor, which is not the case here because the donor never had a right to the income.

Considering the uncertainty and difference of opinion on this matter, a charity and a donor, pursuant to a consultation with their own legal counsels, should decide whether to include both *inter vivos* and testamentary powers of revocation or a testamentary power only. Because there is no statutory authority for concluding that payments would be taxable to the donor if there is an *inter vivos* power, and because there are advantages to retaining an *inter vivos* power, the author suggests that gift annuity agreements do include both an *inter vivos* and a testamentary power.

C. Gift Annuity That Provides Inflation Protection

Donors may be attracted to a plan that combines the security of fixed payments with periodic increases in cash flow. That plan is the step annuity, which is the bundling of an immediate gift annuity with a number of deferred gift annuities that have successively later payment-starting dates. While it may be possible to draft a single gift annuity agreement that contains all of these provisions, the more

prudent course is to execute simultaneously multiple agreements, differing only in the timing and amount of payments. The charity could issue one quarterly check combining the amounts due from all of the annuities.

Kenneth, who was born November 20, 1946, wants his annual payments to increase at the average historical inflation rate (approximately 3.5 percent). The following chart shows how much he would have contributed on January 1, 2012, if he wanted these adjustments annually for eight years. Actually, he could have provided for them for whatever period he chose. The calculations are based on the February CMFR of 1.4 percent.

Type of Annuity	Contribution Amount	Payment Beginning Date	Payment Increment	Total Payment
Immediate	\$100,000	3/31/2012	\$4,700	\$4,700
Deferred	\$3,290	3/31/2013	\$165	\$4,865
Deferred	\$3,333	3/31/2014	\$170	\$5,035
Deferred	\$3,259	3/31/2015	\$176	\$5,211
Deferred	\$3,193	3/31/2016	\$182	\$5,393
Deferred	\$3,150	3/31/2017	\$189	\$5,582
Deferred	\$3,047	3/31/2018	\$195	\$5,777
Deferred	\$2,971	3/31/2019	\$202	\$5,979
Deferred	\$2,944	3/31/2020	\$209	\$6,188

Mr. K's total contribution in January 1, 2012 was \$125,187, and his payments would retain their purchasing power for the next eight years (or for whatever period he chose), assuming the future rate of inflation approximates the historical average.

A charity might hesitate to agree to this plan because the amount contributed for each deferred gift annuity is less than the stated minimum in the gift acceptance policies. However, the charity may be willing to make an exception because the total amount contributed is well above the minimum, the bundled annuities are identical except for the payment-beginning date and the annuity amount, and they can be consolidated for the purpose of making the payments. The plan should not prove to be an administrative burden, and it could appeal to donors concerned about escalating prices.

D. Super-Flexible Gift Annuity as a Supplemental Retirement Plan

Most gift planners by now are probably familiar with the flexible deferred gift annuity. Three Private Letter Ruling pertaining to it have been issued (9743054, 200449033, and 200742010). Ordinarily, the donor would establish a single annuity pursuant to an agreement that allows the donor to decide later when to begin payments. The older the donor (or other annuitant(s)) when payments begin, the larger the payments.

Example:

Donald, whose date of birth is October 13, 1961, wanted to supplement his income when he retired, but he did not know when he would be ready to retire. On February 28 2012, he contributed stock having a fair market value of \$100,000 and a cost basis of \$60,000 for a gift annuity, and he reserved the option to start quarterly payments on June 30 of any year during the period 2022-2032. The calculations are based on the February, 2012 CMFR of 1.4 percent.

The income tax charitable deduction (the lowest deduction resulting from any of the possible payment start dates) was \$10,186. The following table shows taxation of payments for full years during life expectancy.

Elective Start Date	Age at Start Date	Capital Gain	Tax-free Portion	Ordinary Income	Total Annuity
6/30/2022	61	\$1,490.84	\$2,236.26	\$2,372.90	\$6,100.00
6/30/2023	62	\$1,547.28	\$2,320.92	\$2,431.80	\$6,300.00
6/30/2024	63	\$1,605.12	\$2,407.68	\$2,587.20	\$6,600.00
6/30/2025	64	\$1,670.08	\$2,505.12	\$2,624.80	\$6,800.00
6/30/2026	65	\$1,736.65	\$2,604.95	\$2,858.40	\$7,200.00
6/30/2027	66	\$1,805.76	\$2,708.64	\$3085.60	\$7,600.00
6/30/2028	67	\$1,881.60	\$2,822.40	\$3,296.00	\$8,000.00
6/30/2029	68	\$1,962.12	\$2,943.18	\$3,394.70	\$8,300.00
6/30/2030	69	\$2,053.20	\$3,079.80	\$3,567.00	\$8,700.00
6/30/2031	70	\$2,152.80	\$3,229.20	\$3,818.00	\$9,200.00
6/30/2032	71	\$2,258.16	\$3,387.24	\$4,054.60	\$9,700.00

The disadvantage for Donald is that once he makes the election, he must start receiving the entire amount. To maximize flexibility, he could simultaneously establish 10 flexible deferred gift annuities, each funded with \$10,000. Then he could elect payments as needed. In the event he becomes disabled or ill, he could elect payments from all 10 annuities at the same time.

This bundle of flexible deferred gift annuities could also be combined with an immediate gift annuity to provide inflation protection. However, unlike the step annuity described in the example pertaining to Kenneth above, the increases in cash flow would not be predetermined. The annuitant could control the cash flow by choosing year-by-year whether to begin payments from any of the flexible deferred annuities. A plan that combines the inflation protection of the step annuity with the ability to base the timing of payments on circumstances is what is meant by the **super flexible deferred gift annuity**.

Suppose that Donald created 10 flexible deferred gift annuities, each funded with \$10,000, rather than a single flexible deferred gift annuity funded with \$100,000. He could elect payments from any of the annuities per the following schedule:

Election Start Date	Age at Start Date	Total Annuity
6/30/2022	61	\$610
6/30/2023	62	\$630
6/30/2024	63	\$660
6/30/2025	64	\$680
6/30/2026	65	\$720
6/30/2027	66	\$760
6/30/2028	67	\$800
6/30/2029	68	\$830
6/30/2030	69	\$870
6/30/2031	70	\$920
6/30/2032	71	\$970

At age 62, Donald decides to reduce his work hours to allow more time for travel. Then, at age 65 he retires but continues to do some consulting. He elects to activate two of the annuities at age 62, three more at age 65, and on each year beginning at age 66. His payments would be:

Beginning at Age	Annual Payment
62	\$1,320
65	\$3,600
66	\$4,400
67	\$5,230
68	\$6,100
69	\$7,020
70	\$7,990

V. Marketing Suggestions

A. Accept Certain Non-Traditional Assets for a Gift Annuity

Most gift annuities are funded with cash and/or publicly-traded securities. In fact, these are the only assets some charities will accept. If they were open to a wider variety of assets, they might increase their volume of gift annuities.

Following are some assets that can be readily converted to cash and, therefore, could be accepted for a gift annuity with little risk:

Precious metals such as gold and silver coins, bullion, or Exchange-Traded Funds.

Commercial deferred variable annuities

Life insurance policies with accumulated cash value

Proceeds received pursuant to the cash surrender of a Savings Bond

Assets that might be accepted in some circumstances subject to due diligence and a plan for monetizing the asset.

Tangible personal property, such as artworks and collections

Shares in closely-held companies

Real estate

Of all of these non-traditional funding assets, the one most commonly offered for a gift annuity is real estate. The instrument of choice when a donor wants to give real estate and receive life income is a net-income charitable remainder unitrust with a “flip” provision. However, such a trust may not be possible or practical, and the donor may insist on payments that are immediate and fixed from the outset.

One consideration is whether the real estate would be an acceptable asset to satisfy the reserve requirements of states that require a segregated reserve fund.

Another is how to minimize the charity’s risk. Charities that accept real estate for gift annuities often employ one or more of the following risk-control strategies:

- They offer a lower-than-normal gift annuity rate to take into consideration the fact that net proceeds might be less than the appraised value. The risk is lessened, but by no means eliminated, because the sale could be considerably delayed and the net proceeds much less than anticipated. (Lower rates normally should be offered in the case of any illiquid asset where the selling price and date of sale are unknown.)
- They do advance marketing and identify a buyer prior to the date the property is transferred, but neither the donor nor the charity signs a

purchase and sale agreement. The donor should not be exposed to taxation on the gain because the charity was under no obligation to sell at the time of the gift. However, the prospective buyer might walk away leaving the charity with a payment obligation and uncertainty about a future sale.

- Wanting more assurance, the charity might go a step further and enter into a sales agreement with the prospective buyer contingent on the property's being given to the charity. Some authorities argue that this does not expose the donor to taxation on the gain, per Rev. Rul 78-197 because the donor has not subjected the charity to an obligation to sell, but the charity, being under no obligation to do so, has simply contracted to sell in the event it receives certain property by gift.

In summary, generally accept assets that can be readily converted for cash of a known amount. Be very careful about the second category of assets above, but perhaps consider them on a case-by-case basis.

B. When Marketing Gift Annuities in this Low-Interest Environment, Emphasize Cash Flow

Gift annuity rates, as a whole, are now the lowest they have ever been in history, but the interest rates paid on money market funds, CDs, and bonds are also near historic lows. Thus, relatively speaking, the gift annuity is no less appealing.

The important comparison, the one that will determine your success in marketing gift annuities, is net cash flow from gift annuities vs. net cash flow from fixed-income investments.

If cash flow compares favorably, gift annuities can be successfully marketed even though rates have decreased. Consider the example of a 70-year old donor who contributes \$100,000 for a gift annuity and names herself as annuitant.

If she had made the gift in December, her annual payment would have been \$5,800, and her charitable deduction would have been \$27,013 (based on a 1.4 percent CMFR). If she made the gift in early 2012, her annual payment would have been \$5,100, and her charitable deduction would have been \$35,821 (again based on a 1.4 percent CMFR).

In the case of the December gift, her net contribution (\$100,000 less tax savings, 33% tax rate) would have been \$91,086, and her after-tax annual payment would have been \$5,400. The after-tax payment as a percentage of the net contribution was 5.93 percent.

In the case of the 2012 gift, her net contribution would have been \$88,179, and her after-tax payment was \$4,748. The after-tax payment as a percentage of the net contribution was 5.38 percent.

Yes, she received more when the old rates were in effect, but what she receives after tax in 2012 still compares very well with after-tax cash flow from fixed income investments. Indeed, she would have to have a gross return of 8.0 percent on a taxable investment to realize 5.38 percent after-tax. Thus, rather than despairing because rates have gone down, emphasize the positive aspects of gift annuities in the marketplace.

This is also a good time to mention testamentary gift annuities for survivors. These are provided for in a will or other instrument and come into existence at death. The applicable rates will be those in effect at death, so the donor is not locking in rates now when they are particularly low.

C. Remember that Gift Annuity Donors Are Prospects for Other Types of Gifts

According to the most recent national survey of charities issuing gift annuities conducted by the ACGA, over 30 percent of people who contribute for a gift annuity increase their annual giving. There is also anecdotal evidence that they are more likely to leave a bequest to the charity. These corollary benefits result from the close relationship a charity develops with gift annuity donors. A person receiving regular checks will be more receptive to information about the charity and its programs.

D. If Age Information for Donors is Available, Send Batch Mailing to a Certain Demographic Indicating in Each Case the Benefits of a Gift annuity for a Person of the Recipient's Age

Some software companies will do this for you if you provide the data. This is often more effective than simply inviting people to request a personal illustration if interested.

E. Experiment with a Variety of Print and Electronic Marketing Techniques

The best prospects for immediate gift annuities are over age 70, and they are accustomed to getting information through printed materials. However, a significant percentage of them do use the Internet. While you will probably be more effective in reaching them through newsletters and target mailings, some will respond to your website and electronic communications. Of course, print may become comparatively less important as the next generation matures. The important thing is to have a multi-faceted marketing plan. Don't focus on a single technique, but experiment with many.

F. Remind Donors Who Do Not Need Their Annuity Payments That They Can Assign Them to The Charity.

Some people do not really need their payments, so they might be willing to give up the right to future payments. They would receive an additional charitable deduction, and they could see their gift in action. The charity, relieved of the payment obligation, could withdraw the residuum for the annuity from the reserve fund and use it currently for the charitable purpose they had designated.

G. Invite Existing Donors to Establish Additional Annuities

According to one survey, over one-half of all gift annuities are established by previous gift annuity donors. One donor had funded approximately 260 annuities by the time he died. Some donors test the waters with a modest gift annuity, and seeing it work to their satisfaction, do additional gift annuities. Consider contacting these donors at an actuarial age change or on the anniversary of an annuity they have established. Offer to provide an illustration for a new annuity.

Appendix

COMPARISON OF GIFT ANNUITIES AND CHARITABLE REMAINDER TRUSTS

	Gift Annuities	Charitable Remainder Trusts
Type of property accepted	Cash, publicly-traded securities, and possibly other assets	Cash, publicly-traded securities, closely held stock, real estate
Number of individual beneficiaries	Maximum of 2	No maximum, provided present value of remainder interest is at least 10% of value of property contributed
Amount of payments	Fixed amount based on age(s) of beneficiaries at time of contribution	CRAT - Fixed amount, at least 5% of initial value of contributed assets CRUT - set percentage (at least 5%) of trust assets as revalued annually
Duration of payments	Life of beneficiaries	Life of beneficiaries or term of years, not exceeding 20
Taxation of payments	Determined in advance.	Per four-tier system: ordinary

	If cash contributed, partly tax-free, partly ordinary income for duration of life expectancy. If appreciated property contributed, partly ordinary income, partly capital gain and possibly partly tax free	income, capital gain, tax-free depending on source of distribution for duration of life expectancy
Income tax charitable deduction	Yes, for excess of contribution over present value of payments	Yes, for present value of charitable remainder interest
Tax on capital gain	Charity not taxed on gain. The gain, attributable to present value of payment ratably reported by donor if donor is a beneficiary. If donor not a beneficiary this gain taxed up front to donor	Trust not taxed on gain. Distributed gain taxed to beneficiary(ies)
	Gift Annuities	Charitable Remainder Trusts
Charity at risk?	Yes, backs payments by total assets	No, unless charity is fiduciary
Beneficiary at risk?	If charity becomes insolvent	If trust assets are exhausted
Possible to designate purpose of gift	Yes, subject to charity's policies	Yes, subject to charity's policies
Ability to change charitable recipient	No, assets transferred to charity in exchange for contractual obligation	Yes, can retain right in agreement

WE ARE COMMITTED TO TWO THINGS:

Our clients and our clients' donors

SSgA Charitable Asset Management is a leading financial services provider for planned gifts, providing investment management, tax, administration and program consulting services.

For more information, please contact:

Julie Hassel (julie_hassel@ssga.com) at +1 617 664 8754 or

Jen Katstra (jennifer_katstra@ssga.com) at +1 617 664 2069

**STATE STREET
GLOBAL ADVISORS®**





***Retirement Accounts - Charitable Giving Implications of
the 2012-2013 Income and Estate Tax Environment***

Presented by:

Christopher Hoyt
Professor

University of Missouri (Kansas City) Law School
12821 Pembroke Circle
Leawood, KS 66209
P: 816-235-2395
E: hoytcr@gmail.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

**CHARITABLE PLANNING in
2012-2013 TAX ENVIRONMENT**

ACGA Conference
San Francisco, California 2012

CHRISTOPHER R. HOYT
University of Missouri - Kansas City
School of Law

ESTATE PLANNING

** Estate & Income Tax Changes*
-- Charitable gifts? -- Roth IRA conversions?

** Charitable IRA Rollover in 2012*

** Bequests of Retirement Assets*
-- spouse & family
-- charity

FUTURE OF ESTATE TAX ?

<u>Year</u>	<u>Threshold</u>
2001	\$ 675,000
2002-2003	\$ 1,000,000
2004-2005	\$ 1,500,000
2006-2008	\$ 2,000,000
2009	\$ 3,500,000
2010	REPEALED ! [* carryover basis]
2011-2012	\$ 5,000,000 !
2013	\$ 1,000,000

Federal Estate Tax Returns Filed

2011 <small>[exclud portab]</small>	8,300 <small>(estim)</small>	26% charit
2007	38,000	20%
2004	62,700	18%
2001	108,000	17%
1998	97,900	17%
1995	69,780	19%
1992	59,200	19%

OTHER TRANSFER TAX CHANGES

	<u>2011</u>	<u>2012</u>	<u>2013</u>
■ \$5 million Gift Tax	*	*	
■ \$5 million GST	*	*	
■ 35% tax rate	*	*	
■ Portability for married couples	*	*	

Income Tax Changes

	<u>2011</u>	<u>2012</u>	<u>2013</u>
■ Social Security tax to 4.2%	*	**	
■ Bush tax rates –		*	*
-- 15% long term capital gain		*	*
-- no phaseout itemized deductions		*	*
■ AMT relief & “extenders”	*		
■ New health taxes - 3.8% /0.9%			*

**THE YEAR 2012:
The “Perfect Storm” for Taxes**

- The “Bush Tax Cuts” expire in 2012
 - Return to Clinton-era tax rates in 2013
- New Health Care Tax in 2013 if income over \$200,000 (\$250,000 joint returns)
 - 3.8% investment income surtax
 - 0.9% earned income (wages, etc.)

FUTURE INCOME TAX RATES

<i>Highest tax rates</i>	<u>2011-12</u>	<u>Otherwise</u>	<u>2013</u>
■ Investment income	35%	39.6%	43.4%
■ Earned income (wages – 1.45% health)	36.4%	41.0%	41.9%
■ Dividends	15%	39.6%	43.4%
■ LT Capital Gains	15%	20%	23.8%

FUTURE INCOME TAX RATES

STRATEGIES FOR HIGH-INCOMES

- Municipal bonds
- Roth IRA conversion in 2012 [not 2013]
- Avoid spikes in income from major gains on property sales
 - tax-exempt CRTs & installment sale

**PLANNING FOR
CHARITABLE GIFTS
OF APPRECIATED STOCK
IN LIGHT OF FUTURE
TAX RATE CHANGES**

**DONORS LIKE TO CONTRIBUTE
APPRECIATED STOCK**

DOUBLE-TAX ADVANTAGE

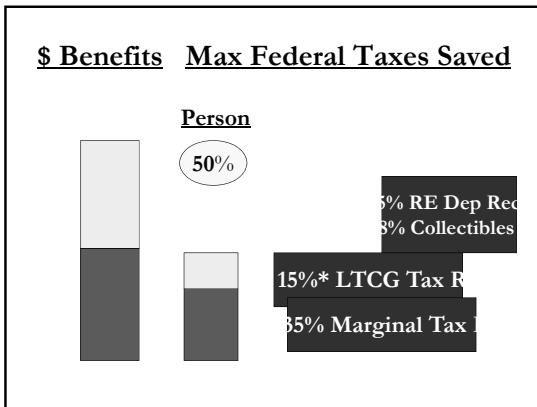
- Charitable Income Tax Deduction for the Full Appreciated Value of the Stock
- Never Pay Income Tax on the Growth of the Value of the Stock
- Loss Property? Sell for tax loss; give cash

**DOUBLE BENEFIT FROM GIFT
OF APPRECIATED L.T.C.G.
PROPERTY**



**AVOID LONG-TERM
CAPITAL GAIN TAX**

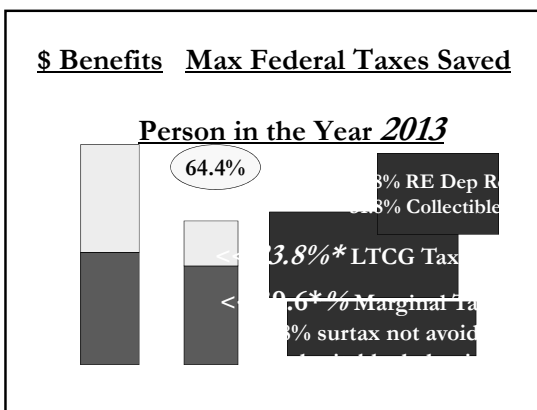
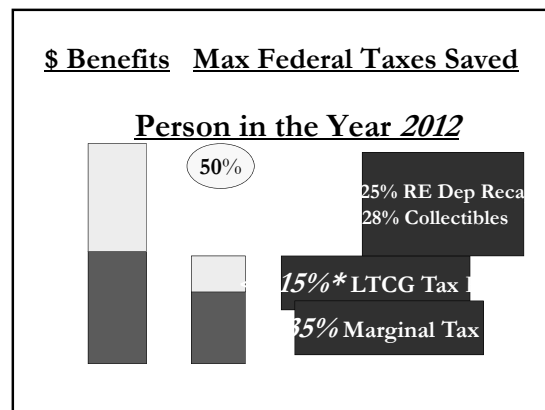
**CHARITABLE INCOME
TAX DEDUCTION**



**IMPACT OF
INDIVIDUAL INCOME
TAX RATE CHANGES
IN 2012 AND 2013**

FUTURE INCOME TAX RATES

<i>Highest tax rates</i>	<i>2011-12</i>	<i>Otherwise</i>	<i>2013</i>
■ Investment income	35%	39.6%	43.4%
■ Earned income (wages – 1.45% health)	36.4%	41.0%	41.9%
■ Dividends	15%	39.6%	43.4%
■ LT Capital Gains	15%	20%	23.8%



**PROPOSALS TO
CHANGE THE
INCOME TAX DEDUCTION
FOR
CHARITABLE GIFTS**

Obama Budget Proposal:

TAX BENEFIT FROM CHARITABLE GIFTS & MORTGAGE INTEREST
LIMITED TO 28%

Example: Rich person has \$100 income
 \$ 35 <<-- Pay tax at 35%
 -28 <<<-- Tax savings from \$100 gift
 \$ 7 <<<<-- Cost of making \$100 gift

2011 CBO REPORT:
PROPOSALS TO CHANGE CHARITABLE DEDUCTION

May 2011 Congressional Budget Office Report
“Options for Changing the Tax Treatment of Charitable Giving”

Eleven proposals – examine impact on :
 -- charitable giving and
 -- tax collections

2011 CBO REPORT:
PROPOSALS TO CHANGE CHARITABLE DEDUCTION

“FLOOR” PROPOSAL – can only deduct when gifts exceed dollar amount [\$500/\$1,000 joint] or percent of income [2% of income]

“would reduce gifts, but add incentive for increased charitable giving”

LIFETIME AND TESTAMENTARY CHARITABLE GIFTS FROM RETIREMENT ACCOUNTS

THREE STAGES OF A RETIREMENT ACCOUNT

- **Accumulate Wealth**
- **Retirement Withdrawals**
- **Distributions After Death**

Accumulate Wealth

- Tax deduction at contribution
- Accumulate in tax-exempt trust
- Taxed upon distribution

= ***Tax Deferred Compensation***

- COMPARE:
Roth IRA, Roth 401(k) & Roth 403(b)

**Objective of Tax Laws:
Provide Retirement Income**

Consequently, there are laws to:

- **Discourage** distributions before age 59 ½
- **Force** distributions after age 70 ½

TYPES OF QRPs

- 1. Sec. 401 – Company plans
- 2. Sec. 408 – IRAs
 - SEP & SIMPLE IRAs
- 3. Sec. 403(b) & 457–Charities
- 4. Roth IRAs & 401(k)/403(b)

RETIREMENT ACCOUNTS

ESTATE PLANNER'S DILEMMA:

- **Cannot*** make a lifetime gift of retirement assets, like stock or land
 - * exception: "Charitable IRA"
- **Can** make a bequest of retirement assets, but usually taxable income to recipient

Roth IRA,

Roth 401(k), or Roth 403(b)

INVERSE OF TRADITIONAL:

- **No** tax deduction at contribution
- Accumulate in tax-exempt trust
- **Not** taxed upon distribution

THREE STAGES

- Accumulate Wealth
- **Retirement Withdrawals**
- Distributions After Death

RETIREMENT

TAXATION

General Rule – Ordinary income

Exceptions:

- Tax-free return of capital
- NUA for appreciated employer stock
- Roth distributions are tax-free

USUAL OBJECTIVE:

Defer paying income taxes in order to get greater cash flow

	<u>Principal</u>	<u>10% Yield</u>
■ Amount	\$ 100,000	\$ 10,000
■ Income Tax on Distribution (40%)	<u>40,000</u>	
■ Amount Left to Invest	\$ 60,000	\$ 6,000

REQUIRED MINIMUM DISTRIBUTION (“RMD”)

BACKGROUND: 50% penalty if not receive distribution from IRA, 401(k), etc:

#1 – lifetime distributions from own IRA:

→ beginning after age 70 ½

#2 – an inherited IRA, 401(k), etc –

→ beginning year after death *

REQUIRED MINIMUM DISTRIBUTIONS***LIFETIME DISTRIBUTIONS***

<u>Age of Account Owner</u>	<u>Required Payout</u>
70 1/2	3.65%
75	4.37%
80	5.35%
85	6.76%
90	8.75%
95	11.63%
100	15.88%

ADVANTAGES OF ROTH IRAs

■ Unlike a regular IRA,

no mandatory lifetime distributions from a

Roth IRA after age 70 ½

■ Yes, there are mandatory distributions after death

Charitable IRA Rollover

-- Lifetime Gifts from IRAs --

- Pension Protection Act of 2006
- Eligible Donors:
 - Won't report charitable gifts from IRAs as taxable income
 - Not entitled to charitable income tax deduction

Charitable IRA Rollover

-- Lifetime Gifts from IRAs --

- IRA owner must be over age 70 ½
- Maximum: \$100,000 per year
- Yes! Charitable gift satisfies required minimum distribution requirement from IRA!

WHO WINS?

- Donors who do not itemize tax deductions (“standard deduction”)
- Donors who live in states where state income tax laws have no charitable deduction

WHO WINS ?

- Donors who lose tax deductions as their income increases
 - social security benefits taxable
 - medical expenses (7.5% of AGI)
 - Medicare “B” premiums
 - [begin 2013] 3% of all itemized deductions if AGI > \$170,000

WHO WINS ?

- Donors subject to annual charitable deduction limitation (50% of AGI)
- Wealthy individuals who want to reduce the proportion of retirement assets in their estates

WHO SHOULD AVOID CHARITABLE IRA ROLLOVER ?

- Donors about to sell highly appreciated stock and make a cash gift
 - >> better to donate that stock to charity
- Donors who live in states where the state income tax exempts retirement income from tax but allows tax deductions for charitable gifts
Colorado, Kentucky, New York

LEGAL REQUIREMENTS

- Over age 70 ½
- IRA (only) – not 403(b), 401(k), etc.
- “Directly” from the IRA to charity
 - OK to send check to donor who forwards to charity

LEGAL REQUIREMENTS

- ELIGIBLE CHARITY – Public charity or private operating foundation
 - however, a donor advised fund or supporting org is not eligible
- Must qualify for full charitable deduction – no dinners; no CGAs

LEGAL REQUIREMENTS

- Taxable part of IRA distributions (only)
 - tax-free distributions protected
- Donor must have letter from charity that donor received no goods or services in exchange for the gift

TECHNICAL ISSUES

- Yes! Charitable IRA gifts can satisfy legally binding pledges!
- Joint return? Up to \$200,000
- No withholding taxes
- Beneficiary of an inherited IRA who is over age 70 1/2 can make charitable gifts of required distributions

Will Law Be Extended to 2012?

Proposed: Public Good IRA Rollover Act of 2011
 Expand law to include deferred gifts; DAFs; SOs

>Planning strategy for 2012

if, like in 2008 & 2010, law hasn't been extended until December!:

>Give RMD to charity;

> can't lose ! (Some IRAs balk)

Will Law Be Extended to 2012?

IRS Notice 2007-7; Q & A 38

"If made such a 'Charitable IRA' gift in 2006 before the law was first enacted, it is valid for this new law" [*restated*]

Point: if person could make such a gift before the law was first enacted, then a person can make such a gift in 2012 before the law is merely extended.

THREE STAGES

- Accumulate Wealth
- Retirement Withdrawals
- Distributions After Death

Distributions After Death

- > Income taxation
- > Mandatory ERISA distributions
- > Estate taxation

Collision of three tax worlds at death

INCOME IN RESPECT OF A DECEDENT - “IRD” – Sec. 691

- No stepped up basis for retirement assets
- After death, payments are *income in respect of a decedent* (“IRD”) to the beneficiaries
- Common mistake in the past: children liquidate inherited retirement accounts.

CHARITABLE BEQUESTS FROM QRPs

- Best type of bequest: taxable income !
- Easier than formality of a will: Name charity as beneficiary on form of plan
 - no need for attorney to draft
 - no need for witnesses, etc.

“You can’t make a charitable bequest unless you have a will”

Wrong. A retirement plan is a trust with its own beneficiary designations. Like other trusts, assets can pass outside probate.

Name a charity as a beneficiary
- the cheapest “charitable remainder trust”

LIFETIME GIFTS: *ONLY IRAs* BEQUESTS: *ANY QRP*

1. Sec. 401 – Company plans
2. Sec. 408 – IRAs
 - SEP & SIMPLE IRAs
3. Sec. 403(b) & 457–Charities
4. Roth IRAs & 401(k)/403(b)

Distributions After Death

- > Income taxation
- > **Mandatory ERISA distributions**
- > Estate taxation

Collision of three tax worlds at death

Distributions After Death

After death, must start liquidating account

- Tax planning for family members who inherit: *DEFER* distributions as long as possible – greater tax savings
- “Stretch IRA” – make payments over beneficiary’s life expectancy

Distributions After Death

“*life expectancy*”

Oversimplified: Half of population will die before that age, and half will die after

Implication: For the 50% of people who live beyond L.E. date, an inherited IRA will be empty before they die.

REQUIRED MINIMUM DISTRIBUTIONS *LIFE EXPECTANCY TABLE*

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>	
30	83	53.3 more years
40	83	43.6
50	84	34.2
60	85	25.2
70	87	17.0
80	90	10.2
90	97	6.9

REQUIRED MIN. DISTRIBUTIONS *LIFE EXPECTANCY TABLE* “STRETCH IRAS”

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>
30	53.3 more years
40	43.6
50	34.2
60	25.2
70	17.0
80	10.2
90	6.9

REQUIRED MIN. DISTRIBUTIONS *LIFE EXPECTANCY TABLE* “STRETCH IRAS”

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>	
30	1.9%	53.3 more years
40	2.3%	43.6
50	2.9%	34.2
60	4.0%	25.2
70	5.9%	17.0
80	10.0%	10.2
90	14.5%	6.9

REQUIRED MINIMUM DISTRIBUTIONS * *DEFINITIONS* *

- **Required Beginning Date (“RBD”)**
April 1 in year after attain age 70 ½
- **Designated Beneficiary (“DB”)**
A human being. An estate or charity can be a beneficiary of an account, but not a DB.
- **Determination Date**
September 30 in year after death.

HOW TO ELIMINATE BENEFICIARIES BEFORE DETERMINATION DATE

- Disclaimers
- Full distribution of share
- Divide into separate accounts

HOW TO LEAVE ACCOUNT TO BOTH FAMILY & CHARITY

- Other beneficiaries cannot do *stretch IRA* if charity is also a beneficiary?
- **Solutions:**
 - * cash out charity's share by Sept 30
 - or
 - * separate account for charity

2012 SENATE PROPOSAL: LIQUIDATE ALL INHERITED IRAs IN FIVE YEARS

- Feb 7, 2012 – Highway Bill – not enacted
- Senator Baucus – Senator Kyl – “We will look at it again later this year”

EXCEPTIONS

- -- Spouse -- minor child -- disabled
- -- Person not more than ten years younger

REQUIRED MINIMUM DISTRIBUTIONS
Example: Death at age 80?
CURRENT LAW: *Life Expectancy Table*

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>	<u>Life Expectancy</u>
30	1.9%	53.3 more years
40	2.3%	43.6
50	2.9%	34.2
60	4.0%	25.2
70	5.9%	17.0
80	10.0%	10.2
90	10.0%	6.9 * [10.2 yrs]

REQUIRED MINIMUM DISTRIBUTIONS
Example: Death at age 80?
PROPOSED: FIVE YEARS if >10 yrs younger

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>	<u>Life Expectancy</u>
30		5 years
40		5
50		5
60		5
70	5.9%	17.0
80	10.0%	10.2
90	10.00%	6.9 * [10.2 yrs]

2012 SENATE PROPOSAL: LIQUIDATE ALL INHERITED IRAs IN FIVE YEARS

IMPLICATIONS FOR CHARITIES

Donors more likely to consider

- Outright bequests
- Retirement assets to tax-exempt CRT
 - Spouse only (marital estate tax deduction)
 - Spouse & children (no marital deduction)

FUNDING TRUSTS WITH RETIREMENT ASSETS

FUNDING TRUSTS

General Rule: Trust is not DB

Exception: “Look-through”
trust if four conditions

Types:-- “*accumulation trusts*”
-- “*conduit trusts*”

MULTIPLE BENEFICIARIES OF A SINGLE IRA?

- Must liquidate over life expectancy of oldest beneficiary
- Payable to a trust? Use life expectancy of oldest trust beneficiary

FUNDING TRUSTS WITH RETIREMENT ASSETS

Challenges when there are multiple beneficiaries with a big age spread (Mom and children)

Common problem with marital bypass trusts and QTIP trusts when surviving spouse is elderly and other beneficiaries are young

Challenge with Elderly Couple

Multiple beneficiaries of a single IRA? Must liquidate inherited IRA over life expectancy of oldest.

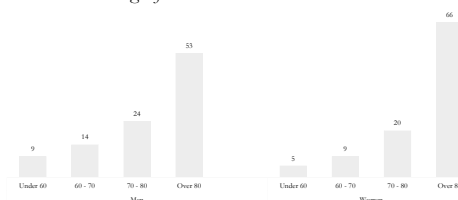
That is a problem when an IRA is payable to a trust that has both older and younger beneficiaries.

REQUIRED MINIMUM DISTRIBUTIONS *LIFE EXPECTANCY TABLE*

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>
30	53.3 more years
40	43.6
50	34.2
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70	17.0
80	10.2
90	6.9

AGE AT DEATH

Men/Women
Percentage of 2007 Federal Estate Tax Returns



**REQUIRED MINIMUM
DISTRIBUTIONS
*LIFE EXPECTANCY TABLE***

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>
30	53.3 more years
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60	25.2
70	17.0
80	10.2
90	6.9

MANDATORY DISTRIBUTIONS
[Assume surviving spouse inherits IRA
at age 80 and dies at 92]

	Rollover	Accumulation	Conduit
<u>AGE</u>	<u>IRA</u>	<u>Trust</u>	<u>Trust</u>
80	5.35%	9.80%	9.80%
85	6.76%	19.23%	13.16%
90	8.78%	100.00%	18.18%
91	9.26%	empty	19.23%
92	9.81%	empty	20.41%

**2-GENERATION CHARITABLE
REMAINDER TRUST**

- Typically pays 5% to elderly surviving spouse for life, then 5% to children for life, then liquidates to charity
- Like an IRA, a CRT is exempt from income tax
- Can operate like *a credit-shelter trust for IRD assets* [*no marital deduction*]

**2-GENERATION CHARITABLE
REMAINDER TRUST**

- Can be a solution for *second marriages* when estate is top-heavy with retirement assets. Example:
 - Half of IRA to surviving spouse
 - Other half of IRA to a CRT for 2nd spouse and children from 1st marriage

**2-GENERATION CHARITABLE
REMAINDER TRUST**

TECHNICAL REQUIREMENTS

- Minimum 10% charitable deduction
 - all children should be over age 40
- CRUT – minimum 5% annual distrib
- Not eligible for marital deduction
(see 2002 Hoyt article on topic)

MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 92]

	Rollover	Accumulation	Conduit	
<u>AGE</u>	<u>IRA</u>	<u>Trust</u>	<u>Trust</u>	<u>CRT</u>
80	5.35%	9.80%	9.80%	5.00%
85	6.76%	19.23%	13.16%	5.00%
90	8.78%	100.00%	18.18%	5.00%
91	9.26%	empty	19.23%	5.00%
92	9.81%	empty	20.41%	5.00%

YEARS OF TAX DEFERRAL

- ROLLOVER** – Actual Life + Life Expect kids
- ACCUM CST** – Life Expect of surviving spouse
- CONDUIT CST** – Actual life + few more years
- CRT** – Actual life of spouse & actual lives of kids

**YEARS OF TAX DEFERRAL
IF MANDATORY 5 YEAR PAYOUT?**

- ROLLOVER** – Actual Life + 5 years
- ACCUM CST** – Life Expect of surviving spouse
- CONDUIT CST** – Actual life + few more years
- CRT** – Actual life of spouse & actual lives of kids

**DISTRIBUTIONS
AFTER DEATH**

- > Income taxation
- > Mandatory ERISA distributions
- > **Estate taxation**

Collision of three tax worlds at death

UNMARRIED?
NO MARITAL DEDUCTION

**WHAT IS THE TAX RATE
THAT RICH PEOPLE PAY
ON THEIR INCOME ?**

- Income tax?
- Estate tax?

**IF RICH ENOUGH TO PAY
ESTATE TAX, CONSIDER
CHARITY & PHILANTHROPY**

Combination of income & estate taxes

Income	\$100	
Income tax	<u>35</u>	(35%)
Net	\$ 65	
Estate Tax	<u>23</u>	(35%)
Net to Heirs	\$ 42 <i>in 2012</i>

FUTURE INCOME TAX RATES

<u>Highest tax rates</u>	<u>2012</u>	<u>Otherwise</u>	<u>2013</u>
Investment income	35%	39.6%	43.4%
Earned income	36.4%	41.0%	41.9%
(wages – 1.45% health)			
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LT Capital Gains	15%	20%	23.8%

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2001	\$ 675,000
2002-2003	\$ 1,000,000
2004-2005	\$ 1,500,000
2006-2008	\$ 2,000,000
2009	\$ 3,500,000
2010	REPEALED ! [* carryover basis]
2011-2012	\$ 5,000,000 !
2013	\$ 1,000,000

IF RICH ENOUGH TO PAY ESTATE TAX, CONSIDER CHARITY & PHILANTHROPY

Combination of income & estate taxes

Income	\$100
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Estate Tax	<u>23</u> (35%)
Net to Heirs	\$ 42 <i>in 2012</i>

IF RICH ENOUGH TO PAY ESTATE TAX, CONSIDER CHARITY & PHILANTHROPY

Combination of income & estate taxes

Income	\$100
Income tax	<u>40</u> (39.6%)
Net	\$ 60
Estate Tax	<u>33</u> (55%)
Net to Heirs	\$ 27 <i>in 2013</i>

Roth IRA Conversion and a Charitable Bequest Disclaimer

- **Pre-Mortem Planning:**
Roth IRA Conversion
- **Post-Mortem Planning:**
Charitable Bequest via Disclaimer
(charity named as contingent beneficiary of a retirement account)

Roth IRA & Estate Tax

	<u>Assets</u>
Cash, etc.	\$ 4.1 million
IRA (<i>taxable IRD</i>)	1.0 million
Tx-exmp Roth	- 0-
Liab	<u>-0-</u>
Net Estate	\$ 5.1 million

Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	4.1	4.1
IRA	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Liab	<u>-0-</u>	
Net Estate	5.1	

Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	4.1	4.1
IRA	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Liab	<u>-0-</u>	<u>-0.1</u>
Net Estate	5.1	5.0

Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	4.1	4.0 paid>
IRA (<i>taxable IRD</i>)	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Liab	<u>-0-</u>	<u>-0-</u> paid>
Net Estate	5.1	5.0

Roth IRA & Estate Tax

	<u>Assets</u>	<u>Death</u>
Cash, etc.	\$ 4.1 million	\$4.3
IRA	1.0 million	
Tx-exmp Roth	- 0-	
Charit. Bequest	- 0 -	
Liab	<u>-0-</u>	
Net Estate	\$ 5.1 million	\$5.3

Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	4.3	4.3
IRA	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Charit. Bequest	- 0-	- 0 -
Liab	<u>-0-</u>	<u>-0.1</u>
Net Estate	5.3	5.2

Charitable Disclaimer

	<u>Before</u>	<u>After</u>
Cash, etc.	4.3	4.3
IRA	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Charit. Bequest	- 0-	-0.2
Liab	<u>-0-</u>	<u>-0.1</u>
Net Estate	5.3	5.0

Charitable Disclaimer

	<u>Before</u>	<u>After</u>
Cash, etc.	4.3	4.2 paid>
IRA (<i>taxable</i>)	1.0	0.5 paid>
Tx-exmp Roth	- 0-	0.3
Charit. Bequest	- 0-	-0.2 paid>
Liab	<u>-0-</u>	<u>-0-</u> paid>
Net Estate	5.3	5.0 0.2

Charitable Disclaimer

Estate planner said to me:
 “Show me the child that will actually disclaim an inheritance to a charity to avoid an estate tax”

Charitable Disclaimer

- A charity the *child* supports
- Donor advised fund (problems with disclaimers to a private foundation)

HOW TO LEAVE A RETIREMENT ACCOUNT TO BOTH FAMILY & CHARITY

Avoiding Problems With Charitable Bequests

- * Let Other Beneficiaries Have Stretch IRA
- *Keep IRD Off of Estate’s Income Tax Return
- * Guarantee Offsetting Charitable Income Tax Deduction if Have to Report Income

REQUIRED MIN. DISTRIBUTIONS *LIFE EXPECTANCY TABLE* “STRETCH IRAS”

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>
30	53.3 more years
40	43.6
50	34.2
60	25.2
70	17.0
80	10.2
90	6.9

Avoiding Problems With Charitable Bequests

- * Let Other Beneficiaries Have Stretch IRA
- *Keep IRD Off of Estate’s Income Tax Return
- * Guarantee Offsetting Charitable Income Tax Deduction if Have to Report Income

WHAT CAN GO WRONG ?**TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT**

- #1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT
- #2 – PAY ACCOUNT TO ESTATE OR TRUST THAT THEN MAKES A CHARITABLE BEQUEST

Avoiding Problems With Charitable Bequests

* Let Other Beneficiaries Have Stretch IRA

- *Keep IRD Off of Estate's Income Tax Return
- * Guarantee Offsetting Charitable Income Tax Deduction if Have to Report Income

WHAT CAN GO WRONG #1?

- Other beneficiaries cannot do *stretch IRA* if charity is beneficiary?
- **Solutions:**
 - * cash out charity's share by Sept 30
 - or
 - * separate account for charity p.39

WHAT CAN GO WRONG #2 ?**TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT**

- #1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT
- #2 – *PAY ACCOUNT TO ESTATE OR TRUST THAT THEN MAKES A CHARITABLE BEQUEST*

WHAT CAN GO WRONG #2?

Estate or trust has taxable income from receiving IRA distribution, but maybe there is no offsetting charitable income tax deduction when the IRA check is given to a charity.

WHAT CAN GO WRONG?

- IRS Chief Counsel Memorandum ILM 200848020
- Decedent left his IRA to a trust that benefited his six children and several charities
- Trust received cash from IRA; paid entire charitable share, leaving the six children as the only remaining beneficiaries of the trust.
- IRS: "Taxable income from IRA, but no charitable deduction." Reason: trust had no instructions to pay income to charities p.39

WHAT CAN GO WRONG?

- Solution #1 – Keep IRD off of estate’s/trust’s income tax return
 - a. Name charity as beneficiary of IRA
 - b. “Distribute” IRA to charity if document allows
 - **Caution:** IRS memo on danger of using retirement accounts to satisfy pecuniary bequests p.41

WHAT CAN GO WRONG?

- SOLUTION #2 – draft document to get an offsetting charitable income tax deduction in case estate or trust has income
- *I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from "income in respect of a decedent"* p.42

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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

***Working Productively with your Finance Office
and Actually Enjoying It***

Presented by:

Andrew M. Coddington

Assistant Vice President of
Institutional Advancement &
Director of Planned Gifts
Colgate University
13 Oak Drive
Hamilton, NY 13346
P: 315-228-7450
E: acoddington@colgate.edu

David B. Hale

Vice President for Finance &
Administration
Colgate University
13 Oak Drive
Hamilton, NY 13346
P: 315-228-7422
E: dhale@colgate.edu

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

WORKING PRODUCTIVELY WITH YOUR FINANCIAL OFFICE
AND
ACTUALLY ENJOYING IT

This session features the Director of Gift Planning, Andrew Coddington, and the Vice President for Finance and Administration, David Hale, at Colgate University. Founded in 1819, Colgate University is a highly selective Liberal Arts college consisting of 2,900 students and roughly 300 faculty in Hamilton, New York. It is an institution that focuses on teaching; the close connections between students and faculty. It also offers many opportunities for undergraduate research, including a program at the NIH, and two-dozen, faculty-lead, study abroad programs. Colgate's 25 varsity athletic teams compete at the Division I level in the Patriot League. The Colgate endowment market value was \$701 million at the conclusion of fiscal year 2011. The university's operating budget for fiscal year 2012 totals \$156 million. Colgate is larger than many liberal arts institutions and has less endowment per student than the majority of its fellow *USNW* top 25 liberal arts institutions making the financial operations of an institution like Colgate a highly complex balance, particularly when it comes to financial aid. Forty percent of Colgate students are receiving financial aid. Colgate fully meets the demonstrated need of admitted students. However, Colgate is not "need-blind", which remains a long-term goal of the university. The average financial aid grant is roughly \$35,000 per year. Colgate's tuition, room and board is roughly \$55,000. Colgate is completing a capital campaign on June 30, 2012. As of fiscal year-end 2011, Colgate raised \$427 million during its Campaign, surpassing its goal of \$400 million. By fiscal year-end 2011, Colgate's planned gifts stood at \$123.5 million within the Campaign. Colgate counts revocable arrangements in its campaign, which total \$93 million through fiscal year-end 2011.

Our program will contain two planned gift scenarios to make certain points about the different ways gift planners and finance officers consider the ramifications of the same gift, and also how we work together as colleagues. We will stop along the way to point out our different perspectives, and discuss what we feel is important for a successful relationship and a successful overall program.

The following are some questions that might be helpful to consider as we go into the session:

How do gift planners and their finance office counterparts work together?

Is there a right way and a wrong way to approach our work together?

How different are the perspectives of an institution's advancement officers, particularly gift planners, from their finance office colleagues?

Certainly, our motivations and perspectives will necessarily be different when considering a planned gift, so how do we get to a place of consensus in order to benefit the institution?

Institutions are of different sizes, shapes, and purposes, but all institutions that accept deferred/planned gifts have to be connected in some way to their finance office. How can gift planners use that point of common purpose to promote the efficacy of their work not only to their CFO, but to their President, and their Board?

Do typical donors make much distinction between an institution's operating units? If they see an institution as a "whole" how does our working relationship between Advancement and Finance reflect that perspective?

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- providing specialized reports, such as: individual gift valuations; FASB liabilities; as well as key data for use in the preparation of annual gift annuity filings in regulating states
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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

ACGA Closing Breakfast

Presented by:

Conrad Teitell

Partner

Cummings & Lockwood

Six Landmark Square

Stanford, CT 06901

P: 203-351-4164

E: cteitell@cl-law.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

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Editor: Conrad Teitell, LL.B., LL.M.

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February/March
2012
— 50th year —

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Washington Legislative Climate for

Charitable, Estate and Financial Planning

- forecast of fog — sometimes lifts retroactively
- tax, lies and ticker tape
- Charitable IRA interruptus

"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns* — there are things we do not know we don't know."

Former United States Secretary of Defense
Donald Rumsfeld — press briefing 2/12/02

With Mr. Rumsfeld's words ringing in my ears, I'll tell you:

- What is now known about the income, capital gains, gift and estate tax rules for 2012.
- What is now known about the income, capital gains, gift and estate tax rules for 2013 if Congress takes no action this year. (Remember David Brinkley's admonition: "If you turn on your TV and see nothing is happening, do not call a serviceman. You have tuned in the U.S. Senate.") Be mindful, Congress can by midnight December 31, 2013 enact laws that would be retroactively effective as of January 1, 2013.
- About the tax revision proposals for 2013 of the President, the Bowles-Simpson Commission and, in alphabetical order, the major candidates for the Republican presidential nomination: Newt Gingrich, Ron Paul, Mitt Romney and Rick Santorum. **Plus, the much-heralded Buffett Rule.**
- **The known unknowns:** who will be the next president and the party that will control the House and the Senate.
- **The unknown unknowns:** Oh, if I only knew!

The expired Charitable IRA: See the Special Supplement insert for the statement submitted by the American Council on Gift Annuities to the Senate Finance Committee on its hearing on extending 60 expired tax laws. On page 23, I suggest what charities can do to try to have the Charitable IRA extended permanently and expanded to include life-income gifts. Charities have a good case for asking the Congress to act on the Charitable IRA now and not wait until it takes up the other expired provisions that benefit businesses and classes of individual taxpayers. The Charitable IRA benefits the people served by our nation's charities.

*Unknown unknowns are related to the relevance paradox: You think that you have all relevant information, but are unaware that additional relevant information exists because its relevance is not known until you have that information.

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FOR 2012**

Ordinary income tax rates: 10%, 15%, 25%, 28%, 33%, and 35%.

Capital gains and dividend rates. For taxpayers in the 25% bracket and above, the capital gains and qualified dividend rate is 15%. For taxpayers below the 25% bracket, the rate is zero.

Exceptions. Gains on sales of artworks (and so-called collectibles) held long term (more than one year) are taxable at 28%. Unrecaptured gain on a sale of real property is subject to a 25% rate. The gain on sales of capital assets held short term (one year or less) is taxed in the regular income tax brackets — up to 35%.

No personal exemption phase-out. Personal exemptions allow a certain amount per person to be exempt from tax. Under a personal exemption phase-out (PEP), exemptions are phased out for taxpayers with AGIs above a certain level. The PEP is inapplicable in 2012.

No itemized deduction limitation. Since 1991, the amount of certain itemized deductions (including the charitable deduction) that a taxpayer may claim had been reduced, to the extent the taxpayer's AGI was above a specified — adjusted for inflation — amount. This limitation is often called the "Pease limitation," or the "3% haircut." That limitation on itemized deductions is inapplicable in 2012.

Six important charitable tax incentives expired in 2011 (but if the past is a guide, could be reenacted at the very end of this year and apply retroactively for all of 2012). The beautiful half-dozen (described soon) were enacted in 2006 with a sunset date. Sometimes the provisions lapsed, but were then extended retroactively. Well, as you know, they lapsed again. When and if Congress will reenact them is unknown. **It is important, however, to know about these expired provisions — especially the Charitable IRA.** A donor who takes her required minimum distribution before any retroactive reenactment won't be able to use it to make a tax-free gift from her IRA. Conversely, a donor who before reenactment directs that her RMD (or part of it) be delivered directly to a qualified charity should be entitled to tax-free treatment if the law is reenacted retroactively. If the law isn't reenacted, an itemizer can claim a charitable deduction for the amount given to charity from the IRA — subject to the usual AGI ceilings and carryovers.

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The Charitable/IRA Rollover.

An individual age 70½ or older could make direct charitable gifts from an IRA, **including required minimum distributions**, of up to \$100,000, to public charities (other than donor advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his or her federal income tax return. Most private foundations were ineligible donees, but private-operating and passthrough (conduit) foundations were eligible. The tax-free rollover was for outright (direct) gifts only — not life-income gifts. There was no charitable deduction for the IRA distributions. However, not paying tax on otherwise taxable income is the equivalent of a charitable deduction.

Favorable Basis Adjustment to Stock of S Corps Making Contributions

Background. When an S Corp contributes money or property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining her own income tax liability. But the S Corp shareholder has to reduce the basis in her S Corp stock by the amount of the contribution that flowed through to her.

For 2006 through 2011. The amount of a shareholder's basis reduction in her S Corp stock — because of the S Corp's charitable gift — equals the shareholder's pro rata share of the basis of the contributed property. [See Rev. Rul. 96-11 (1996-1 C.B. 140) for a rule reaching a similar result for charitable contributions made by partnerships.]

Food Inventory Gifts

Background. The deduction for contributions of inventory generally is limited to the donor's basis (typically, cost) in the inventory or fair market value, whichever is lower.

Exception. Qualifying C corporations can claim an enhanced deduction for the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.

A C corporation's charitable contribution deductions for a year can't exceed 10% of the corporation's taxable income (with a five-year carryover).

To be eligible for the enhanced deduction: The contributed property must be inventory contributed to an IRC §501(c)(3) charity (with the exception of private nonoperating foundations), and the donee must (1) use the property in a manner consistent with the donee's exempt purpose solely for the care of the ill, the needy, or minors, (2) not transfer the property in exchange for money, other property, or ser-

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vices, and (3) provide the taxpayer with a written statement that the donee's use of the property will be consistent with those requirements. For contributed property subject to the Federal Food, Drug and Cosmetic Act, the property must satisfy the applicable requirements of the Act on the date of transfer and for 180 days before the transfer.

Any taxpayer, whether or not a C corporation, engaged in a trade or business was eligible to claim the enhanced deduction for donations of food inventory in 2011.

For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally could not exceed 10% of the taxpayer's net income for the taxable year from all sole proprietorships, S corporations and partnerships (or other entity that isn't a C corporation) from which contributions of apparently wholesome food are made.

Temporary suspension in 2011 of corporation's 10% limit for qualified farmers and ranchers: In the case of a qualified farmer or rancher, the percentage limitation was eliminated for any charitable contribution of food and the contribution was treated as if it were a qualified conservation easement (see page 5 for Conservation Gifts).

Book Inventory Gifts

Background. A donor's deduction for inventory gifts generally is limited to the taxpayer's basis (typically, cost) in the inventory or fair market value, whichever is lower.

Exception for 2011. For some contributions of inventory, C corporations could claim an enhanced deduction for the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. A C corporation's charitable deductions for a year couldn't exceed 10% of its taxable income (with a five-year carryover).

To be eligible for the enhanced deduction. The contributed property must be inventory contributed to an IRC §501(c)(3) charity (with the exception of private nonoperating foundations) and the donee must (1) use the property consistent with the donor's exempt purpose solely for the care of the ill, the needy, or minors, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with those requirements.

To get the enhanced deduction. The taxpayer had to establish that the fair market value of the donated item exceeded basis.

Qualified book contributions. A gift of books to a public school that provides elementary education or secondary education (kindergarten through grade 12) and is an educational organization that normally

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maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on.

Required for enhanced deduction. The donee had to certify in writing that the contributed books were suitable, in terms of currency, content, and quantity, for use in its educational programs and that the donee would use the books in those programs.

Limited category of donors. Unlike gifts of food inventory, the enhanced deduction for book-inventory gifts was available only to C corporations — not individuals, partnerships and S Corps.

Corporate Gifts of Qualified Research and Computer Technology in 2011

A qualified research contribution is a charitable contribution by a corporation of scientific equipment or apparatus to a qualified educational or scientific organization and must be made not later than two years after construction or assembly of the property is substantially completed. The original use of the property must be by the donee, and be used substantially for research or experimentation, or for research training, in the U.S. in the physical or biological sciences. The scientific equipment or apparatus must be constructed or assembled by the donor, and may not be transferred by the donee in exchange for money, other property, or services. The donee must provide the donor with a written statement representing that it will use the property in accordance with the conditions for the deduction. For purposes of the enhanced deduction, property is considered constructed or assembled by the donor only if the cost of the parts used in the construction or assembly of the property (other than parts manufactured by the donor or a related person) do not exceed 50% of the taxpayer's basis in the property.

A qualified computer contribution means a charitable contribution of any computer technology or equipment, which meets standards of functionality and suitability established by the Secretary of the Treasury. The contribution must be to certain educational organizations or public libraries and made not later than three years after the donor acquired the property or, if the donor constructed or assembled the property, not later than the date construction or assembly of the property is substantially completed. The original use of the property must be by the donor or the donee, and in the case of the donee, must be used substantially for educational purposes related to the function or purpose of the donee. The property must fit productively into the donee's education plan. The donee may not transfer the property in exchange for money, other property, or services, except for shipping, installation, and transfer costs.

Conservation Gifts in 2011

Qualified conservation contributions — background. Qualified conser-

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vation contributions aren't subject to the rules that generally bar deductions for gifts of partial interests in property.

Qualified conservation contribution. A gift of a qualified real property interest to a qualified organization exclusively for conservation purposes.

Qualified real property interest is: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction, granted in perpetuity on the use that may be made of the real property.

Qualified organizations. Public charities, governmental units and certain supporting organizations (an organization organized and operated exclusively for the benefit of, to perform the functions of, or carry out the purposes of a charity).

Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where that preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or under a clearly delineated federal, state, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Ceilings on deductibility. Before 2006, qualified conservation contributions of capital gain property were subject to the same percentage of adjusted gross income ceilings and carryover rules that apply to other charitable gifts of capital gain property.

Increased 50% of adjusted gross income ceiling - rules through 2011. The 30% AGI ceiling on deductibility for individuals doesn't apply to qualified conservation contributions (as defined above).

Instead, individuals may deduct the fair market value of any qualified conservation contribution to a charity described in IRC §170(b)(1)(A) to the extent of the excess of 50% of adjusted gross income over the amount of all other allowable charitable contributions. Conservation gifts aren't taken into account in determining the amount of other allowable charitable contributions.

Other increased benefit — 15-year carryover. Individuals are allowed to carry over any qualified conservation contributions that exceed the 50% of AGI limit for up to 15 years. (Normally, the carryover period is five years.)

Farmers and ranchers — even more increased benefits. For an individual who is a qualified farmer or rancher for the taxable year in

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which the contribution is made, a deduction for a qualified conservation contribution is allowable for up to 100% of the excess of the taxpayer's adjusted gross income over the amount of all other allowable charitable deductions.

Corporate farmers and ranchers. For a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100% of the excess of the corporation's taxable income (as computed under IRC §170(b)(2)) over the amount of all other allowable charitable contributions. A corporation's ceiling on deductibility is normally 10% of its taxable income. But for corporate farmers and ranchers, any excess may be carried forward for up to 15 years as a contribution subject to the 100% limitation.

Requirement that land be available for agriculture or livestock production. As an additional condition of eligibility for the 100% limitation, for any contribution of property in agriculture or livestock production, or that is available for that production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. This additional condition doesn't apply to contributions made after December 31, 2005, and on or before August 17, 2006.

Meeting the production test. There is no requirement for any specific use in agriculture or farming, or necessarily that the property be used for those purposes; merely that the property remain available for those purposes.

How are you going to keep them down on the farm — or ranch? A qualified farmer or rancher is a taxpayer whose gross income from the trade or business of farming (under IRC §2032A(e)(5)) is greater than 50% of the taxpayer's gross income for the taxable year.

Oh the farmer and the cowman should be (and frequently are) friends — comment. Why these special benefits for farmers and ranchers? When enacted, Max Baucus (D-Montana) and Charles Grassley (R-Iowa) were chairman and ranking member, respectively, of the Senate Finance Committee. In this 112th Congress, Sen. Baucus is still Chairman; the ranking member is Orrin Hatch (R-Utah). Sen. Grassley remains a powerful Committee member.

BASIS RULES BEFORE 2010 AND AFTER 2010

General rule. Gain or loss on the disposition of property is measured by the proceeds received by the taxpayer less that taxpayer's basis in the property. Basis generally is a taxpayer's investment in the property, with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements to the property and decreased by depreciation deductions taken.

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Determining basis is important when making outright and life-income charitable gifts during lifetime. Depending on the holding period, the type of property and the charitable donee, charitable gifts of appreciated assets are deductible at basis or fair market value. For gift annuities, determining basis is also important to compute any capital gains on the transfer for the annuity and how payments will be taxable to annuitants. For charitable remainder trusts, the basis in the transferred property is needed to determine how the payments are taxable to the beneficiaries. Basis is also needed in determining the tax implications of charitable lead trusts. Plus, an asset's basis is needed for determining the tax implications of bargain sales.

Basis in property received by lifetime gift. Property received from a donor of a lifetime gift generally takes a carryover basis — the basis in the hands of the donee is the same as it was in the hands of the donor (and so is the holding period). The basis of property transferred by lifetime gift also is generally increased, but not above fair market value, by any gift tax paid by the donor on the property's appreciation. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift. If the basis of property is greater than the fair market value of the property on the date of the gift, then, for purposes of determining loss, the basis is the property's fair market value on the date of the gift.

Basis in property received from a decedent who dies after 2010 or who died before 2010. That property passing from a decedent generally takes a "stepped-up" basis. Thus, the basis is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). This step up in basis generally eliminates the recognition of income on any appreciation of the property that occurred before the decedent's death. If the value of property on the date of the decedent's death was less than its adjusted basis, the property takes a stepped-down basis when it passes from a decedent's estate. This stepped-down basis eliminates the tax benefit from any unrealized loss.

Income in respect of a decedent (IRD). The rule that assets subject to the federal estate tax receive a stepped-up basis doesn't apply to "income in respect of a decedent." The basis of those assets is a carryover basis (i.e., the basis of the assets to the estate or heir is the same as it was in the hands of the decedent) increased by estate tax paid on that asset. Income in respect of a decedent includes rights to income that has been earned, but not recognized, by the date of death (e.g., wages that were earned, but not paid, before death, individual retirement accounts (IRAs), assets held in accounts governed by IRC §401(k), U.S. savings bonds).

Charitable pointer. Use IRD assets to make testamentary charitable gifts. Charities don't pay tax on IRD. And an IRA can often be advantageously used to fund a testamentary charitable remainder trust.

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Rule in community property states. A surviving spouse's one-half share of community property held by the decedent and the surviving spouse generally is treated as having passed from the decedent and, thus, is eligible for stepped-up basis.

Basis Rules for 2010

Modified carryover basis replaced stepped-up basis for heirs of decedents who died in 2010. A total of \$1.3 million appreciation step-up was allowed plus an additional \$3 million appreciation step-up for bequests to a U.S. citizen spouse.

Election for estates of decedents dying in 2010. The estate could have the estate tax rules for 2011 (exemptions, rate and step-up basis) apply for 2010 instead of the modified carryover basis rules applying for 2010. *Note:* Default rule for a 2010 estate is that estate tax rules apply. Modified carryover basis rules had to be elected.

Generally, being subject to the 2011 estate tax law was beneficial for estates that weren't taxable because of the \$5 million exemption. There would be no estate tax and the heirs would have a stepped-up basis.

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FOR 2013
AND BEYOND IF
CONGRESS
FAILS TO ACT
THIS YEAR**

Ordinary income tax rates: 15%, 25%, 28%, 31%, 36%, 39.6%.

Capital gains and qualified dividends. Taxed at 20%.

Exception. Gains on the sale of artworks (and so-called collectibles) held long-term (more than one year) will continue to be taxed at 28%. Unrecaptured gain on a sale of real property will continue to be taxed at 25%. The gain on the sale of assets held short term (one year or less) will be taxed at regular income tax rates — up to 39.6%.

Charitable gifts. No enhanced tax incentives for Charitable IRAs, gifts of stock by S Corps, food inventory gifts, book inventory gifts, corporate gifts of qualified research and computer technology, and conservation gifts.

Personal exemption phase-out for upper-income taxpayers. This will apply to taxpayers with AGIs above threshold levels that vary by filing status. The AGI thresholds are indexed for inflation.

Limitation on itemized deductions for upper-income taxpayers
Background. Individual taxpayers may elect to itemize their deductions instead of claiming a standard deduction. Itemized deductions include medical and dental expenses (in excess of 7.5% of AGI), state and local property taxes and income taxes, interest paid, gifts to charities, casualty and theft losses (above 10% of AGI), job expenses and certain miscellaneous expenses (some only above 2% of AGI).

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The charitable and other Itemized deductions (other than medical expenses, investment interest, theft and casualty losses) would be reduced by 3% of the amount by which AGI exceeds statutory thresholds, but not by more than 80% of the otherwise allowable deductions.

2012: Estate, Gift and Generation-Skipping Taxes: Rates and Exemptions

Background. EGTRRA '01 phased out the estate and generation-skipping transfer taxes and they were fully repealed for 2010. However, the gift tax remained in 2010 with a 35% rate and a \$1 million exemption.

The exemption in 2012 is \$5,120,000 per person and the tax rate is 35% for estate, gift, and generation-skipping transfer taxes. The exemption amount was \$5 million in 2011 and was indexed to \$5,120,000 for 2012.

The estate tax was retroactively imposed for 2010, but an estate could elect to not have the estate tax rules apply, but be subject to the modified carryover basis rules.

Reunification of estate and gift tax exemptions. Before 2001, the estate and gift taxes were unified. The single lifetime exemption could be used for gifts and/or bequests. A 2001 law decoupled those taxes.

For 2012, the estate and gift tax exemptions are again unified. So the \$5,120,000 exemption can be used during life and/or at death. The question has been raised whether using that exemption to make gifts in 2011 and 2012 would completely protect those gifts from tax if the unified exemption is reduced starting in 2013. And if Congress doesn't act, the exemption reverts to \$1 million in 2013. It is understood that Congress didn't intend this result. This issue may be resolved by an IRS pronouncement or a technical amendment — or not resolved at all.

“Portability” of unused exemption — in brief. Under earlier law, spouses had to do complicated estate planning to claim their entire exemption (\$7 million for a couple in 2009, for example). For 2011 and 2012 the executor of a deceased spouse's estate can transfer any unused exemption to the surviving spouse obviating the need for a credit shelter trust. But for many estates, portability won't be the best plan and portability only applies for 2011 and 2012. What happens in 2013 and beyond if the law is not extended? The generation-skipping transfer tax exemption isn't portable.

Any unused unified gift and estate tax \$5 million exemption in 2011 and \$5,120,000 exemption in 2012 (applicable exclusion amount) as of the death of a spouse who dies after December 31, 2010 (the “deceased spousal unused exclusion amount” DSUEA), generally is

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available for use by the surviving spouse, as an addition to the surviving spouse's unused exemption.

If a surviving spouse is predeceased by more than one spouse.

The amount of unused exemption that is available for use by that surviving spouse is limited to the lesser of \$5 million in 2011 or \$5,120,000 in 2012 or the unused exemption of the last deceased spouse. A surviving spouse may use the predeceased spousal carryover amount in addition to the surviving spouse's own \$5 million or \$5,120,000 exemption for taxable transfers made during life or at death.

A deceased spousal unused exemption is available to a surviving spouse only if an election is made on a timely filed estate tax return (including extensions) of the predeceased spouse on which the amount is computed. This rule applies regardless of whether the estate of the predeceased spouse otherwise is required to file an estate tax return.

Statute of limitations. Notwithstanding the statute of limitations for assessing estate or gift tax for the predeceased spouse, the Treasury may examine the return of a predeceased spouse for purposes of determining the deceased spousal unused exemption amount (DSUEA) available for use by the surviving spouse. **A surviving spouse may not use the unused generation skipping transfer tax exemption of a predeceased spouse.**

Example 1. Assume that Husband 1 dies in 2011, having made taxable transfers of \$3 million and having no taxable estate. An election is made on Husband 1's estate tax return to permit Wife to use Husband 1's deceased spousal unused exclusion amount. As of Husband 1's death, Wife has made no taxable gifts. Thereafter, Wife's applicable exclusion amount is \$7 million (her \$5 million basic exclusion amount plus \$2 million deceased spousal unused exclusion amount from Husband 1), which she may use for lifetime gifts and/or transfers at death.

Example 2. Assume the same facts as in Example 1, except that Wife subsequently marries Husband 2. Husband 2 also predeceases Wife, having made \$4 million in taxable transfers and having no taxable estate. An election is made on Husband 2's estate tax return to permit Wife to use Husband 2's deceased spousal unused exclusion amount. Although the combined amount of unused exclusion of Husband 1 and Husband 2 is \$3 million (\$2 million for Husband 1 and \$1 million of Husband 2), only Husband 2's \$1 million unused exclusion is available for use by Wife, because the DSUEA is limited to the lesser of the basic exclusion amount (\$5 million) or the unused exclusion of *the last deceased spouse of the surviving spouse* (here, Husband 2's \$1 million unused exclusion). Thereafter, Wife's applicable exclusion amount is \$6 million (her \$5 million basic exclusion amount plus \$1

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million deceased spousal unused exclusion amount from Husband 2), which she may use for lifetime gifts and/or transfers at death.

Example 3. Assume the same facts as in Examples 1 and 2, except that Wife predeceases Husband 2. Following Husband 1's death, Wife's applicable exclusion amount is \$7 million (her \$5 million basic exclusion amount plus \$2 million deceased spousal unused exclusion amount from Husband 1). Wife made no taxable transfers and has a taxable estate of \$3 million. An election is made on Wife's estate tax return to permit Husband 2 to use Wife's deceased spousal unused exclusion amount, which is \$4 million (Wife's \$7 million applicable exclusion amount less her \$3 million taxable estate). Husband 2's applicable exclusion amount is increased by \$4 million — the amount of deceased spousal unused exclusion amount of Wife.

Alert. Some commentators have questioned this example (from the explanation of this tax law by the staff of the Joint Committee). They maintain that the language of the Code does not allow Husband 2's estate to benefit from the \$2 million of unused exclusion received by wife from Husband 1. Stay tuned for possible clarification by the IRS or a technical amendment.

Portability or Credit Shelter (Bypass) Trust — Cons and Pros

- Portability expires at end of 2012; thus no assurance for decedents who die after 2012.
- Credit shelter trust shelters future growth after the death of the first-to-die spouse from the estate tax at death of the survivor spouse.
- Credit shelter trust can assure the ultimate disposition of the assets, not so for portability.
- Portability must be elected on timely estate tax return on the death of the first spouse (even though no estate tax return is required); forfeited if election not made.
- State estate tax law may not provide for portability.
- Credit shelter trust provides creditor protection.
- Portability provides simplicity for smaller estates.
- Portability is inapplicable for the generation-skipping transfer tax exemption.
- Portability (and not credit shelter trust) provides for step up in basis on surviving spouse's death.

TAXWISE GIVING®

Special Supplement — February/March 2012

Editor: Conrad Teitell, LL.B., LL.M.

Sydney Prerau, Editor 1962-1967

United States Senate Finance Committee

Statement for the Record: January 31, 2012 Hearing

Extenders and Tax Reform: Seeking Long-Term Solutions

Mr. Chairman Baucus, Mr. Ranking Member Hatch, and members of the Committee:

I am Conrad Teitell, volunteer legal counsel for the American Council on Gift Annuities (ACGA), and submit this statement for the record on its behalf.

Let's win this one for the giver. Make permanent now the expired law that allows generous individuals 70½ or older to contribute up to \$100,000 annually from their IRAs directly to public charities. Although transfers from IRAs to charities from the expired law saved taxes for some givers, those charitable individuals would have been far better off financially by not making gifts.

Actually, the real winners are the Americans who are served by our nation's charities.

The federal government is also a winner. Americans making gifts to charity provide funds to meet needs that in many cases would otherwise be a function of government.

We ask Congress to now permanently extend and expand the expired Charitable IRA.

Question. Why are we asking Congress to act on the Charitable IRA now even though it may not act on all the other expired provisions until the very end of this year — or even next year?

"Others" is the answer. Over 100 years ago, General William Booth, the founder of The Salvation Army, was asked what one word describes the work of the Army. He replied, "Others."

The Charitable IRA benefits others. There can be bipartisan agreement on this. The other expired provisions, no matter how worthy, benefit businesses and some classes of individual taxpayers.

The remainder of this statement describes the expired Charitable IRA and a proposed expansion to include transfers for life-income arrangements.

Background — the off-again-on-again-off-again law that allowed tax-free IRA rollovers for direct (outright) transfers to specified categories of charitable organizations. The law, enacted in 2006, expired a few times, but was extended (sometimes retroactively). It expired again on December 31, 2011. The Charitable IRA is an important source of support for America's charities. Being off-again-on-again-off-again is confusing and reduces the number of new donors and repeat annual donors. The law should be made permanent.

The expired 2011 law in a nutshell. An individual age 70½ or older can make outright (direct) charitable gifts from an IRA — including required minimum distributions — of up to \$100,000 to public charities (other than donor-advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his or her federal income tax return. Most private foundations are not eligible donees, but private operating and pass-through (conduit) foundations are. The tax-free rollover is for outright gifts only, not life-income gifts. A charitable deduction is not allowable for the amount transferred to charity from an IRA, but the donor is not taxable on the amount transferred — up to \$100,000. Not being taxable on income that would otherwise be taxable is the equivalent of a charitable deduction.

The American Council on Gift Annuities (ACGA) (formerly the Committee on Gift Annuities) was formed in 1927, is an IRC §501(c)(3) organization described in IRC §170(b)(1)(A)(vi). ACGA's officers, board of directors and its legal counsel are all unpaid volunteers. **ACGA is sponsored by over 1,000 social welfare charities, health organizations, environmental organizations, colleges, universities, religious organizations and other charities.** The Mission of ACGA is to "actively promote responsible philanthropy through actuarially sound charitable gift annuity rate recommendations, quality training opportunities and the advocacy of appropriate consumer protection." Contact information: The American Council on Gift Annuities, 1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546, Phone: (770) 874-3355, Fax: (770) 433-2907, email: acga@acga-web.org.

Statement prepared by: Conrad Teitell, volunteer counsel to American Council on Gift Annuities, (Chairman, National Charitable Planning Group, Cummings & Lockwood, Six Landmark Square, Stamford, CT 06901. Phone: (203) 351-4164; Fax: (203) 708-3840; e-mail: cteitell@cl-law.com).

The IRA/charitable rollover is unique in that it gives tax incentives to the two-thirds of taxpayers who don't itemize but take the standard deduction.

Although no charitable deduction is allowable for IRA/charitable rollovers, the rollovers aren't taxable. No tax on otherwise taxable income is the equivalent of a charitable deduction for the two-thirds of taxpayers who take the standard deduction.

Mr. Chairman Baucus, at the October 18, 2011 hearing, Tax Reform Options — Incentives for Charitable Giving, you stated: “Most Americans aren't able to receive tax benefits from the charitable deductions since they don't itemize. Less than one-third of taxpayers itemized their deductions last year.”

Making the expired Charitable IRA permanent would continue to provide charitable tax incentives for nonitemizers.

The Charitable IRA should be expanded to include life-income charitable gifts — gifts that pay income to the donor for life, with a remainder to a qualified charity. This would be at no revenue loss to the government because annual payments to the donor would be fully taxable at ordinary income tax rates.

The Senate now has before it a bipartisan bill co-sponsored by three Senate Finance Committee members that would make the IRA/charitable rollover permanent and expand it to include life-income charitable gifts.

The Public Good IRA Rollover Act of 2011 was introduced by Senator Charles Schumer (D-NY) and Senator Olympia Snowe (R-ME) on March 10, 2011 with co-sponsors: Sherrod Brown (D-OH), Richard Burr (R-NC), Kirsten Gillibrand (D-NY), Tim Johnson (D-SD), John Kerry (D-MA), Patrick Leahy (D-VT), Carl Levin (D-MI), Mark Pryor (D-AR).

The Public Good IRA Rollover Act has been introduced in every Congress over a number of years. The original co-sponsors were Senator Byron Dorgan (D-ND) and Senator Olympia Snowe (R-ME).

The Public Good IRA Rollover Act — in a nutshell. It would allow tax-free IRA rollovers for both outright and life-income gifts and with no annual ceiling. And it includes rollovers to *all* public charities and *all* private foundations.

If it is deemed that the absence of annual ceilings on the amount that can be rolled over outright annually would make this bill too costly at this time and if there are concerns about including donor advised funds, supporting organizations and private foundations as qualified donees, we ask the Senate Finance Committee to report out ACGA's proposed All-American Charitable IRA Rollover.

The All-American Charitable IRA Rollover Act would:

(draft language is at the end of this statement)

- Make permanent the expired law (the provision that was in effect for years 2006 through 2011) that allowed individuals age 70½ or older to make direct (outright) gifts from an IRA of up to \$100,000 per year to public charities (other than donor advised funds and supporting organizations) and to private operating and passthrough (conduit) foundations without having to report the IRA distributions as taxable income on their federal income tax returns.
- **Expand current law to authorize tax-free IRA rollovers for gifts that benefit charities and provide taxable retirement income for the donors.** The qualified charities would be the same donees authorized under the expired law for direct rollovers. There would be a \$500,000 annual ceiling for life-income rollovers and donors must be age 59½ or older.
- The types of life-income plans assure that the annual taxable payments will be equal to (or greater than) what an individual would receive under the required minimum distribution rules had he or she kept the funds in the IRA instead of rolling them over for a life-income plan. The life income paid from the rollover cannot be assigned.
- Under the authorized life-income plans, the IRA owner will be taxable on income received at ordinary income tax rates. Because the payouts are 5% or more, there will be more income paid with the charitable plans than under the normal payouts of the minimum required distribution rules. The higher payout amounts will produce greater tax revenue for the Treasury.

The expired outright (direct) IRA/charitable rollover has resulted in millions of dollars of charitable gifts that would not otherwise have been made. It helps the Americans served by our nation's charities — provides for housing assistance, feeding the hungry, education, medical services and thousands of other services that American citizens need. The life-income rollover would greatly increase those gifts.

Why would IRA owners not just give outright to charity (a direct gift) from an IRA as provided under the expired law? Many IRA owners want to make charitable gifts, but also need retirement income. The life-income IRA rollover is an excellent way for donors of average resources to combine a charitable gift with retirement income. Many charities have donors who are "standing by" and wish to make life-income charitable gifts from their IRAs.

This is an All-American Charitable IRA Rollover. It allows all Americans with IRAs — not just those with large stock portfolios — who meet the minimum age requirements, to benefit charities. And since it encourages non-itemizers (over 65% of taxpayers) as well as itemizers, it is truly All-American.

Senate Finance Committee member Snowe was the original co-sponsor of the Public Good IRA Rollover Act. On November 14, 2007, the Senate Finance Committee held a hearing titled: "Federal Estate Tax — Uncertainty in Planning Under the Current Law." I was one of the four invited witnesses.

Among the written questions asked of me by Committee members after the hearing, was this question from Senator Snowe and my response:

Senator Snowe

Mr. Teitell, thank you so much for your reference in your written testimony to the Public Good IRA Rollover Act of 2007 (S. 819) that I introduced with Senator Byron Dorgan earlier this year. I agree with you that it is a critical incentive for both donors and charities.

Mr. Teitell, focusing on the planned-giving component of this legislation through which an individual could donate to a charity and receive life income that is taxable, could you please comment on how this provision would promote charitable donations while simultaneously reducing individuals' present-law estate tax liabilities and addressing Congress' concern that individuals do not outlive their retirement savings?

Conrad Teitell

Senator Snowe, many individuals would like to give part or all of their IRAs outright to charity, but they need the retirement income from their IRAs. Allowing them to roll over their IRAs at age 59½ or older to a life-income plan that would pay the individual (and a spouse, if desired) income for life (through a charitable gift annuity, charitable remainder unitrust or annuity trust, pooled income fund gift) would enable them to provide retirement income for life and make a charitable commitment. The charities could plan on receiving the gift after the life interest terminates.

A life-income rollover is truly an All-American IRA/Charitable Rollover. It would encourage philanthropy by all Americans—not just those who can afford to part with their assets now and not just those who itemize their deductions on their tax returns.

The ability to roll over an IRA to charity directly—or for a life-income plan—gives charitable tax incentives to the approximately two-thirds of taxpayers who take the standard deduction. Not being taxed on income that would otherwise be taxed (withdrawal from an IRA) is the equivalent of a charitable deduction.

The IRA assets rolled over for a life-income plan would not be included in the taxpayer's estate at death. However, the vast majority of the rollover gifts would come from individuals who have no estate tax concerns.

The life-income rollover shouldn't cost the government anything because the payments received from the life-income plans would be fully taxable—just as if the payments were received from the original IRA custodian or administrator. The big difference is that the nation's charities and the people they serve will be greatly benefitted.

Rolling over an IRA for a charity's life-income plan is not giving away the assets in the plan. The individual continues to receive income for life—just as if she or he had kept the IRA assets with the current custodian or administrator.

Senator Snowe, as you know the IRA/charitable rollover law that allowed tax-free rollovers for direct (outright) rollovers to charity for 2006 and 2007 wasn't in an extenders' bill at the end of 2007. When the Senate this year (soon, I hope) considers extending the just-expired IRA/charitable rollover provision, I hope that it will add the life-income component of the Public Good IRA Rollover Act of 2007 (S. 819).

As volunteer legal counsel to the American Council on Gift Annuities (an organization of over 1200 charities receiving support through life-income plans), I convey ACGA's thanks for your being an initial co-sponsor of S. 819 with Senator Byron Dorgan—not only in this Congress, but also several years ago in an earlier Congress.

The bill that you and Senator Dorgan initiated now has wide bipartisan co-sponsorship in both the Senate and the House—including many members of the Finance and Ways and Means Committees.

To sum up: The IRA/charitable life-income rollover is not a revenue drainer and it doesn't decrease retirement savings—just puts an IRA in a different container. I hope that Congress agrees that passage should be a no-brainer.

To sum up. Decreased support from federal, state and local governments and increased burdens on charities make this the time to enact a permanent Charitable IRA and expand it to include life-income charitable gifts. Charities need the funds to do their vital work now.

Please act now.

There is a tide in the affairs of men
Which taken at the flood, leads to fortune,
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
On such a full sea are we now afloat,
And we must take the current where it serves,
Or lose our ventures.

— *Shakespeare's Julius Caesar*

All-American Charitable IRA Rollover Act of 2012 — Draft Bill

To amend the Internal Revenue Code of 1986 to expand tax-free distributions from individual retirement accounts to include rollovers for charitable life-income plans for charitable purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "All-American Charitable IRA Rollover Act of 2012."

SEC. 2. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS FOR CHARITABLE PURPOSES.

(a) In General -- Paragraph (8) of section 408(d) of the Internal Revenue Code of 1986 (relating to tax treatment of distributions) is amended to read as follows:

(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES

(A) IN GENERAL

For purposes of this paragraph, so much of the aggregate amount of qualified charitable distributions with respect to a taxpayer made during any taxable year --

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed \$100,000, shall not be includable in gross income of such taxpayer for such taxable year, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed \$500,000, shall not be includable in gross income of such taxpayer for such taxable year.

(B) QUALIFIED CHARITABLE DISTRIBUTION

For purposes of this paragraph, the term "qualified charitable distribution" means any distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) -

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 70½, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of one or more organizations described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 59½.

A distribution shall be treated as a qualified charitable distribution only to the extent that the distribution would be includable in gross income without regard to subparagraph (A).

(C) CONTRIBUTIONS MUST BE OTHERWISE DEDUCTIBLE

For purposes of this paragraph -

(i) a distribution to an organization described in subparagraph (B)(i) shall be treated as a qualified charitable distribution only if a deduction for the entire distribution would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph), or

(ii) a distribution to a split-interest entity described in subparagraph (B)(ii) shall be treated as a qualified charitable distribution only if a deduction for the entire value of the interest in the distribution for the benefit of an

organization described in subparagraph (B)(ii) would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph).

(D) APPLICATION OF SECTION 72

Notwithstanding section 72, in determining the extent to which a distribution is a qualified charitable distribution, the entire amount of the distribution shall be treated as includable in gross income without regard to subparagraph (A) to the extent that such amount does not exceed the aggregate amount which would have been so includable if all amounts in all individual retirement plans of the individual were distributed during such taxable year and all such plans were treated as one contract for purposes of determining under section 72 the aggregate amount which would have been so includable. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(E) SPLIT-INTEREST ENTITY DEFINED

For purposes of this paragraph, the term "split-interest entity" shall include -

(i) a charitable remainder annuity trust as defined in section 664(d)(1) which must be funded exclusively by a qualified charitable distribution, or

(ii) a charitable remainder unitrust as defined in section 664(d)(2) which must be funded exclusively by one or more qualified charitable distributions, or

(iii) a charitable gift annuity as defined in section 501(m)(5) which must be funded exclusively by a qualified charitable distribution, and shall commence fixed payments of 5% or greater not later than one year from date of funding.

(iv) No person may hold an income interest in a charitable remainder annuity trust, a charitable remainder unitrust or a charitable gift annuity funded by a qualified charitable distribution other than one or both of the following: the individual for whose benefit the individual retirement plan is maintained and the spouse of such individual. Income interests in split-interest entities funded by qualified charitable distributions shall not be assignable.

(F) SPLIT-INTEREST ENTITY DISTRIBUTIONS

For purposes of this paragraph -

(i) notwithstanding section 664(b), distributions made from a trust described in subparagraph (E)(i) or subparagraph (E)(ii) shall be treated as ordinary income in the hands of the beneficiary to whom is paid the annuity described in section 664(d)(1)(A) or the payment described in section 664(d)(2)(A), and

(ii) qualified charitable distributions made for the purpose of funding a charitable gift annuity shall not be treated as an investment in the contract under section 72(c).

(G) DETERMINING DEDUCTION UNDER SECTION 170

Qualified charitable distributions shall not be taken into account in determining the deduction under section 170.

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- Portability is the answer when the first spouse's will failed to create a credit shelter trust.
- Portability is the answer when the first spouse dies intestate.

2013: Estate, Gift and Generation-Skipping Taxes if Congress Takes No Action Before 2013. The unified gift and estate tax exemption will be \$1 million and the rate will be 55% (60% on part of a transfer by larger estates. The generation-skipping tax exemption will be \$1 million. "Portability" will be inapplicable.

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INCOME TAX

Reinstate the 36% and 39.6% tax rates for upper income taxpayers. Replace part of the 33% and all of the 35% tax rate brackets with the prior law tax rate brackets of 36% and 39.6%. The 36% tax rate bracket would begin at a taxable income level calculated as the appropriate AGI threshold minus the appropriate standard deduction and one personal exemption (two for married taxpayers filing jointly). The AGI thresholds would be \$250,000 for married taxpayers filing joint returns, \$225,000 for head-of household taxpayers, \$200,000 for single taxpayers, and \$125,000 for married taxpayers filing separately. (The AGI thresholds are at 2009 levels, and would be indexed for inflation thereafter.)

Tax qualified dividends as ordinary income for upper income taxpayers. The proposal would allow the current 15% reduced tax rates on qualified dividends to expire at end of 2012 as scheduled. **Thus dividends would be taxed at the ordinary income rates up to the top rate of 39.6%.**

Tax net long-term capital gains at a 20% rate for upper income taxpayers. Allow the current 2012 15% tax rate on long-term capital gains to expire as scheduled at the end of 2012. Repeal the special reduced rate on gains from assets held over five years.

Exceptions. The special 25% rate applying to recapture of depreciation on certain real estate (IRC §1250 recapture) and 28% on art works (so-called collectibles), and the special provisions applying to the sale of certain small business stock would be retained.

Carried interests (profits). Tax as ordinary income a partner's share of income on an "investment services partnership interest" (ISPI) in an investment partnership, regardless of the character of the income at the partnership level. Thus, that income would not be eligible for the reduced rates that apply to long-term capital gains. In addition, require the partner to pay self-employment taxes on that income. In order to prevent income derived from labor services from avoiding taxation at

**PRESIDENT
OBAMA'S
BUDGET
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ordinary income rates, this proposal assumes that the gain recognized on the sale of an ISPI would generally be taxed as ordinary income, not as capital gain. This could be called the Anti-Romney Rule (see page 16 for the Buffett Rule).

Reduce the value of certain tax expenditures.* Limit the tax value of specified deductions or exclusions from AGI and **all itemized deductions** [emphasis supplied]. This limitation would reduce the value to 28% of the specified exclusions and deductions (including the charitable deduction) that would otherwise reduce taxable income in tax brackets above 28%. A similar limitation also would apply under the alternative minimum tax.

Reinstate the limitation on itemized deductions for upper income taxpayers. Itemized deductions (other than medical expenses, investment interest, theft and casualty losses) would be reduced by 3% of the amount by which AGI exceeds statutory thresholds, but not by more than 80% of the otherwise allowable deductions. The thresholds would be \$250,000 for married taxpayers filing joint returns, \$225,000 for head-of-household taxpayers, \$200,000 for single taxpayers, and \$125,000 for married taxpayers filing separately. (The AGI thresholds are at 2009 levels, and would be indexed for inflation thereafter.)

Reinstate the personal exemption phase-out for upper income taxpayers. Reinstate the phase-out of personal exemptions for upper-income taxpayers. The proposal would affect taxpayers with AGI above threshold levels that vary by filing status: \$250,000 for married taxpayers filing joint returns, \$225,000 for head-of-household taxpayers, \$200,000 for single taxpayers, and \$125,000 for married taxpayers filing separately. (The AGI thresholds are at 2009 levels, and would be indexed for inflation thereafter.) The amount of each personal exemption would be reduced (but not below zero) by 2% of the exemption amount for that year for each \$2,500 (\$1,250 if married filing separately) or fraction thereof by which AGI exceeded the threshold.

The income exclusions and deductions limited by this provision **would include** [emphasis supplied]:

1. any tax-exempt state and local bond interest, employer-sponsored health insurance paid for by employers or with before-tax employee dollars

*A tax provision that excludes income from taxation by way of a deduction, for example, in budget analysis is regarded as analogous to a government expenditure; thus the term "tax expenditures." It is argued that this theory violates the deeply ingrained principal that income belongs to those who generate it and that only through the democratic process becomes subject to taxation.

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2. health insurance costs of self-employed individuals
3. employee contributions to defined contribution retirement plans and individual retirement arrangements
4. the deduction for income attributable to domestic production activities
5. certain trade and business deductions of employees
6. moving expenses
7. contributions to health savings accounts and Archer MSAs
8. interest on education loans, and
9. certain higher education expenses

Note that the charitable deduction is not specifically mentioned. But the listing 1-9 is not all inclusive. "Would include" gives examples. Also in the prior paragraph, the words "all itemized deductions" is used. Further, in earlier administration and treasury pronouncements and proposals, the charitable deduction is specifically mentioned.

The proposal would apply to itemized deductions "after they have been reduced by the statutory limitation on certain itemized deductions for higher income taxpayers." (This refers to the "3% AGI" reduction rule described on the prior page.)

ESTATE AND GIFT TAX PROPOSALS

Make permanent the estate, gift, and generation-skipping transfer tax laws in effect in 2009. The top tax rate would be 45% and the exclusion amount would be \$3.5 million for estate and GST taxes, and \$1 million for gift taxes. **The portability of any unused estate and gift tax exclusion between spouses would be made permanent.**

Dynasty trusts: limit the duration of generation-skipping transfer (GST) tax exemption. Many states now either have repealed or limited the application of their rule against perpetuities (RAP) statutes. Trusts created subject to the law of those jurisdictions may continue in perpetuity. A trust may be situated (located) anywhere; a grantor is not limited to the jurisdiction of the grantor's domicile for this purpose. As a result, the transfer tax shield provided by the GST exemption effectively has been expanded from trusts funded with \$1 million (the exemption at the time of enactment) and a maximum duration limited by the RAP, to trusts funded with \$5,120,000 and continuing (and growing) in perpetuity.

This proposal provides that, on the 90th anniversary of the creation of a trust, the GST exclusion allocated to the trust would terminate. Specifically, this would be achieved by increasing the inclusion ratio of the trust (as defined in IRC §2642) to one, thereby rendering no part of the trust exempt from GST tax. Because contributions to a trust from a different grantor are deemed to be held in a separate trust under IRC §2654(b), each such separate trust would be subject to the same 90-year rule, measured from the date of the first contribution by the grantor of that separate trust. The special rule for pour-over trusts under IRC §2653(b)(2) would continue to apply to pour-over trusts and to trusts created under a decanting author-

**PRESIDENT
OBAMA'S
BUDGET
PROPOSALS —
FOR 2013
AND BEYOND
(Cont.)**

ity, and for purposes of this rule, those trusts will be deemed to have the same date of creation as the initial trust, with one exception. If, prior to the 90th anniversary of the trust, trust property is distributed to a trust for a beneficiary of the initial trust, and the distributee trust is as described in IRC §2642(c)(2), the inclusion ratio of the distributee trust will not be changed to one (with regard to the distribution from the initial trust) by reason of this rule. This exception is intended to permit an incapacitated beneficiary's distribution to continue to be held in trust without incurring GST tax on distributions to the beneficiary as long as that trust is to be used for the sole benefit of that beneficiary and any trust balance remaining on the beneficiary's death will be included in the beneficiary's gross estate for Federal estate tax purposes. The other rules of IRC §2653 also would continue to apply, and would be relevant in determining when a taxable distribution or taxable termination occurs after the 90th anniversary of the trust.

Effective date: Trusts created after enactment, and to the portion of a pre-existing trust attributable to additions to such a trust made after that date, subject to rules substantially similar to the grandfather rules currently in effect for additions to trusts created before the effective date of the GST tax.

**THE BUFFETT
RULE**

Although frequently orally stated by the President and his advisers, you won't find the Buffett Rule spelled out in the President's 2013 budget proposal or in any other "official" document. So, it is an *Unwritten Buffett Rule* — a guideline, says the administration, rather than a tax proposal. The President's spokespeople say that preferably the rule should be part of overall tax reform, rather than a separate piece of legislation. But the administration would support the proposal if Congress wanted to enact it that way.

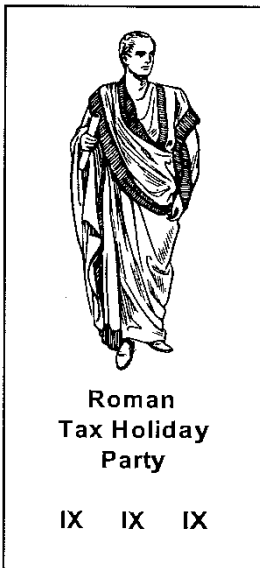
So what is the Buffett Rule — named for Warren E. Buffett, Berkshire Hathaway's billionaire? Mr. Buffett says that his secretary's tax rate is higher than his. He pays only 15% because his income is from dividends and capital gains, not from salary that is currently taxable up to 35%.

Basically, the Buffett Rule would be a 30% alternative minimum tax for individuals earning over \$1 million. In his State of the Union address, Mr. Obama said that the Buffett Rule wouldn't create disincentives to charitable giving.

How can the administration get a more concrete proposal that sounds as if it comes from 16 Pennsylvania Avenue?

Simple. The Paying-A-Fair-Share Act (S. 20549), introduced by Senator Sheldon Whitehouse (D-RI) does just that. The Whitehouse bill provides that all deductions, except for the charitable deduction, would be eliminated. Then a minimum tax of 30% would be imposed. But there would be a phase-in of the 30% tax rate between \$1 million and \$2 million. The Buffett Rule AMT would be tied in with the current AMT. That's tax simplification for you.

**REPUBLICAN
PRESIDENTIAL
NOMINATION
CANDIDATES —
TAX REVISION
PROPOSALS**



In alphabetical order

Newt Gingrich

- Stop the 2013 tax increases to promote stability in the economy. Job creation improved after Congress extended tax relief for two years in December. We should make the rates permanent.
- Move toward an optional flat tax of 15% that would allow Americans the freedom to choose to file their taxes on a postcard, saving hundreds of billions in unnecessary costs each year. This optional flat tax system will preserve deductions on charitable giving and home ownership, and create a new personal deduction [exemption] of \$12,000 for every American. This deduction [exemption] is well above the current poverty level, ensuring that this new system does not unfairly target the poor.
- Abolish estate tax.

Ron Paul

- The power to tax is the power to destroy, that is why Ron Paul will never support higher taxes.
- Lowering taxes will leave you more money to take care of yourself and your family, and it will allow businesses greater opportunities to hire new workers, increase current salaries, and expand their companies.
- Would support a Liberty Amendment to the Constitution to abolish the income and death [estate] taxes. (Although the gift tax isn't mentioned, I'll give you odds that he's against that too.)
- Capital gains taxes, which punish you for success (and interfere with your efforts to hedge against inflation by purchasing gold and silver coins), should also be immediately repealed.
- Has consistently endorsed legislation to let Americans claim more tax credits and deductions, including on educational costs, alternative energy vehicles, and health care. Also believes it is immoral to tax senior citizens twice by requiring them to include Social Security benefits in their gross income at tax time. A first step to eliminating that requirement would be to repeal the 1993 increase in taxes on Social Security benefits. Then we must abolish that tax entirely.
- While a Flat Tax or a Fair Tax would each be a better alternative to the income tax system, believes that the 16th Amendment should be repealed to avoid having both the income tax and one of these systems as an additional tax.
- Restraining federal spending by enforcing the Constitution's strict limits on the federal government's power would help result in a 0% income tax rate for Americans.
- Will be proud to be the one who finally turns off the lights at the IRS for good.

Mitt Romney

Taxes are needed to pay for the operations of government. But they should be collected by a system that is simple and fair, and that causes the least possible disruption to the productive economy.

- Would make permanent the Bush-era tax cuts scheduled to expire on December 31.
- Then reduce income tax rates for all Americans by 20%. That would reduce the current top rate of 35% to 28%.
- Above proposal would create jobs, boost the economy and would not cost the federal government a dime in lost revenue.
- Eliminate the death [estate] tax. Note. No mention of the gift tax.
- Pursue a conservative overhaul of the tax system over the long term that includes lower, flatter rates on a broader base.

**REPUBLICAN
PRESIDENTIAL
NOMINATION
CANDIDATES —
TAX REVISION
PROPOSALS
(Cont.)**

Rick Santorum

- Cut and simplify personal income taxes by cutting the number of tax rates to just two — 10% and 28% and return to Reagan era pro-growth tax rates.
- Simplify the tax code and reduce middle income taxes by eliminating the Alternative Minimum Tax (AMT).
- Simplify the tax code, encourage savings and investment, and reduce taxes by eliminating the Death [estate] Tax. *Note.* No mention of the gift tax.
- Lower the capital gains and dividend tax rates to 12% to spur economic growth and investment.
- Reduce taxes for families by tripling the personal deduction [exemption] for each child.
- Reduce and simplify taxes for families by eliminating marriage tax penalties throughout the federal tax code.
- Retain deductions for charitable giving, home mortgage interest, healthcare, retirement savings, and children.
- Eliminate the cap on deductions for losses incurred in the sale of a principal residence.

**BOWLES-
SIMPSON —
NATIONAL
COMMISSION ON
FISCAL
RESPONSIBILITY
— REPORT**

Tax reform should lower tax rates, reduce the deficit, simplify the tax code, reduce the tax gap, and make America the best place to start a business and create jobs. Rather than tinker around the edges of the existing tax code, fundamental and comprehensive tax reform is proposed:

- **Lower rates, broaden the base, and cut spending in the tax code.** The current tax code is riddled with \$1.1 trillion of tax expenditures: backdoor spending hidden in the tax code. Tax reform must reduce the size and number of these tax expenditures and lower marginal tax rates for individuals and corporations, thereby simplifying the code, improving fairness, reducing the tax gap, and spurring economic growth. Simplifying the code will dramatically reduce the cost and burden of tax preparation and compliance for individuals and corporations.
- **Reduce the deficit.** To escape our nation's crushing debt and deficit problem, we must have shared sacrifice, and that means a portion of the savings from cutting tax expenditures must be dedicated to deficit reduction. At the same time, revenue cannot constantly increase as a share of the economy. Deficit reduction from tax reform will be accompanied by deficit reduction from spending cuts—which will come first. Under our plan, revenue reaches 21% of GDP by 2022 and is then capped at that level.
- **Maintain or increase progressivity of the tax code.** Though reducing the deficit will require shared sacrifice, those of us who are best off will need to contribute the most. Tax reform must continue to protect those who are most vulnerable, and eliminate tax loopholes favoring those who need help least.
- **Make America the best place to start a business and create jobs.** The current tax code saps the competitiveness of U.S. companies. Tax reform should make the United States the best place for starting and building businesses. Additionally, the tax code should help U.S.-based multinationals compete abroad in active foreign operations and in acquiring foreign businesses.

**BOWLES-
SIMPSON —
NATIONAL
COMMISSION ON
FISCAL
RESPONSIBILITY
— REPORT
(Cont.)**

Recommendation: Enact Fundamental Tax Reform by 2012 to Lower Rates, Reduce Deficits, and Simplify the Code. Eliminate all income tax expenditures, dedicate a portion of the additional revenue to deficit reduction, and use the remaining revenue to lower rates and add back necessary expenditures and credits.

Comment. Piece of cake in this election year — or any other year.

Fundamental tax reform will require significant revisions to the current tax code and will need to take into account the transition to new and modified provisions. These tasks are not insignificant and the Commission recognizes that for Congress and the President to consider and implement these sweeping changes, a comprehensive process will be needed. To this end, the Commission recommends requiring the House Committee on Ways and Means and the Senate Committee on Finance, in cooperation with the Department of the Treasury, to report out comprehensive tax reform legislation through a fast track process by 2012.

The Commission proposes tax reform that relies on “zero-base budgeting” by eliminating all income tax expenditures (but maintaining the current payroll tax base, which should be modified only in the context of Social Security reform), and then using the revenue to lower rates and reduce deficits. The revenue from eliminating tax expenditures should be dedicated to three clear purposes: 1) substantially lowering marginal tax rates; 2) reducing the reduction; and 3) supporting a small number of simpler, more targeted provisions that promote work, home ownership, health care, charity, and savings. As a matter of principle, tax reform must increase or maintain progressivity.

A “zero plan” could reduce income tax rates to as low as 8%, 14%, and 23%. Even after adding back a number of larger tax expenditures, rates would still remain significantly lower than under current law.

In designing tax reform, Congress must abide by the following parameters in order to receive a fast-tracked status:

Cut rates across the board, and reduce the top rate to between 23% and 29%. Real tax reform must dedicate a portion of the savings from cutting tax expenditures to lowering individual rates.

The top rate must not exceed 29%.

Dedicate \$80 billion to deficit reduction in 2015 and \$180 billion in 2020. In addition to reducing rates, reform must be projected to raise \$80 billion of additional revenue (relative to the alternative fiscal scenario) in 2015 and \$180 billion in 2020. To the extent that the dynamic effects of tax reform result in additional revenue beyond these targets, excess funds must go to rate reductions and deficit reduction, not to new spending.

**BOWLES-
SIMPSON —
NATIONAL
COMMISSION ON
FISCAL
RESPONSIBILITY
— REPORT
(Cont.)**

Simplify key provisions to promote work, homes, health, charity, and savings while increasing or maintaining progressivity. Congress and the President must decide which tax expenditures to include in the tax code in smaller and more targeted form than under current law, recognizing that any add-backs will raise rates. The new tax code must include provisions (in some cases permanent, in others temporary) for the following:

- Support for low-income workers and families (e.g., the child credit and EITC);
- Mortgage interest only for principal residences;
- Employer-provided health insurance;
- Charitable giving;
- Retirement savings and pensions.

Additional tax expenditures could be added to the provisions above, but must be paid for with higher rates. Furthermore, the revised code must increase or maintain progressivity, across the income spectrum, relative to the alternative fiscal scenario. In enacting tax reform, Congress and the President should design appropriate transition rules that minimize economic distortions, achieve the necessary revenue targets, and allow taxpayers to adapt to the changes.

**WHILE WE'RE IN
THE DARK
ABOUT TAXES —
REMEMBER
ESTATE
PLANNING
BASICS**

The hoopla and the hullabaloo. As detailed earlier, the current unified gift and estate tax exemption is \$5,120,000 per person (\$10,240,000 per couple). The generation-skipping transfer tax exemption is also \$5,129,000 per person. The tax rate for those taxes is 35%. The exemption amount is indexed beginning in 2012.

As noted, if Congress doesn't act in 2012, the unified gift and estate tax exemption and the GST exemption will be \$1 million starting in 2013 with a 55% rate (60% for part of larger estates). And, as also noted, Congress may act late in 2013 to retroactively change the estate and GST laws again.

Getting down to brass tax. Nobody knows what the gift, estate and generation-skipping taxes will or won't be. So let's look at the non-tax aspects of estate planning for the super-rich, merely-rich, comfortable and uncomfortable individuals.

Simply put, modern-day estate planning involves: how to provide for yourself, your family and causes that are important to you right now — and in a meaningful way.

It also involves providing for retirement, possible mental or physical incapacity — and providing for your family and continuing your philanthropic legacy after your lifetime.

**WHILE WE'RE IN
THE DARK
ABOUT TAXES —
REMEMBER
ESTATE
PLANNING
BASICS
(Cont.)**

Estate Planning Essentials

- Determine your current and estimated down-the-road needs, including retirement and the possibility of disability.
- Make a list of your assets — including cost basis, current fair market value and how they are owned (separate property, joint property, tenancy in common, community property). How much income do they pay? Should they be held or sold? Should the type of ownership be changed.
- List your debts (including potential federal estate and any state estate taxes) and the assets your estate will use to pay them.
- Decide on what you wish to pass on to others. Consider the strengths and weaknesses of potential beneficiaries and their current and future needs.
- Charitable gifts during life and by will are an important part of many estate plans. So are charitable plans that pay you and others life income before the charity gets the gift. You'll find that the tax laws enable you to be a philanthropist at wholesale cost.
- Determine who would be appropriate fiduciaries — trustees, executors, guardians for minors, holders of durable powers of attorney, health-care proxies.
- Consider the pros and cons of transferring some assets during your lifetime.
- Plan for the continuation, sale or transfer of a business with minimum erosion by taxes and mismanagement.
- Maintain an up-to-date will, or living trust, that will carry out your wishes and minimize administration expenses and taxes on your estate.
- Review your life insurance and pension plans, including beneficiary designations and payment options.
- Be sure to have a current living will.
- Maintain an up-to-date durable health care power of attorney (a health-care proxy) that empowers the named person to make health care decisions for you if you are incapable of doing so.
- Maintain a current durable power of attorney, or a trust, for financial matters that gives another individual or trust company the power to act on your behalf should you become incapacitated.

**WHILE WE'RE IN
THE DARK
ABOUT TAXES —
REMEMBER
ESTATE
PLANNING
BASICS
(Cont.)**

- The 2012 unified gift and estate tax exemption is \$5,120,000 per person and twice that per couple. The generation-skipping transfer tax exemption is also \$5,120,000 per person. The tax rate for those taxes is 35%. If Congress doesn't act, the unified exemption and the GST exemption will be \$1 million starting in 2013 with a 55% rate (60% for a part of larger estates). **Caution:** With marital and credit shelter trusts that are often keyed to formulas, major distortions to an estate plan can result if the recent higher exemptions and possible lower exemptions (or estate tax repeal) aren't taken into account.
- "Portability" of unused exemption: Under earlier law, couples had to do complicated estate planning to claim their entire exemption (\$7 million for a couple in 2009, for example). For 2011 and 2012 the executor of a deceased spouse's estate can transfer any unused exemption to the surviving spouse obviating the need for a credit shelter trust. But for some estates, portability won't be the best plan; and portability only applies for 2011 and 2012. What happens in 2013 and beyond if that law is not extended?
- Speak to your adviser about continuing to take advantage of the \$13,000 annual-per-donee gift tax exclusion (\$26,000 for married individuals). Gifts that qualify for the annual exclusion don't reduce the \$5,120,000 unified gift and estate tax exemption and the generation-skipping transfer tax exemption. Also remember the additional annual exclusion for tuition (paid directly to the educational institution) and for medical expenses (paid directly to the health-care provider). **Caution:** Some advisers believe that if the unified gift and estate tax exemption is reduced in 2013 below the current exemption, part of the exemption could be "clawed back."
- High-net-worth individuals should still consider tax-saving techniques such as family limited partnerships. And for some individuals, qualified personal residence trusts, grantor retained annuity trusts and life insurance trusts can make good tax sense.
- Consider trusts for yourself and beneficiaries to provide protection from creditors.
- Keep good financial and tax records.
- Disclaimers and powers of appointment can often play an important role in estate plans. They provide flexibility in dealing with a shifting tax picture and changed family and financial circumstances.**
- Meet with your lawyer to tie it all together.
- Review your plan periodically. Keep an eye on the ever-changing tax laws, while also taking into account any changed personal, family and financial circumstances.

**EXPIRED
CHARITABLE IRA
— MAKING IT
PERMANENT AND
TO INCLUDE
LIFE-INCOME
GIFTS**

The American Council on Gift Annuities Statement to the Senate Finance Committee (see Special Insert) details the importance of the expired Charitable IRA, tells why it should be permanently reenacted and expanded to include life-income gifts.

Suggestion. If these gifts are important to your charity, have your president and influential board members communicate with your U.S. Senators and members of the House of Representatives. Be specific. Tell how your charity has benefitted from charitable IRAs. Generalities don't make the case.

A letter I recently received can serve as a model for your communications.

I read with interest the American Council on Gift Annuities statement to the Senate Finance Committee on qualified IRA charitable distributions.

I work for the Catholic Diocese of Kansas City — St. Joseph — the 27 counties of northwest Missouri bordering Iowa on the north and Kansas on the west. Since 2006, we have made Qualified Charitable Distributions (QCDs) a regular part of our promotion of charitable giving. I often say that, for persons over 70 and ½, their IRA is their personal "donor advised fund."

We received just short of \$300,000 in QCDs in 2011 from about 150 donors for mostly our parishes, schools and special ministries (like seminarian education, priests' retirement, etc.) To my business managers and other finance officers, receiving a QCD distribution is much better than relying on weekly or monthly giving throughout the calendar year. You know the old joke, "We have plenty of money to run our organization. The only problem is the money is in your pockets and we need it in our treasury." QCDs enable this transfer.

The last-minute extension of the 2006 enabling legislation in 2008 and 2010 has disqualified many of my most faithful donors who had already made their required minimum distributions before Congress authorized the extension. Many of my donors are asking this year, "Will tax-free IRA giving (that is what we have called it in our diocese) be extended?" I have to tell them that we don't really know—that we will advise them immediately if it is. With so many other matters and the election on the minds of our Senators and Representatives, I tend to downplay a quick extension.

Last year's final tally for our Diocese were second only to 2007 (the only other year with an rmd that had QCDs for the entire year) when we eclipsed \$550,000. We also received over \$166,000 + in 2006 and over \$188,000 in 2008, each year increasing the number of donors. We find that almost all of our donors fit the type that you portray in your testimony who are not able to give significantly from other assets and who can really benefit by the tax-free nature of QCDs. In all the time that we have encouraged this type of giving, we have had only three gifts of \$50,000 and a handful of gifts of \$25,000 or more. Our typical donor is in the \$2-3,000 level. This is truly an "everyperson's" method of giving from savings in their IRAs.

**EXPIRED
CHARITABLE IRA
— MAKING IT
PERMANENT AND
TO INCLUDE
LIFE-INCOME
GIFTS
(Cont.)**

If the giving method could be expanded to allow gift annuities and other life-income gifts, I think it would be even more popular in our Diocese.

Thanks to the American Council on Gift Annuities for encouraging its extension and expansion.

Greg Vranicar, CFRE, Planned Giving Director
Stewardship & Development
Diocese of Kansas City-St. Joseph

**CHARITABLE MID-TERM FEDERAL RATES FOR SPLIT-
INTEREST GIFTS—2012**

January — 1.4% February — 1.4% March — 1.4%

**CHARITABLE MID-TERM FEDERAL RATES FOR SPLIT-
INTEREST GIFTS—2011**

January — 2.4% February — 2.8% March — 3.0%
April — 3.0% May — 3.0% June — 2.8%
July — 2.4% August — 2.2% September — 2.0%
October — 1.4% November — 1.6% December — 1.6%

Caution → → → →

Low rates may result in not meeting the 10% minimum remainder interest requirement for CRTs, the more-than-10%-gift portion for CGAs, and flunking the 5% probability test of Rev. Rul. 77-374 for CRATs. Be careful out there!

Two-month lookback. For income, gift and estate tax charitable deductions, the donor may use the rate for the month of the transfer or the rate for either of the two preceding months. **Back reference.** *Split-Interest Valuation Regulations, Taxwise Giving, July '94, page 2.*

For charitable remainder trusts and gift annuities, the higher the rate the larger the charitable contribution. For remainders in personal residences, remainders in farms, and charitable lead trusts, the lower the rate the larger the charitable contribution.

Deemed rate of return for young pooled income funds. If a pooled fund has less than three taxable years' experience, a deemed rate of return is used to compute the charitable deduction. Donors use the deemed rate for the actual year of the gift. For 2012, it is 1.8%. For 2011, it was 2.8%. It was 4.6% in 2010 and 4.8% in 2009 and 2008. IRS recomputes the deemed rate each calendar year. It determines each year's deemed rate by subtracting 1% from the highest annual average of the monthly rates for the three prior calendar years, rounded to the nearest 0.2%. **Back reference.** *Split-Interest Valuation Regulations, Taxwise Giving, July '94, page 2.*

Mature pooled income funds. Donors to funds with more than three taxable years' experience compute the deduction using the highest rate of return from the fund's three previous years.

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ON TRACK FOR TOMORROW
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Can Beneficiary Happiness and Trusts Co-Exist?

Presented by:

Christopher Cline
Regional Fiduciary Manager
Wells Fargo Bank, N.A.
1300 S.W. Fifth Avenue, Suite 1800
Portland, OR 97201
P: 503-886-3283
E: Christopher.cline@wellsfargo.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org



Happiness and Trusts: Can They Coexist?

Christopher P. Cline
Senior Vice President,
Senior Regional Fiduciary Manager

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Introduction



Trusts are everywhere in estate planning. They are used to financially support those who cannot support themselves, to provide creditor protection and for tax planning. But they also can be a source of stress, disputes and litigation if not done properly.

- **What is a Trust?** – A trust is simply a contract between three people: the person who creates the trust (the “grantor”), the person who holds title to the assets (the “trustee”) and the person for whose benefit the trust is created (the “beneficiary”).
 - The trustee receives property from the grantor, and agrees to manage it on behalf of the beneficiary according to the terms of the written trust agreement (which acts as the “contract”).
 - Trusts can be either revocable (meaning they can be revoked) or irrevocable (meaning they can't). For purposes of this discussion, we're talking only about irrevocable trusts.

3

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Why a Trust?



Trusts tend to fall into the following categories:

- **Protect the beneficiary from herself** – Typically when the beneficiary is unable to handle money, either because she is a minor, hasn't matured yet or has a disability or substance abuse problem.
- **Protect the beneficiaries from each other** – For example, when the second spouse is the current beneficiary and the children from a prior marriage are remainder beneficiaries.
- **Protect the beneficiaries from the IRS** – Trusts can be used to avoid estate, gift or income tax consequences.
- **Protect the beneficiaries from outside creditors** – This can include future ex-spouses, at least to some extent.
- **Blatant manipulation** – Never a good idea; some grantors just want their children to behave in a certain way, not necessarily for the children's best interest.
- **Behavior modification** – Trusts are often used to encourage particular behaviors.

But can they make a beneficiary happier?

4

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Do We Know What Makes Us Happy?



Many books have been written recently about the "science of happiness." They tend to show that people are not very good at predicting what makes them happy. The following are roadblocks:

- **Biology** People are "hardwired" for desire, not happiness. A cave dweller who constantly sought food, shelter and mates tended to survive longer and produce more little cave dwellers. So the brain generates cravings, not happiness.
- **Perceived "Uniqueness"** Studies show that people think they are more unique than they really are: They think they are above average at our jobs, more generous and even more selfish. People don't think they're better than average, just unique, and this keeps them from learning from the experiences of others.
- **Lack of Imagination** When most people imagine the future, they think of one that looks identical to current conditions and can fail to recognize that their "future" selves will view the world differently. (But just remember how people viewed the world before the recent financial meltdown!)
- **Perceived Control** People think they have more control over the future than they really do. (In fact, the only group that has an accurate grasp on the degree to which they can control future events are the clinically depressed!)

In other words, clients shouldn't be too quick to reach conclusions about what will make their heirs happy, when they may not be very good at figuring out how to make themselves happy.

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Money Doesn't Make Us Happy



Recent research confirms the old cliché: money can't buy happiness. Or not exactly.

- In some cases money can add to happiness. A report in the Proceedings of the National Academy of Sciences* posits that people's emotional well-being increases along with their income, up to about \$75,000 per year. This report, based on surveys of 450,000 Americans conducted in 2008 and 2009, shows that people's happiness increases with annual income, but only up to \$75,000 per year. Increases in income above that level (say the increase from \$100,000 to \$200,000) may produce a greater sense of success generally, but not more happiness day to day.
- It also seems that incremental increases in income once a person is safely above the poverty (or perhaps above the annual \$75,000 level) do not result in incremental increases in happiness.
- Further, income level is not determinative by itself. One critically important factor is social comparison: a majority of people surveyed would rather make \$50,000 a year when those around them are making \$25,000 on average, than make \$100,000 a year when those around them are making an average of \$250,000. Happiness as measured by income, in other words, is more a function of comparison rather than absolute dollars.

*Cited in "It's Official: Money Buys Happiness . . . sort of," The Oregonian, p. A-1 (9/7/2010).

6 20070549 119-1R2102 (08/07)

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Control is More Important Than Money



Research on happiness in the last ten years has solidified what many of us already understood. Control, not money, is a much greater determinant of happiness.

- **Distinguish among types of control** – It's not always actual control, or control "of" one person by another. It can be greater knowledge, for example.
- **Extrinsic Motivation Doesn't Work** – External rewards actually decrease internal motivation in the form of personal productivity. There are only a couple of exceptions to this rule: motivating someone to undertake a boring activity, and getting someone to try something new.
- **"Self-Efficacy," or Self Control, Does** –Self-efficacy, for instance, is a "better predictor of career selection and success than actual ability, prior preparation, achievement and level of interest."

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200707099 TPB-PE21058 (08/07)

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Important – There are Two Types of Control



As an advisor, it is critical to understand that there are two types of control. If a client or beneficiary cannot have one type, it still helps greatly to have the other:

- **Actual Control** – The person can actually cause particular outcomes; and
- **Knowledge as Control** – The person has sufficient information about a process or outcome so that he or she can make plans based on that knowledge. This second type of control indicates that one's involvement, even if it is only to be fully informed and without any actual control, can be empowering.

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What Else Makes Us Happy?



- The "Big Seven" – One author (Layard, *Happiness: Lessons from a New Science* 62-63 (2005)) notes seven factors that seem to make people happy:
 - Family relationships;
 - Financial situation (stability, not increased wealth);
 - Meaningful work;
 - Community and Friends;
 - Health;
 - Personal freedom; and
 - Personal values.

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200706049 119-1R21002 (07/07)

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Can Trusts Help Make Beneficiaries Happy?



Now that some of the reasons for trusts and the factors for happiness have been mentioned, is it possible that trusts can make their beneficiaries happy?

- Trusts can't solve every problem, because in the end they are financial devices, and (as we've learned) money can't buy happiness.
- Further, trusts may be designed to give control to a person other than the beneficiary. The beneficiaries could resent the presence of a trustee.
- In light of those factors, grantors should limit their expectations for trusts; they may not be able to make beneficiaries happy. Perhaps the goal should be to make the beneficiaries less unhappy.

However, by following some of the happiness guidelines already discussed, trusts can be made more "user friendly" for the beneficiaries, giving them a greater sense of control over the trust and therefore making them better able to accept and work with the trustee.

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Types of Trust Terms – Subjective vs. Objective



One way to ensure that a trust is designed correctly is to check the type of distribution language it uses. In this way, you can test whether the trust properly documents the purpose for which it was designed. Trust distribution language can be either objective or subjective:

- Subjective Language – These types of provisions are based on goals and require trustee decisions.
 - Examples: The beneficiary shall receive distributions for “support,” or shall receive distributions for “advancing in a productive career,” each of which requires the trustee to make decisions about what those things are.
 - Pros – The terms allow for flexibility in light of changed circumstances, they more accurately reflect the grantor’s intent if drafted correctly.
 - Cons – The trustee has the flexibility to make distribution choices the grantor would not have approved of.

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Types of Trust Terms – Subjective vs. Objective (Cont.)



- Objective Language – These types of provisions are based on objective, measurable criteria.
 - Examples: The beneficiary shall receive distributions equal to his or her earned income, shall receive all trust income, shall receive fixed amounts if he or she has no driving violations, shall not receive distributions if he or she fails a drug or alcohol test.
 - Pros – The terms are very specific, so there is less chance of trustee error or misinterpretation, the terms can be pinpointed to encourage or discourage very specific behaviors.
 - Cons – External rewards like this actually discourage productivity (unless the goal is to get the beneficiary to do something boring or to try something new), objective terms are inflexible, they don’t address the real purpose the grantor had in mind (e.g., the grantor wanted to encourage personal productivity, but tries to do so by simply encouraging earnings, which may lead to the beneficiary pursuing a boring but high paying job).

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Subjective vs. Objective – Which is the Right Choice?



As with any complicated problem, there is no one right or easy answer:

- Most estate planning experts who have thought about the issue seem to agree that, as a general matter, subjective is better than objective.
- However, objective is better in the following cases:
 - Desperate situations (for instance, as an alternative to disinheritance for a beneficiary who is engaging in anti-social behavior); or
 - The grantor chose the trustee for his or her ability to manage money, but has concerns about the trustee's ability to make distribution decisions consistent with the grantor's values.
- If subjective is used, the following should be considered:
 - Clear guidance in the trust agreement about how discretion is to be exercised;
 - Explain to the trustee that he or she has been named to act and explain the consequences of acting, so that the grantor knows whether the trustee will want to serve under those circumstances; and
 - Consider language exonerating the trustee from being sued for making difficult decisions (this will give the trustee more comfort in making those decisions).

13 200706049 TFB-TR21002 (07/07)

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Trusts Must Have a Clear Purpose



If a trust is to give greater control, its purpose has to be very clearly spelled out.

- Purpose in a document gives the most knowledge about why the trust exists. Failure to define purpose is one of the biggest drafting flaws because it allows the beneficiary to say, "but Mom always wanted me to . . . [fill in the blank with greater expenses]"
- Over 50 years ago, the Oregon Supreme Court noted that

The difficulty in many if not most of these [abuse of trustee discretion] cases is finding the purpose of the settlor with sufficient definiteness to be helpful . . . The settlor's specific design in framing a discretionary trust is normally unexpressed or vaguely outlined. *Rowe v. Rowe*, 219 Or. 599, 606; 347 P.2d 968, 972 (1959).
- Two years later, Professor Edward C. Halbach, Jr., repeated those sentiments:

[t]oo frequently trust instruments provide no guidance as to the purpose and scope of the [discretionary] power. Although determining and assisting in the formulation of the donor's intentions is a primary counseling function, it is apparently one of the most neglected aspects of estate planning. A poorly defined discretionary power often results. Halbach, *Problems of Discretion in Discretionary Trusts*, 61 Colum. L. Rev., 1424, 1434 (1961).

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Trust Terms – Some Suggestions



So, in light of all that has been discussed, a client considering adding or revising trusts in their estate plans should think about the following:

- **Use “Intent” Language** – Often referred to as “precatory” language by attorneys, these are provisions that are not binding, but rather tell the trustee what you are thinking, and why you are using a trust in the first place. Such provisions are the LEAST used, but often MOST important, in the entire trust agreement. Examples include:
 - Statement of beneficiary preference – For example, a trust might be created for a client’s second spouse for the spouse’s lifetime, with the trust property passing at the spouse’s death to the grantor’s children by a prior marriage. This situation often leads to conflict, because the spouse thinks the trustee should make generous distributions to him or her, while the children think the trustee should make only minimal distributions and preserve the trust property for the children. Intent language that says that the trust is designed primarily for the spouse, or primarily for the children, would go a long way to relieving that tension.
 - Statement of distribution preference – A trust might provide that a beneficiary can receive distributions for support and for education, and specify what education expenses really are (so tuition and books only, support while in school, purchase of a car while in school). The grantor might state in the document that the main purpose of the trust is to pay for education, and that support payments are to be minimal so that education can be funded, or that support is only to be paid while the beneficiary is in school.

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Trust Terms – Some Suggestions (Cont.)



- **Allow for Greater Beneficiary Control** – As already described, control leads to happiness. This can be in the form of actual control (e.g., the beneficiary has input on investment decisions) or at least greater information (e.g., the beneficiary has to be given advance notice of certain decisions for the coming year). The beneficiary should have the ability to remove and replace the trustee (often with limitations; e.g., they can only replace with a corporate trustee, not a crony!)
- **Use Separate Trusts** – Many attorneys suggest using “pot” trusts for minors; that is, a single trust for the benefit of more than one person. As already noted, happiness is tied in part to economic comparisons, and people are less happy if they don’t compare favorably. Pot trusts encourage comparison (e.g., “he got more than me!”), so should be avoided unless there is an important reason for them (e.g., one beneficiary has significant medical needs and should receive more).
- **Address the “Family Conundrum”**– These materials show that a happy home life is critical to happiness. But many clients use trusts to help keep family assets out of the hands of in-laws if there is a divorce. Some thoughts:
 - If the grantor is worried about the effects of divorce, provide that, if the in-law signs a prenuptial agreement waiving any rights to the trust in the event of divorce, the trust will pay the necessary legal fees and will then begin making distributions to that in-law as long as they are married.
 - Recognize the importance of the child’s or grandchild’s spouse; include them in family discussions and decisions. Again, giving the feeling of control is critical.

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Trust Terms – Some Suggestions (Cont.)



- **Beware of Stock Language** – Attorneys historically have drafted trusts that give a beneficiary the trust “income” and principal for “support.” However, while sometimes these are important provisions (or even required, for tax purposes), often they are counterproductive for “happiness” purposes. Remember that money doesn’t bring happiness, but meaningful work does. Consider giving an inflation-adjusted dollar amount, rather than income, and “support” only during those times when meaningful work isn’t available (e.g., while in school, while sick, during an economic downturn, etc.).
- **Use Distributions that Foster Achievement and Values** – Rather than simply handing the trust property over to a beneficiary, consider doing so only for those times when it promotes their own better impulses and achievements. Examples:
 - Allow the trustee to give the beneficiary an amount equal to her charitable contributions for the year (perhaps capped to a certain amount);
 - Allow for distributions that begin only after the beneficiary has received his or her first promotion in a chosen career;
 - Allow unlimited distributions for medical care and for retirement if the beneficiary has pursued a career in social services or the arts and has supported herself throughout that career (this allows the beneficiary to take valuable but low-paying jobs without fear of illness or retirement).

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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

***Charitable Gift Annuities:
When Things Don't Go As Expected***

Presented by:

David A. Libengood
Director, Relationship Management
Kaspick & Company
One Beacon Street, 8th Floor
Boston, MA 02108
P: 617-788-5875
E: dlibengood@kaspick.com

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

Charitable Gift Annuities: When Things Don't Go As Expected

**The 30th Conference on Gift Annuities
April 20, 2012
San Francisco, CA**

**David A. Libengood
Director, Relationship Management
KASPICK & COMPANY, LLC**

Charitable Gift Annuities: When Things Don't Go As Expected

David A. Libengood

SESSION SUMMARY

Things don't always go according to plan with the funding, administration, and investment of charitable gift annuities. This session will use a series of interactive case studies to explore (1) the types of problems that can arise for both donors and the charities they wish to benefit, (2) how those problems can be resolved or ameliorated, and (3) what policies and practices can help to eliminate problems and surprises in the future. The case studies are based on actual situations that have occurred at KASPICK & COMPANY clients in the past few years.

The fact situations and relevant law (where applicable) are displayed in the outline below; however, the specific identification of issues and their potential resolution are reserved for the conference session in order to promote discussion and learning. Electronic copies of the session slides will be made available upon request immediately after the conference.

FUNDING OF CHARITABLE GIFT ANNUITIES

Case #1—A Surprise Funding Asset

In March 2011, ABC Charity received a letter from Ben, one of its regular annual donors, containing an application for a charitable gift annuity and a check made out to ABC for \$50,000. Mary, who works in the gift planning office of ABC Charity, noticed that the check was drawn on an IRA account.

Mary checked ABC Charity's development database and discovered that Ben had established his first gift annuity with ABC Charity, also for \$50,000, in the summer of 2009. In reviewing ABC's files for that earlier gift, Mary discovered a cover letter that stated the donation was being made "pursuant to the Charitable IRA Distribution provision of the Pension Protection Act of 2006." Apparently, the staff member who processed the gift in 2009 did not see this paragraph in the cover letter.

Issue(s)

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Relevant Law

- Requirements for a Qualified Charitable IRA Distribution—IRC § 408(d)(8)
 - Donor must be at least age 70 ½ at the time of the distribution
 - Distribution must be made from an IRA or Roth IRA
 - Distribution must be made directly to charity
 - The maximum amount in any one year is \$100,000
 - The recipient organization must be a qualified public charity other than a donor advised fund or a supporting organization
 - The distribution must be such that, if made to the donor instead of the charity, it would be taxable
 - The distribution must be such that, if made by the donor, it would be deductible
 - The donor must obtain a gift receipt from the charity that would qualify the gift for a full income tax deduction under normal circumstances
 - The donor can receive no value in return from the charitable organization

- Note: As of the submission date of the outline, the opportunity for Qualified Charitable IRA Distributions expired January 1, 2012 and has not been extended by Congress

Possible Solution(s)

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Case #2—Know Your Donor

John Simmons and his wife Marcie each graduated from professional schools at XYZ University in the late 1960s. Much of their wealth was generated from an energy business they sold to Schlumberger. John and Marcie have made several major gifts to XYZ in the past, and want to participate in the University’s capital campaign. They want to make another large outright gift, but also want to establish a \$3 million joint and survivor charitable gift annuity to help offset an anticipated reduction in their retirement plan income due to the Great Recession.

Patricia, the Director of Gift Planning at XYZ University, prepared an illustration of a gift annuity assuming that it would be funded with \$3 million in low basis Schlumberger stock. John and Marcie personally delivered the stock certificates during a visit to campus to meet with the Dean of the Graduate School and the Vice President for Development. Shortly after the meeting, Patricia opened the envelope containing the stock certificates and notices the certificates were in the name of “Marcie Simmons.”

Issue(s)

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Relevant Law

- Treasury Regulation § 1.1011-2(a)(4)(ii)
- Internal Revenue Code § 2523

Possible Solution(s)

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ADMINISTRATION OF CHARITABLE GIFT ANNUITIES

Case #3—The Best Laid Plans Often Go Awry

In 1995, Dr. and Mrs. Philip Winters wanted to provide additional retirement income for themselves and also make a charitable gift to their alma mater, Idyllic College. Philip at the time was 36 years of age, and his wife Maryse was 40 years of age. The Winters transferred \$100,000 to Idyllic College in exchange for the College's promise to pay \$22,200 annually to them jointly, and to the survivor of them for his or her life, in quarterly installments. The payments were to begin on January 1, 2025.

In December of 2010, Jim, the Gift Planning Director at Idyllic College, received a short letter from Maryse indicating that she and Philip had divorced a few years earlier. Her letter states, "Enclosed you will find a copy of the 'Marital Assets & Liabilities Distribution Schedule' from my divorce decree. As you can see, the deferred gift annuity belongs to me. Therefore, please note in your files that when the payments begin, they should be made only to me (Maryse Winters)."

When Jim looks at the attachment to Maryse's letter, it consists of only a single page, the printing on which has been entirely redacted except for a single line that says "Deferred Gift Annuities (4) @ \$100,000 each, Tax Basis = \$0".

Issue(s)

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Relevant Law

- Internal Revenue Code § 1041
- Internal Revenue Code § 2516; Revenue Ruling 60-160, 1960-1 CB 374

Possible Solution(s)

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Case #4—A Financial Reversal

Anita, single and aged 62, is the sole annuitant of a gift annuity contract issued by The Alpha Foundation, a public charity. The gift annuity was established several years when Anita's father (now deceased) transferred \$200,000 in cash to Alpha. Per the terms of the gift annuity contract, she receives payments of \$3,150 at the end of each calendar quarter.

Unfortunately, Anita lost her job during the recent economic downturn and has been struggling to make ends meet. Jeff, the Assistant Treasurer of Alpha Foundation, has had regular telephone conversations with Anita, each occurring a few weeks in advance of the end of the quarter. During these conversations, Anita has been pleading with Jeff for him to send her the quarterly check early so that she can meet living expenses.

You are the Associate General Counsel of Alpha Foundation. Jeff asks you for your practical and legal advice on what might be done.

Issue(s)

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Relevant Law

- Treasury Regulation §1.7520-3(b)(3)

Possible Solution(s)

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INVESTMENT OF CHARITABLE GIFT ANNUITIES

Case #5—A Variety of Outcomes

Mike is the relatively new Vice President of Advancement for Curiosity College. He recently visited one of the college's most consistent and senior donors, Paul Blake (Class of 1941). Mr. Blake funded a series of \$50,000 charitable gift annuities over the last fifteen years to provide scholarships for Curiosity students. When Mike learned that Paul planned to come back to campus for reunion, he thought it would be a great idea to recognize Paul at a luncheon event. In preparation for that possibility, Mike asked Kristi, the Director of Gift Planning at Curiosity College, to put together a table listing the current values of all of Mr. Blake's gift annuities as of the College's fiscal year end of June 30, 2011.

Kristi consulted with Lori at her planned gift management service provider and gathered the following information:

Year of Gift	Gift Amount	Payout Rate	Market Value
1994	\$50,000	7.7%	\$98,817
1996	50,000	8.1%	69,169
1997	50,000	9.0%	45,584
1998	50,000	9.2%	40,204
2000*	50,000	9.4%	14,863
2001*	50,000	9.4%	18,703
2002	50,000	9.7%	46,691
2003	50,000	9.4%	43,249
2004	50,000	9.5%	37,770
2005	50,000	9.9%	33,348
2009	50,000	10.1%	63,415
2010	50,000	9.5%	53,733
2011	50,000	9.5%	48,088
Totals	\$650,000		\$613,634

Kristi was struck by the wide variety of current market values for Mr. Blake's contracts, each of which was funded with \$50,000, and wonders how she will explain this to Mike. She was also a little surprised when Lori noted that the contracts with asterisks would probably run out of money if Mr. Blake lived his life expectancy. Kristi asks Lori, "What is going on here?"

Issue(s)

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Some Best Practices

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

Case #6—Preparing for the Future

Diane is the Vice President for Finance at Decentralized University Foundation (“DCU”). When the financial markets swooned in late 2008 and early 2009, the investment committee of the Foundation Board began to ask more detailed questions about the fixed liabilities represented by the gift annuity payments under contracts issued by the Foundation. Diane enlisted the help of Donald at DCU’s planned gift management services provider to “get her arms around the risk” inherent in DCU’s gift annuity pool.

The good news was that Diane and Donald discovered, overall, DCU’s gift annuity pool was in good shape. The effective payout rate of the overall pool (i.e., the total annual payments on all contracts divided by the current fair market value of the program’s investments) was only about 6.5%. No contracts had yet run out of money, and only about five contracts had a significant likelihood of “running dry” within the next five years. Moreover, the total of the annual payments on the contracts that might run dry within five years was only a few thousand dollars.

The analysis also revealed some bad news, however. One particular donor, Ronald Amundsen, had established four deferred gift annuities for nieces and nephews in the late 1990s. The payments on these contracts did not begin for until the late 2000s. However, the Donald’s analysis showed that those payments represented a significant fraction of the contracts’ current market values, as displayed below:

Year of Gift	Gift Amount	Market Value	Annual Payment	Contract Horizon
1997	\$75,000	\$69,604	\$6,975	38 years
1997	75,000	85,847	8,475	38 years
1997	75,000	69,982	6,600	36 years
1999	75,000	102,293	9,000	38 years

Donald’s analysis showed further that if Mr. Amundsen’s relatives lived their life expectancies and DCU’s pool earned its long-term expected investment rate of return, DCU would have to eventually come up over \$400,000 in cash to make payments on these contracts as they ran dry.

Diane remarked, “Nearly every last one of our gift annuity contracts benefit specific schools and purposes at DCU, and the Foundation doesn’t exactly have a lot of unrestricted cash lying around. So we need to come up with a way to prepare to fund payments on these contracts, and any others like them, if they run out of money.”

What suggestions do you have for Diane? What are the advantages and disadvantages of the various potential solutions to DCU’s problem?

Possible Solution(s)

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Lawyer

Law Offices of Winton C. Smith, Jr.

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P: 800-727-1040

E: winton@wintonsmith.com

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7

**THE CAMPAIGN
PLANNED GIFT SOURCES**

\$150,000,000 Goal

◆
40% Current
\$60,000,000

◆
60% Deferred
\$90,000,000

8

40% CURRENT

◆
Cash
Stocks & Bonds
Family Corporate Stock
Real Estate
Life Insurance
Personal Property
Bargain Sales
Charitable Lead Trusts

9

60% DEFERRED

◆
Estate Gifts
Life Insurance
CRUTs
CRATs
Gift Annuities
Pooled Income Funds
Life Estate Contracts
Pension Plan Gifts

10

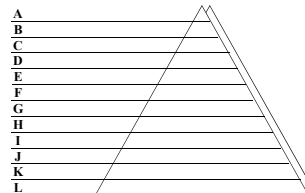
BOARD of TRUSTEES

◆
TOPIC — The Role of Gift Planning in the
\$150,000,000 Capital Campaign.
WHEN — Prior to solicitation of leadership
gifts, preferably at a Campaign Retreat or
regular board meeting.
LENGTH — One to one and one-half hours.

11

THE GIFT PYRAMID

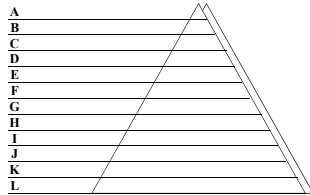
150,000,000 Campaign Objective



12

THE GIFT PYRAMID

Where Is Your Gift?



13

TOP PRIORITY GIFTS

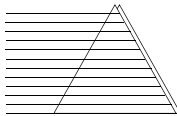
\$150,000,000 Objective

SIZE OF GIFT	# GIFTS	# PROSPECTS
\$15,000,000	1	5
10,000,000	1	5
5,000,000	3	15
2,500,000	5	20
1,000,000	14	42

14

THE LEADERSHIP GIFT

Best Possible Method

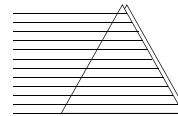


As you consider making a Campaign leadership gift, would you be willing to visit with a charitable gift planning specialist who can help you explore the best possible method of giving for yourself, your family and our organization?

15

THE LEADERSHIP GIFT

The Benefits



DONOR — maximum gift at minimum cost.
CHARITY — more resources for meeting the needs of others.
PLANNER — satisfaction in helping people give more than they dreamed possible.

16

THE CAMPAIGN STRUCTURE



17

THE PLANNED GIVING COMMITTEE

Membership Qualifications

- Key to Success—*Through Involvement Comes Investment*
- Chairperson—The best prospect for a major bequest or other planned gift
- Inner Circle—6-15 additional people who are the best prospects for bequests or other planned gifts for your organization
- Effective committees do not require board members, but it is helpful to have one or two board members if they meet criteria
- No professional advisors

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THE PLANNED GIFT COMMITTEE

Agenda

- The Purpose of the Planned Giving Committee
- The Types of Planned Gifts
- The Planned Gift Guidelines
- The Role of the Bequest
- The Bequest Recognition Society
- The Bequest Recognition Society Resolution
- The Bequest Recognition Society Annual Event
- The Bequest Recognition Society Gift

19

PLANNED GIFT GUIDELINES

- The Types of Gifts
- The Policies & Procedures
- The Donor's Interest First
- The Use of Legal Counsel
- No Conflict of Interest
- No Commission Fundraising
- Investment Guidelines
- Planned Gift Minimums
- Acceptance Guidelines for Planned Gifts
- Records & Business Procedures
- The Planned Gift Committees
- Planned Giving Direct Mail
- Planned Giving Electronic Marketing
- The Legacy Society

20

GIFT PLANNING PRESENTATIONS

- Planned Giving Committee
- Development Committee
- Board of Trustees
- Affiliate Boards
- Capital Campaign Donors
- Major Donors
- Donors
- Professional Advisors

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GIFT PLANNING PRESENTATIONS

- Planned Gift Committee
- Development Committee
- Board of Trustees
- Affiliate Boards
- Capital Campaign Donors
- Major Donors
- Donors
- Professional Advisors

22

PLANNED GIVING PRESENTATION

To the Board of Trustees

- Less Is Better
- 45 Minutes to 1 Hour
- The Purpose of the Program
- Four or Five Planned Gifts
- Stories of Actual Planned Gifts
- Planned Gift Recognition Society Resolution
- Invite Board To Become Charter Members
- Planned Giving Guidelines Resolution
- Offer Special Planned Gift Consultation

23

CTS SEMINARS FOR MAJOR DONORS

-
- What Is the Purpose of this Seminar?
-
- How Long Is this Seminar?
-
- When To Offer this Seminar
-
- Where To Offer this Seminar
-
- Who To Invite to this Seminar

24

WHO TO INVITE TO THE DONOR SEMINAR

◆

- Board of Trustees
- Capital Campaign Committee Members
- Capital Campaign Prospects
- Planned Giving Committee
- Planned Giving Recognition Society Members
- Major Donor Prospects
- Giving Club Donors
- Select Faculty and Staff
- Annual Fund Donors
- Area Philanthropists
- Key Volunteers

25

CTS SEMINARS FOR PROFESSIONAL ADVISORS

◆

- What Is the Purpose of this Seminar?
- How Long Is this Seminar?
- When To Offer this Seminar?
- How Important Is Continuing Ed Credit?
- Where To Offer this Seminar?
- Who To Invite to this Seminar?
- Market Segmentation & Co-Sponsorship

26

WHO TO INVITE TO THE ADVISORS SEMINAR

- Estate Planning Attorneys
- CPA's (Tax Planning)
- Trust Officers
- Investment Advisors
- Stock Brokers
- Chartered Life Underwriters
- Certified Financial Planners
- Certified Tax Practitioners
- Real Estate Investment Advisors
- Charitable Gift Planners

27

SEMINARS FOR PROS



28

WILLS SEMINAR

◆

- What Is the Purpose of this Seminar?
- How Long Is this Seminar?
- What Are the Seminar Topics?
- When To Offer this Seminar
- Where To Offer this Seminar
- How To Conclude this Seminar

29

THE WILLS SEMINAR

◆

- The Planning Process
- The State Made Will
- The Intestate Statute
- The Federal Estate Tax
- The Estate Tax Rates
- The Exemption Amounts
- The Tax Smart Will
- Charitable Gifts through Your Will
- Sample Bequest Provisions
- The Revocable Trust

30

**ESTATE PLANNING
SEMINARS**

◆
How Long Is this Seminar?
What Are the Seminar Topics?
When To Schedule this Seminar?
Where To Offer this Seminar
Who To Invite to this Seminar

31

**ESTATE PLANNING
SEMINAR TOPICS**

◆
Introduction to Estate Planning
◆
Wills and Living Trusts
◆
Estate Tax Strategies
◆
Charitable Estate Planning

32

**PLANNED GIVING
LITERATURE**

◆
Why Is Literature Important?
What Types of Literature are Effective?
How Often Should You Contact Your Donors?
What Subjects Should You Cover?
Who Is the Target Audience?
How Do You Qualify the Audience?
How Do You Follow-up and Close the Gift?

33

**PLANNED GIVING
Print Literature**

The Wills Emphasis Program
◆
WHO? — All Donors
WHEN? — Quarterly
WHY? — Consistency

34

**PLANNED GIVING
PRINT NEWSLETTERS**

The Purpose of this Newsletter
◆
WHO? — Higher Level Donors
WHEN? — Quarterly
WHY? — Consistency

35

**PRINT NEWSLETTER FOR
PROFESSIONAL ADVISORS**

The Purpose of this Newsletter
◆
WHO? — Higher Level Donors
WHEN? — Quarterly
WHY? — Consistency

36

TARGETED DIRECT MAIL SOLICITATIONS

What To Include?



Basic Package

Cover Letter
Brochure or Newsletter
Reply Card
Business Reply Envelope



Your Response

Sample Response Letter
Response Booklet

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PLANNED GIVING WEBSITE

◆

Your Organization's Home Page
Gift Planning Web Site
Planned Gift Donor Stories
Planned Gift Options
Wills and Revocable Trusts
Estate Planning Strategies

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PLANNED GIVING WEBSITE

◆

Tax Alerts & Updates
Develop Your Own Plan
Your Planned Giving Team
Response Device
Planned Giving Brochures
Tracking

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PLANNED GIVING ELECTRONIC MARKETING

◆

WHO? — All Donors & Prospects
WHEN? — Weekly / Monthly
WHY? — Consistency
RESULTS? — Greater

40

PLANNED GIVING WEBINARS

◆

Wills Seminars
Estate Planning Seminars
Charitable Gift Planning Seminars
Seminars for Professional Advisors

41

PLANNED GIVING ELECTRONIC MARKETING SPECIAL EMPHASIS

◆

Wills and Revocable Trust
Qualified Plan Beneficiary Designation
Charitable Gift Annuity
Year End Gifts

42

**PLANNED GIVING
E LITERATURE**

◆
Brochures
Newsletters
Guide to Planned Gifts
Ads
Articles

43

**PLANNED GIVING
E LITERATURE**

◆
Postcards
Letters
Response Cards
Brief Description of Benefits
Specimen Documents

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MORE INFORMATION

Please Contact

◆
Winton C. Smith, Jr., J.D.
4934 William Arnold Rd.
Memphis, TN 38117
800-727-1040
winton@wintonsmith.com

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Keep Your Gift Annuity Program In Tune

Unpredictable investment returns and donor longevity can exhaust reserves and cause discord in a Charitable Gift Annuity program – especially if risk management isn't your specialty. A group annuity from United of Omaha Life Insurance Company can help restore harmony.

Learn how our *Solutions for Gift Annuity Programs* enable you to transfer both investment and longevity risk to us – a highly rated insurer with more than 45 years of annuity experience.

Julie Engel AAPA
(800) 843-2455 ext. 5810
Julie.Engel@mutualofomaha.com

THE POWER OF
Giving

mutualofomaha.com/giftannuity

United of Omaha Life Insurance Company, Mutual of Omaha Plaza, Omaha, NE 68175 is an affiliate of Mutual of Omaha Insurance Company. United of Omaha Life Insurance Company accepts full responsibility for all of United's contractual obligations under its group annuity contract (Form 504-GANC-03). No financial liability will be incurred by the parent or affiliate companies for business transacted by United of Omaha Life Insurance Company. Unless otherwise required by state law, United of Omaha's obligations under its contract are to the charity, as the owner of the contract, and not to individual donors. Charities are solely responsible for determining their reserve fund requirements in the state(s) in which they sell charitable gift annuities. Available for use in all states except NY and OR.

MUGC9035



Mutual of Omaha



ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Investing Planned Giving Assets

Presented by:

William Reeser
Chief Investment Officer
ALSAC/St. Jude Children's Research Hospital
501 St. Jude Place
Memphis, TN 38105
P: 901-578-2115
E: bill.reeser@stjude.org

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

Charitable Gift Annuities
Investment Considerations

William S. Reeser, Senior Vice President and CIO of
ALSAC/St. Jude Children's Research Hospital

Discussion Topics

- ▶ **ACGA Assumptions**
- ▶ **State Reserve Restrictions**
- ▶ **Investment Environment**
 - ▶ Historical
 - ▶ Current
- ▶ **Impact of Diversification**
- ▶ **Regular CGA Pool Monitoring**

ACGA Assumptions

ACGA Gift Annuity Assumptions

- ▶ **Target Residuum**
 - ▶ Residuum at termination of 50%
 - ▶ Minimum 20% present value of original gift
- ▶ **Mortality Assumptions**
 - ▶ Annuity 2000 mortality tables
 - ▶ All annuitants are female and one year younger than actual age

ACGA Gift Annuity Assumptions

- ▶ **Investment Return Assumptions**
 - ▶ Expected return of 4.25% gross
 - ▶ Allocation 40% equity/ 55% bonds/ 5% cash
 - ▶ Administrative and investment expenses of 1%

State Specific Restrictions

State Investment Restrictions

- ▶ **Required Reserve Funds – 16 States**
 - ▶ AL, AR, CA, FL, HI, MD, MT, NH, NJ, NY, ND, OR, PA, TN, WA, WS
- ▶ **Allow “Prudent Investor” Standard – 8 States**
 - ▶ HI, MD, NH, NJ, NY, TN, WA, WS
 - ▶ Arkansas provides option for “Prudent Investor” or specific investment restrictions
- ▶ **“Prudent Investor”**
 - ▶ Guideline that requires a fiduciary to invest assets as if they were his own. The managing investor should consider the needs of the beneficiaries, the provision of regular income, and the preservation of capital avoiding investments that are excessively risky. Further, the decision-making process must follow certain guidelines, even if the final result does not result in the original intent.

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State Reserve Investment Restrictions



- ▶ **Shaded states require reserve funds**
- ▶ **Nine states allow the “Prudent Investor” standard**
- ▶ **California and Florida have specific reserve requirements**

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CA Reserve Fund Restrictions

	California
Structure	Requires Individual Trust For California Assets
U.S. or State Bonds	Unlimited
50% Allocation Limit	Less than or equal to 50% of the Reserve
Corporate Bonds	Subject to 50% Allocation Limit
Common Stock	Subject to 50% Allocation Limit
Preferred Stock	Subject to 50% Allocation Limit
Mutual Funds	Subject to 50% Allocation Limit
Real Estate	None
Foreign Investments	None
Leeway Provision	None

FL Reserve Fund Restrictions

	Florida
U.S. or State Bonds	Unlimited
Corporate Bonds	Considered unlimited except medium to lower tier credits are limited to 13%
50% Allocation Limit	Less than or equal to 50% of the Reserve
Common Stock	Subject to 50% Allocation Limit
Preferred Stock	Max 10% to one fund or company
Equity Mutual Funds	Subject to 50% Allocation Limit Max 10% to one fund
Bond Mutual Funds	No limit on bond funds Max 10% to one fund
Real Estate	5% limit & no more than 1% in one fund
Foreign Investments	5% in general
Leeway Provision	Lesser of 5% or 25% of Surplus

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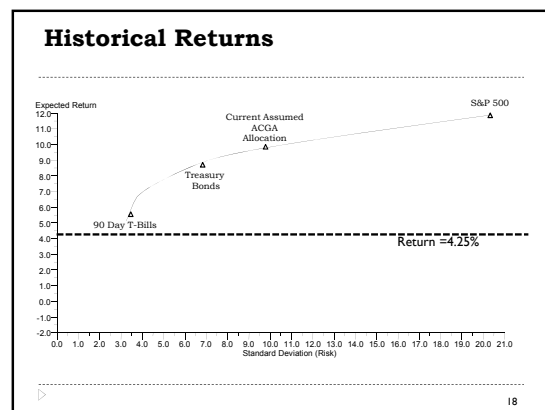
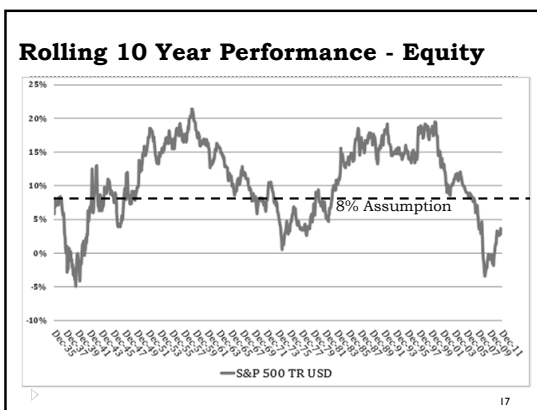
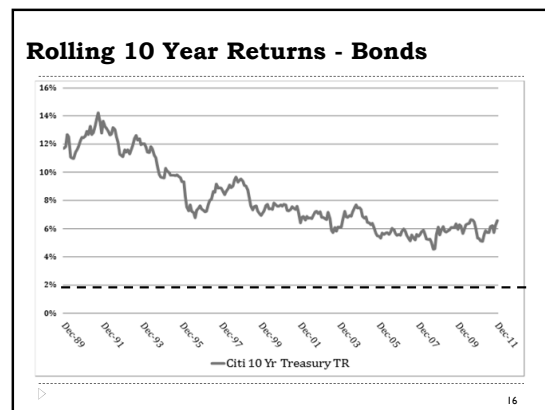
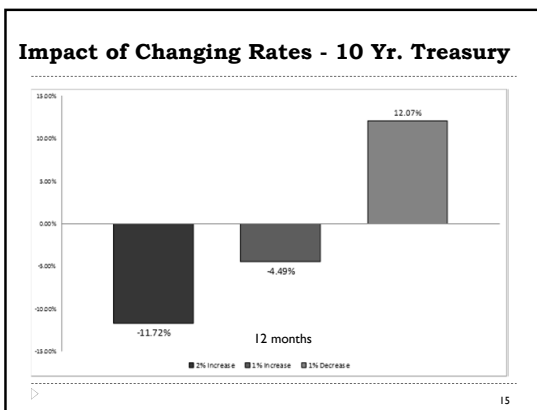
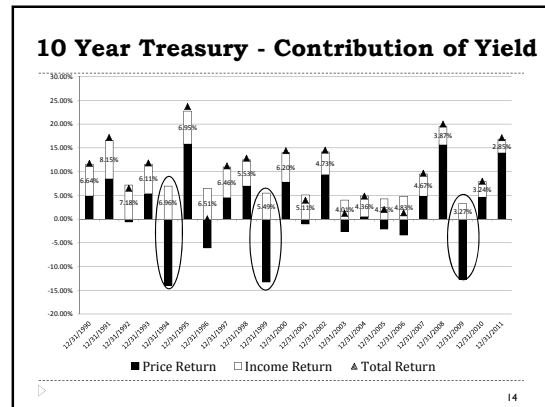
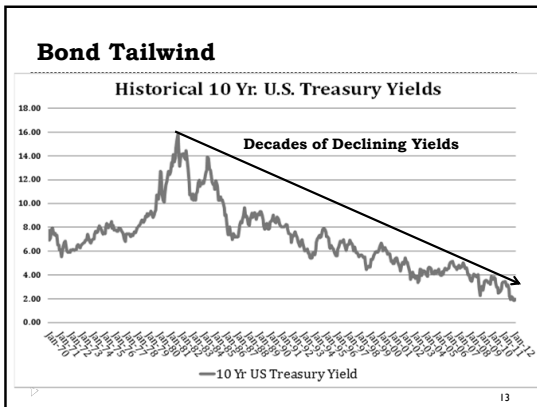
Investment Considerations

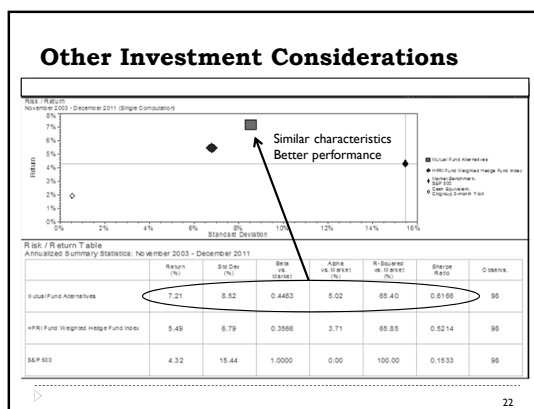
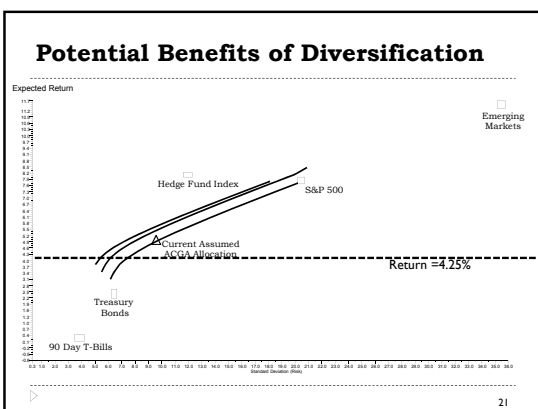
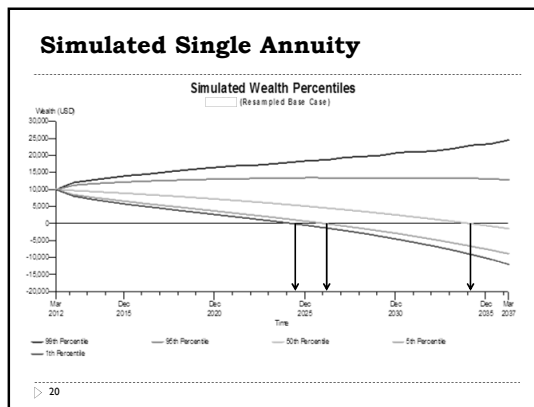
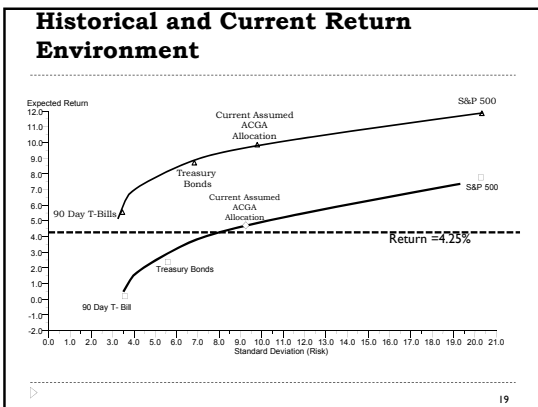
ACGA Gift Annuity Assumptions

- ▶ **Investment Return Assumptions**
 - ▶ Expected return of 4.25% gross
 - ▶ Allocation 40% equity/ 55% bonds/ 5% cash
 - ▶ Administrative and investment expenses of 1%

Asset Class	Proxy	Weight	Current Return Assumption	Return Contribution
Equity	S&P 500	40%	8.0%	3.20%
Fixed Income	U.S. 10 Year Treasury Yield	55%	1.9%	1.05%
Cash	90-Day T-Bills	5%	0.0%	0.00%
				4.25%

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Quarterly CGA Pool Monitoring

Market Value and Reserve Overview		SUMMARY	
National (ex CA) %	%	Total Number Active Contracts	0
National (ex CA) Effective period ¹	%	Total Qtr Value Active Contracts	\$ -
Total Market Value	%	Total Annual Annuity Amount	\$ -
California Reserve ²	%	Average Annual Contract Payout Rate	%
Total Reserve	%		
Total Market Value	%		
STATISTICS		ACTIVITY	
National (ex CA) Contract payout	7.3%	No. New Contracts	0
National (ex CA) Effective period ¹	0.2%	Terminated Contract Payout	\$0
National (ex CA) Average Annuity Age	82	Contract Qtr Value of Terminated Contracts	\$0
National (ex CA) Average Years Remaining	11.1	% of Reserve Value at Termination	%
National (ex CA) Average Life Expectancy ³	10.5	Average Payout of Terminated Contract	\$ -
National (ex CA) Funding Ratio	%	Average Contract Value of Term Contract	\$ -
CA Contract payout	7.3%	Average No. Contract Value for Terminated	0.0
CA Effective period ¹	6.7%		
CA Average Annuity Age	82		
CA Average Years Remaining ⁴	11.2		
CA Average Life Expectancy ³	10.6		
CA Funding Ratio	%		

¹ Required reserves for National calculated based on NY rate 26.5%

² Required reserves for California calculated based on CA

³ Effective Payout is actual annuity payments current market value

⁴ Averages are based on the Ann2000 Normalcy Table

Why should you talk to Gabriel Group about your planned giving program?

Superior, quantifiable RESULTS!

July 2011

Donor Questionnaire for International Relief Organization

105,000 pieces mailed | 22,680 responses | 21.6% response

RESULTS: 4,728 Qualified Planned Giving Leads—

4.5% response rate

June 2011

Data Analytics and Donor Questionnaire for

International Faith-based Social Service Organization

120,000 pieces mailed | 14,585 responses | 12.15% response

RESULTS: 3,783 Qualified Planned Giving Leads—

3.15% response rate

Is it worth stopping by our booth #106 to find out?

We promise, it won't be a waste of your time.



ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

***The Power of the Pyramid: How to Integrate Annual,
Planned and Major Giving***


Presented by:

Philip M. Purcell
Vice President Planned Giving and Endowment
Ball State University Foundation
PO Box 672
Muncie, IN47308
P: 765-730-4321
E: ppurcell@bsu.edu

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org



***The Power of the Pyramid:
Integrating Planned, Major and
Annual Giving***




***The Power
of the Pyramid***

Philip M. Purcell, CFRE, MPA/JD
**Vice-President, Planned Giving and
 Endowment Stewardship**
Ball State University Foundation
888-235-0058
ppurcell@bsu.edu

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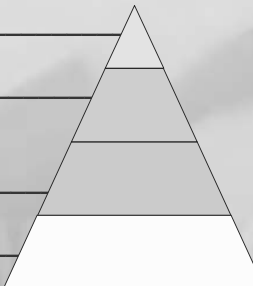



**The Lost Symbol?
Discover the Power!**




Fundraising Pyramid

- *Planned Gifts* _____
- *Major Gifts* _____
- *Repeat/Increased Annual Gifts* _____
- *First Time Gifts* _____





Secrets of The Pyramid

- Number of donors?
- Average size of gift?
- Nature of the relationship?
- Marketing strategies?
- Can donors make all types of gifts?
- Can strategies be integrated by the charitable organization?




Importance of Team



- Challenges and Opportunities
- Fundraising Goals
- Policies and Procedures
- Case for Support: Blended Proposals
- Contact Cues and Clues
- Annual Appeal Integration
- Recognition/Stewardship
- Role of the Board




Current Challenges and Opportunities

Current Challenges and Concerns for Our Donors

- Values of stock portfolios.
- Values of retirement plans.
- Values of home or other real estate.
- Uncertainty of future.
- Need for dependable income.
- Concern for income for loved ones.
- Underperforming charitable remainder trusts, lead trusts, pooled funds.




Current Challenges for Our Organizations

- Reduced budgets for salary and program expenses.
- Staff reduction or hiring freeze.
- Combined positions: major/planned gifts.
- Diminished values of endowments.
- Decreased values of charitable remainder trusts, lead trusts and pooled funds.
- Reduced value of gift annuity reserves.
- Fewer gifts of appreciated property.



Opportunity!


- Needs continue – and increase!
- Deferred gifts are popular.
- Consider other assets.
- Integrated gift plans.
- Secure commitments now – can increase later as market improves.


Fundraising Goals

Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted.


– Albert Einstein



Beauty and the Beast




- **Beauty:** The use of planned gifts to support charitable missions.
- **Beast:** Understanding how to count planned gifts toward campaign goals.




Beholding Beauty ...

...Beauty is in the eye of the Beholder...




Alphabet Soup!




Definitions: Accounting

- Accounting is a process of keeping financial statements 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 position at any given time.
- See FASB (Financial Accounting Standards Board) and GASB Statements.




Definitions: Valuation

- Valuation is an assessment of the actual value of an item to the person or organization that possesses it.
- PPP defines valuation as a reflection of the present value of the ultimate purchasing power of the gift.
- Personalized based on your organization's experience.
- See PPP Valuation Standards at www.pppnet.org.




Definitions: Charitable Tax Benefit Value

The value of tax benefits available pursuant to federal and state law for charitable gifts including the federal income tax deduction, federal capital gains tax savings, federal estate/gift tax deduction, state income tax credits and state death tax benefits.




Definitions: Work Performance Goals


- Annual evaluation of fundraising staff is often based on financial results, contacts, approved activities, etc.
- Performance goals must be personalized to staff and the organization.
- Planned giving success requires special considerations: history of charity and fundraising program, donor base, sophistication of program, staff ability, time allocated to planned giving, etc.



Rising Tide Lifts All Boats




- Allow planned gifts to count toward work goals of all appropriate staff.
- Consider the broader definition of planned gift (current and deferred).



Definitions: Recognition Crediting

- Crediting is institution-specific and represents the way each organization grants recognition to its donors.
- Such recognition need not stem from any of the factors of counting, accounting, tax benefits or valuation, although a given organization may use any of these calculations as the basis of its donor recognition policies.




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.



Campaign and Other Goal-Setting


Definitions: Campaign

A campaign may encompass not only multi-year comprehensive or focused efforts, but any time frame in which a non-profit elects to report fundraising activity, i.e. a specific "reporting period."




Show Me the Money!

- Campaign Goals
- Capital Goals
- Annual Goals
- Major Gift Goals
- Planned Gift Goals
- The Challenge Match





Campaign Evolution






Evolution of Campaigns

<p>Originally:</p> <ol style="list-style-type: none"> 1. Cash Gifts Only 2. Short in Duration 3. Single Focus 4. Outside Counsel does it all 5. Staffed by Volunteers 6. "Unusual" Events in the Life of the Charity 	<p>Currently:</p> <ol style="list-style-type: none"> 1. All Types of Gifts 2. 3-7 Years 3. Multi-Purpose 4. Outside Counsel Guides/Manages 5. Professional Staff 6. On-Going
---	---




Ways of Addressing These Changes ...

1. CASE (Council for Advancement and Support of Education)
2. PPP (Partnership for Philanthropic Planning) formerly NCPG

PPP Recommendations

1. Fundraising campaigns of whatever duration, should set three separate and complementary goals and should report fundraising results along three complementary dimensions:




PPP Recommendations

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



PPP Recommendations

2. Charities should report their progress toward each of these goals separately, using face value numbers.




So What Goes Into The Three Categories?





CATEGORY A: OUTRIGHT GIFTS

- CASH
- MARKETABLE SECURITIES
- OTHER NON-CASH ASSETS
- THE GIFT PORTION OF BARGAIN SALES
- REALIZED BEQUESTS
- REALIZED INSURANCE OR RETIREMENT PLAN BENEFITS
- EXISTING CASH VALUE OF INSURANCE
- CURRENT LEAD TRUST DISTRIBUTIONS
- LEGALLY ENFORCEABLE PLEDGES
- CGA, CRAT, CRUT, PIF MATURATIONS PREVIOUSLY REPORTED IN CATEGORY B



CATEGORY B: IRREVOCABLE DEFERRED GIFTS

- SPLIT INTEREST LIFE INCOME GIFTS
- LIFE ESTATES
- DEATH BENEFIT OF INSURANCE (in excess of cash value in Category A)
- IRREVOCABLE TESTAMENTARY PLEDGES
- FUTURE LEAD TRUST DISTRIBUTIONS




CATEGORY C: REVOCABLE GIFTS

- ESTATE PROVISIONS
- CRT'S IN WHICH DONOR RETAINS RIGHT TO CHANGE BENEFICIARY
- LIVING TRUSTS
- QUALIFIED RETIREMENT PLAN ASSETS IN WHICH DONOR RETAINS RIGHT TO CHANGE BENEFICIARY
- LIFE INSURANCE IN WHICH DONOR RETAINS OWNERSHIP
- DONOR ADVISED FUND ASSETS COMING TO THE CHARITY
- REVOCABLE PLEDGES



Not Beauty and the Beast!







Rather Beauty and the Beholder

- Charitable organizations and their campaigns are diverse.
- PPP encourages you to evaluate a methodology that is the best match for your organization.




Show Me the Money!


- ☑ Campaign Goals
- Capital Goals
- Annual Goals
- Major Gift Goals
- Planned Gift Goals
- The Challenge Match

Capital Goals




- Goal based on capital construction costs.
- Deferred gifts for future operating costs, maintenance endowment funds, payments toward loans or bonding.




Annual Goals

- Based on needs.
- Based on history.
- All forms of annual support:
 1. Annual Fund (Direct Mail, Phone, Web)
 2. Grants
 3. Sponsorships
 4. Special Events
 5. Matured Planned Gifts
 6. Major Gifts



Major Gift Evaluation Metrics

- Budgeting.
- % of solicitations per gift.
- Involvement of key leaders is process.
- Incorporate planned gifts.
- Other metrics included in Appendix.



Major Gift Evaluation

- Indiana University – Chronicle of Philanthropy
- 25 points rating for each of:
 1. Dollars raised.
 2. Number of proposals submitted.
 3. Contacts with donors.
 4. Quality of work.

2005-2006 DEVELOPMENT ACTIVITY BENCHMARKS

VISITS

- Pre-planned, scheduled face-to-face meetings with prospective donor in consultation or steward. Meetings can take place with other staff, donors, volunteers or the President. At least one bench visit with the President per quarter, preferably on campus. Every assigned prospect should be visited at least once a year.
- Suggested number 100-300 per year - 16-25 per month (22 averages)

CONTACTS

- In person (unsubstantiated or informal) or phone contacts with prospects/assigned donors to discuss development issues or University-related activities, and opportunities, follow-up on non-qualifications, thank or acknowledge, invite to attend, "check in", meaningful discussion.
- Suggested number 25-60 per month (22 working days - 4-8 contacts per day - during 20-40 proposals and 20-30 meetings)

GRANT PROPOSALS

- Two or more proposals submitted per month to cleared foundations or corporations. These are to be developed with Faculty and sent to Development for a PIH. Final review and entry in tracking log.
- Suggested number 2-4 per month

CAMPUS ACTIVITIES

- Substantive monthly visits if personal and one-on-one. To emphasize cultivation and prospects by engaging them in the life of the University. Private, Athletic, in-class, student, lecture, speakers, game speakers, banquet, Committee, general meetings, grand openings, Commencement, Prof for a day, etc. Personally invited to attend by DED. Advancement will cover the cost of on-campus event.
- Suggested number 2-3 per month

PROSPECT PORTFOLIO

- Each DED should manage a portfolio of 150 assigned prospects to include 50 in cultivation stage, 50 in active solicitation stage to take place in the next 12 months and 50 leads availability. Central Advancement provides prospect research for newly identified prospects. Requests for prospect clearance and assignment should include a plan of action. Prospect assignments in a fund process and will be reviewed on a monthly basis.

FUNDRAISER METRICS
(Major Gifts, Corporations/Fundations/Planned Giving)

I. Definitions

Relationship Manager - The "Relationship Manager" for a prospective donor is responsible for developing a strategy that deepens the relationship between the prospective donor and the College, in doing so, the relationship manager consistently moves the individual through a process that ultimately leads to a gift or a solicitation.

Stage - The "Stage" the donor is in reflects where on the continuum the donor is in regards to the fundraising gift for which a current strategy is being developed. In other words, a current donor, who is being stewarded for a past gift, could also be in cultivation for a new gift. The stages are defined as follows:

- Identification** - The prospective donor is under consideration as a possible donor to a particular purpose. The focus of the strategy is determining the donor's interest in the organization.
- Extended Cultivation** - The prospective donor is 24 to 36 months away from a solicitation. A strategy is being developed based on one initial visit, with an eye toward solicitation in several years, approximately 25% in segment.
- Active Cultivation** - The prospective donor is 18 - 24 months from solicitation, approximately 25 individuals in segment.
- Ask Approaching** - The prospective donor will be solicited in the next 12 months, approximately 25 individuals in segment.
- Stewardship** - The prospective donor is being personally stewarded for a recent gift.

Visit - A visit is a pre-planned, scheduled face-to-face meetings with a donor or prospective donor to cultivate, solicit or steward a gift. Meetings can take place with others (President, Development, Faculty member, volunteer) or be organized by staff of the President or volunteer in those rare cases where it is best for the fundraiser done not attend. Every prospective donor in Ask Approaching/Cultivation should be visited at least once a year.

Substantive Contact - A substantive contact can be a visit, phone call, email or letter. The contact is "substantive" (and therefore recorded in Millennium) if new information was gathered about the individual's objectives, interests or capacity, if an important conversation took place about development issues or college-related activities, or if there was a meaningful conversation about past or future gifts (e.g., questions re: planned gift pay-out rates, discussion of assets, etc).

Prospect Portfolio - Each front-line fundraiser has a portfolio of current and prospective donors - ideas for those who might be in a prospect portfolio are

provided by Research, as well as other volunteers and referrals from faculty or staff. An individual moves through a solicitation cycle, from In Identification/Cultivation move to the forefront. The prospect portfolio is built a segment of the entire prospective donor pool available in the major gifts officer's assigned giving officer's region.

II. Metrics

Each fundraiser will have 150 - 200 prospective donors in their portfolio, meeting these individuals are actively managed. Relationship Manager has a "prospect pool" that are available for assignment or qualification visits both for adding names as they are planned, and to visit prospective donors as other individuals move through the giving cycle.

The portfolio is divided into **Ask Approaching**, noting those on solicitation track in the upcoming year (12 - 18 months), as well as an **Active Cultivation** and **Extended Cultivation**, representing the next group of donors who will move up to Ask Approaching in subsequent cycles.

The number of those in Ask Approaching is based on some assumptions - it typically leaves time visits to average approximately 100-150 visits per year. Therefore, to accurately measure any active, progressive relationship, we have defined that top progression in terms of groups of 25. As a result, we, in future years will look for 20 annual solicitations per year (180 visits divided by nine visits). However, in the upcoming year, with new officers who do not have this history with the donors and who are making more first visits, we will expect 12 or more solicitations.

Fundraisers will facilitate 120 - 150 visits each year, we expect 250 or more total contacts, including those significant conversations that occur outside of a personal visit.

Development Performance Metrics

Responsibilities	Director of External Affairs	Director of Development	Development Officer	Development Associate	Development Assistant
1. Fundraising Performance	25-30%	25-30%	75-80%	80%	N/A
2. Prospect Pool	10-15 prospects (lead) per \$10K	10-15 prospects (lead) per \$10K	10-15 prospects (lead) per \$10K	10-15 prospects (lead) per \$10K	N/A
3. Solicitation Closed	5-10 quarterly	5-10 quarterly	5-10 quarterly	5-10 quarterly	N/A
4. Solicitation Opened	4-6 quarterly	4-6 quarterly	4-6 quarterly	4-6 quarterly	N/A
5. Visits to Prospects/Meetings	10-15 quarterly	10-15 quarterly	10-15 quarterly	10-15 quarterly	N/A
6. Anticipation	60-70 quarterly	60-70 quarterly	60-70 quarterly	60-70 quarterly	N/A
7. Coordination	Monthly, leads and leads	Monthly, leads and leads	Monthly, leads and leads	Monthly, leads and leads	N/A
8. Travel	2-3 days per month, with 2-3 visits each day	2-3 days per month, with 2-3 visits each day	2-3 days per month, with 2-3 visits each day	2-3 days per month, with 2-3 visits each day	N/A
9. Stewardship	Develop stewardship program	Develop stewardship program	Develop stewardship program	Develop stewardship program	N/A

*In cases where development is a portion of the overall assignment, the stated elements may be reduced according to the percentage of time assigned to development.

Office of External Affairs
Rev. 1/2007

Responsibilities	Director of External Affairs	Director of Development	Development Officer	Development Associate	Development Assistant
10. Supervision	30%	30%	25%	25%	10%
11. DMS Reporting	May file and complete DMS in other cases	May file and complete DMS in other cases	May file and complete DMS in other cases	May file and complete DMS in other cases	May file and complete DMS in other cases
12. Budget	Manages budget for development	Manages budget for development	Manages budget for development	Manages budget for development	Manages budget for development
13. Communications	Develop and communicate strategy and case statements. Lead assigned program.	Develop and communicate strategy and case statements. Lead assigned program.	Develop and communicate strategy and case statements. Lead assigned program.	Develop and communicate strategy and case statements. Lead assigned program.	Develop and communicate strategy and case statements. Lead assigned program.
14. Executive Development Support	Primary staff for Director of External Affairs, Director, Under Secretary and Secretary. May prepare executive briefings, talking points, and follow-up letters.	Primary staff for Director of External Affairs, Director, Under Secretary and Secretary. May prepare executive briefings, talking points, and follow-up letters.	Primary staff for Director of External Affairs, Director, Under Secretary and Secretary. May prepare executive briefings, talking points, and follow-up letters.	Primary staff for Director of External Affairs, Director, Under Secretary and Secretary. May prepare executive briefings, talking points, and follow-up letters.	Primary staff for Director of External Affairs, Director, Under Secretary and Secretary. May prepare executive briefings, talking points, and follow-up letters.


*In cases where development is a portion of the overall assignment, the stated elements may be reduced according to the percentage of time assigned to development.

Office of External Affairs
Rev. 1/2007

Responsibilities	Director of External Affairs	Director of Development	Development Officer	Development Associate	Development Assistant
15. Gift Processing	Provides overall direction in the area to ensure timely and accurate recording of gifts and gifts to ensure acknowledgment.	Supervises gift processing operation and ensure timely and accurate recording of gifts and gifts to ensure acknowledgment.	May supervise gift processing operation and ensure timely and accurate recording of gifts and gifts to ensure acknowledgment.	May supervise gift processing operation and ensure timely and accurate recording of gifts and gifts to ensure acknowledgment.	May supervise gift processing operation and ensure timely and accurate recording of gifts and gifts to ensure acknowledgment.
16. Events and Programming	Develops appropriate events for fundraising and stewardship.	Develops appropriate events for fundraising and stewardship.	Develops appropriate events for fundraising and stewardship.	Develops appropriate events for fundraising and stewardship.	Develops appropriate events for fundraising and stewardship.
17. Support Development Administration	10% responsible for the development of programs, planning and goals.	10% responsible for the development of programs, planning and goals.	10% responsible for the development of programs, planning and goals.	10% responsible for the development of programs, planning and goals.	10% responsible for the development of programs, planning and goals.
18. Non-traditional Development	Responsible for exploring and identifying new sources of revenue. May serve as a member of the staff's executive team responsible for ensuring professional development of staff.	Responsible for exploring and identifying new sources of revenue. May serve as a member of the staff's executive team responsible for ensuring professional development of staff.	Responsible for exploring and identifying new sources of revenue. May serve as a member of the staff's executive team responsible for ensuring professional development of staff.	Responsible for exploring and identifying new sources of revenue. May serve as a member of the staff's executive team responsible for ensuring professional development of staff.	Responsible for exploring and identifying new sources of revenue. May serve as a member of the staff's executive team responsible for ensuring professional development of staff.

*In cases where development is a portion of the overall assignment, the stated elements may be reduced according to the percentage of time assigned to development.

Office of External Affairs
Rev. 1/2007



Planned Gift Goals

- Consider age/sophistication of organization and program.
- Evaluate in terms of investment and long-term benefits.
- For new programs consider activity goals (e.g., number of contacts, program elements) and not dollar goals.
- Develop a dollar goal and action plan worksheet for mature programs. See Appendix for sample.

Dollar Goal Worksheet

Cost of Program

Staff salaries _____

Travel _____

Promotion _____

Teaching _____

Administrative _____

Consulting _____

Other _____

Total Costs: _____

Dollar Goals

Endorsing Percentage (not to rate \$1,000) _____ %

Dollar Goal as Percent Value (Dollar goal divided by Endorsing percentage)

Gifts to Be Closed	Number of Gifts	Average Amount	Gross Value	Percent Value	Total of Percent Value
Request:					
Outright Gifts (limits, etc.)				(25%)	\$
Gift Annuities				(100%)	\$
Charitable Remainder Trusts				(50%)	\$
Planned Interest Funds				(50%)	\$
Other Deferred Gifts (annuities, interests in investments, etc.)				(50%)	\$
Total to Be Raised:					\$

This worksheet is courtesy of Marc Combs, J.D., B.A. & R. Newark Company.

Action Plan Worksheet

Number of Gifts to Be Raised: 1. _____


Number of Persons Who Would Receive visited that make gift: 2. _____ (25%)

Total appointments needed: 3. _____ (Use 1 divided by line 2)

Number of Identified Prospects Needed to Secure Number of Appointments on Line 3: 4. _____ (Use or three times number of appointments needed)

Number of Persons Needed to Visit (Number of Identified Prospects on Line 4): 5. _____ (For example, if direct mail is your main prospecting tool, use a 4% or 5% response rate and divide this a by line 5)

This worksheet is courtesy of Marc Combs, J.D., B.A. & R. Newark Company.



The Challenge Match

- Choose strategic priorities or unpopular needs (e.g., annual operating fund).
- Match outright and planned gifts and pledges.
- Matching funds provided by donors, board members, related foundation.
- See Appendix for example.

Ball State University Comprehensive Campaign

Endowment Challenge Match Incentive

The goal of the Endowment Challenge Match Incentive is to promote endowment building with outright and planned gifts in conjunction with the Ball State University comprehensive campaign. The total proposed Foundation match amount is as follows:

Faculty/Staff Challenge	\$ 300,000
Endowed Faculty Fellows Challenge	\$ 1,000,000
Endowed Scholarship Challenge	\$ 1,000,000
Total:	\$ 2,300,000

I. Faculty/Staff Challenge

Goal: \$300,000 donated by current and emeriti faculty/staff (including those of Ball State Laboratory School and the Business Academy) to create new or supplement existing endowment funds for any of the following purposes:

- Scholarships for freshman merit awards pursuant to current University strategic priorities;
- Incentive matching opportunities, subject to the discretion of the appropriate dean;
- The donor's discretionary funds for excellence as selected by the donor.

Challenge Match Incentive

- Dollar-for-dollar match by the Foundation for endowment fund gifts serving the chosen purpose.
- The matching dollars will be allocated to the endowment fund designated by the donor.
- If a fund receives gifts of less than the required amount of \$25,000 to establish a new Legacy endowment fund (i.e., combined with the Foundation match of \$25,000), then the donor may select any other endowment fund for the gift.
- Maximum of \$25,000 match per donor.
- No maximum dollar amount required for the gift to be matched.
- Matched on first-come, first-awarded basis.

II. Endowed Faculty Fellows Challenge

Goal: 20 Endowed Faculty Fellowships of \$100,000 or more (current and planned gifts).

Challenge Match Incentive

- Donor(s) pledges(s) outright gift(s) of at least \$50,000 payable over five years.
- Donor(s) also pledges(s) a planned gift(s) of at least \$50,000 to the same named endowment fund pursuant to the terms stated below.
- Foundation grants a maximum amount of \$50,000 to the named endowed fellowship fund recommended by the donor.
- Foundation match maximum is 20 x \$50,000 = \$1 million. Granted on a first-come, first-awarded basis.
- Future outright or planned gifts of sufficient amount to Faculty Fellows Funds may create Faculty chairs.

III. Endowed Scholarship Challenge

Three Goals:

- 1) 80 new endowed scholarship funds of \$50,000 or more.
- 2) Growth of existing endowed scholarship funds.
- 3) All scholarships created pursuant to this match opportunity shall include strategic priority criteria of the University (i.e., Freshman and merit-based recruitment).

Challenge Match Incentive

The "Proposed Donor" Challenge for New Endowed Scholarship Funds

- Donor pledges outright gift of at least \$25,000 payable over five years plus a planned gift of \$25,000 designated for a new named endowed scholarship.
- "Proposed Donor" matches this pledge dollar-for-dollar up to a maximum of \$12,500 to reach a total amount of at least \$50,000 (Legacy Fund) by adding the Foundation match (see below).
- The "Proposed Donor" match maximum is 80 x \$12,500 = \$1 million. Granted on a first-come, first-awarded basis.

The Foundation Challenge

EFFEER: (1) Donor pledges a gift of at least \$22,500 qualifying for the "Proposed Donor" Challenge match for a new named endowed named endowed scholarship fund that is not subject to the "Proposed Donor" Challenge.

- In either case, the donor also pledges a planned gift of at least \$25,000 for the new or existing endowed scholarship fund.
- The Foundation matches this current and planned gift pledge with a maximum of \$12,500 which would allow a new named scholarship.

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fund to reach \$50,000 (Legacy Fund) OR allow an existing named scholarship fund to increase in value by at least \$12,500.

- The Foundation match maximum is \$1 million. Granted on a first-come, first-awarded basis.

IV. Policies and Procedures of the Endowment Challenge Match Incentive

- A special agreement would be prepared and signed by the donor, allowing the Foundation's director to modify the fund purpose and use of the original funds provided by the Foundation if the donor's planned gift is not realized.
- Donors may not participate in multiple match opportunities for the same endowment gift.
- A "donor" includes one individual, his/her business, private foundation, donor advised fund and/or matching gift. Spouses and other family members can be separate donors.
- Outright gifts or pledges may count if made after July 1, 2008. Current unfilled pledges may be counted until all of the matching dollars are allocated or until the end of the campaign period (i.e. June 30, 2011), whichever occurs first.
- Matching dollars will be allocated upon completion of each pledge.
- The match for planned gifts would apply to any new planned gift as of July 1, 2004 with a current face value verified in writing by the donor.
- Any match for planned gifts would be available for any revocable or irrevocable planned gift by a donor age 25 or over, or any irrevocable planned gift by a donor under age 25. A match will be provided for the present value of revocable planned gifts made by donors under age 25.
- The donor must provide the Foundation a copy of the legal documentation securing any planned gift. The documentation must utilize language approved by Foundation staff.
- All grants from the Foundation would be deemed grant-endowment pursuant to Financial Accounting Standards Board (FASB) standards. Current or deferred gifts from donors would be deemed permanent endowment.
- Donated class reunion funds may be used to qualify for a match. A member of the class may offer a planned gift to qualify as well.

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12. Exceptions to these policies and procedures may be considered on a case-by-case basis.

V. Benefits for Donors and Ball State

- Creation of permanent endowments providing perpetual support.
- Planning opportunities for donor and/or loved ones.
- Ass opportunity to experience the current use of the funds.
- Promotion of strategic priorities of the University.
- Contribution of many planned gift techniques that offer unique tax and financial planning benefits.
- Planned gifts offer opportunity to grow fund in the future to keep pace with inflation.
- Opportunity for additional outright gifts to the fund prior to realization of the planned gift.

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Policies/Procedures

- Gift Acceptance Policies and Procedures: On-going or campaign-specific.
- Campaign Policies and Procedures:

 1. Campaign Counting and Reporting.
 2. Donor Recognition.

- See Appendix for samples.

6/23/07 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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Ball State University Foundation
Planned Giving and Endowment Stewardship Program
Policies and Procedures
EXECUTIVE SUMMARY

PURPOSE OF THE FOUNDATION FOR PLANNED GIVING AND ENDOWMENT STEWARDSHIP

- Mission.** The mission of the Ball State University Foundation (hereinafter "Foundation") and its Planned Giving and Endowment Stewardship Program is to support missions of Ball State University (hereinafter "University").
- Independent counsel encouraged.** Persons acting on behalf of the Foundation shall not provide legal advice and shall not be held liable for any advice given to a donor. It is the donor's responsibility to obtain independent legal advice on advice of the donor's choice as to whether to do a gift or transfer to Ball State University.
- Confidentiality.** The Foundation staff shall advise 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.
- Charitable gift annuities authorized.** The Foundation is authorized to issue charitable gift annuities, immediate and deferred.
- Investments as trustee.** The Foundation may serve as trustee of charitable remainder trusts, charitable lead trusts and pooled income funds where the Foundation is the most desired charitable beneficiary.

TYPES OF PLANNED GIFT ARRANGEMENTS, PROCEDURES

- Charitable Gift Annuity (Immediate and Deferred).** The minimum initial amount for an annuity agreement is \$2,000. Additional gift annuities from the same donor may be issued for \$5,000 per annuity. Gifts offered for immediate and deferred gift annuities will be as currently recommended by the American Council on Gift Annuities.
- Charitable Remainder Trust.** The minimum amount for a charitable remainder trust for which the Foundation is trustee is \$100,000 (i.e., the total amount donated to the trust must be at least \$100,000).
- Pooled Income Fund.** The minimum initial contribution to the pooled income fund is \$3,000. Additional contributions may be made at any time, and they shall be at least \$2,000.
- Charitable Lead Trust.** The minimum amount for a charitable lead trust with the Foundation as trustee is \$100,000.
- Life Insurance.** A donor may irrevocably assign a paid-up policy to the Foundation. A donor may irrevocably assign to the Foundation an ownership interest in an existing policy. A donor may name the Foundation as primary or secondary beneficiary (but not owner) of a life insurance policy.

- Gift of Responder Interest with Reduced Gift Taxes.** The Foundation and the donor shall execute an agreement in which the donor shall stipulate that the donor shall continue to be responsible for all real estate taxes, property insurance, utilities and maintenance.
- Bequests.** The Foundation may purchase cash, stocks, personal property, or other property for less than fair market value. The value paid for the property should generally not exceed 60 percent of its appraised value.
- Bequests.** Bequests bequeathed through the will and testament and conditional gifts, including endowments, will be available to donors and their survivors to ensure that the bequest is properly designated.
- Bequests with Pledge Designation.** Donors will be encouraged to designate the Foundation as primary or secondary beneficiary of a retirement plan, pension or the donor's appropriate designated procedure, such as a 401(k) plan, 403(b) plan, or 529 plan.
- Qualified Conservation Easement.** As a general matter, the Foundation will consider gifts of qualified conservation easements only on real estate situated within the Foundation in the state in which the property is situated.
- Responsible Pledge Program.** The Foundation accepts gifts of unsecured, non-pledged personal property such as automobiles, air travel, recreational equipment, electronic equipment, computers, televisions, artwork, tape collections of all types, books, jewelry, art, antiques, records, clothing, and other property. Items such as boats, aircraft, artwork, and other items will be accepted by the Foundation as university-owned property, subject to the University's policies on acquisition, management of university assets, and maintenance of university-owned property.
- Gifts of Non-Cash Assets: Immediate Payment Pledge.** Donors may make gifts of intangible personal property such as cash, publicly traded securities, stocks, bonds, contracts or investment funds, U.S. Savings Bonds, and other financial instruments. The Foundation will accept such gifts if the donor provides a written pledge agreement.
- Transfer of Assets for Planned Gifts.** Annuity trust services are being provided for the Foundation's pooled income funds, charitable gift annuities, charitable remainder trusts and charitable lead trusts.

ASSETS FOR GIFTS, PROCEDURES

- Gifts of Non-Cash Assets: Real Estate.** The Foundation has established a supporting organization ("Charitable Properties, Inc.") that may be used to accept real estate gifts of all types.
- Gifts of Non-Cash Assets: Tangible Personal Property.** Donors may make gifts of tangible personal property such as automobiles, air travel, recreational equipment, electronic equipment, computers, televisions, artwork, tape collections of all types, books, jewelry, art, antiques, records, clothing, and other property. Items such as boats, aircraft, artwork, and other items will be accepted by the Foundation as university-owned property, subject to the University's policies on acquisition, management of university assets, and maintenance of university-owned property.
- Gifts of Non-Cash Assets: Intangible Personal Property.** Donors may make gifts of intangible personal property such as cash, publicly traded securities, stocks, bonds, contracts or investment funds, U.S. Savings Bonds, and other financial instruments. The Foundation will accept such gifts if the donor provides a written pledge agreement.
- Transfer of Assets for Planned Gifts.** Annuity trust services are being provided for the Foundation's pooled income funds, charitable gift annuities, charitable remainder trusts and charitable lead trusts.

DOCUMENTATION PROCEDURES

- 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.
- Documentation of Gifts.** The Foundation shall request appropriate documentation for all gifts.
- Documentation of Gift Receipts.** With regard to the acceptance and documentation of gifts with restrictions designated by the donor, the Foundation staff shall comply with all applicable federal and state laws, rulings, rules and regulations.

RECOGNITION AND CREDITING PROCEDURES

- Crediting of Gifts.** The University seeks to give credit to all donors for purposes of donor recognition and the advancement of development goals in an equitable manner for the appropriate amount of planned and pledged gifts.
- Recognition of Gifts.** The Foundation's donor recognition will be extended to all donors who confirm a receivable or irrevocable planned gift in any manner. Planned gift amounts shall be provided to the University for the purpose of its comprehensive lifetime giving recognition plan.

Ball State University
Campaign Counting and Reporting Policies
Final

Introduction

In order to fulfill the highest standards of conduct for fair, accurate and ethical fundraising, these guidelines apply to all counting and reporting for the Ball State University comprehensive campaign. These standards apply to all campaign reporting or counting guidelines. Additional policies and procedures, including those related to donor recognition, are provided in the Ball State University Development and Reporting Manual. The University Foundation Board of Directors are incorporated herein by reference and shall apply to counting and reporting for the comprehensive campaign. The University Foundation Board of Directors shall comply with all applicable laws relative to the implementation of these counting and reporting policies.

I. Campaign Goal

The goal of this comprehensive campaign is to raise \$200 million, including \$50 million in planned gifts, for projects identified by Ball State University through its new strategic plan.

II. Campaign Period

For purposes of these standards, the campaign period refers to the total time encompassed by the active solicitation period for the campaign, including the advance gifts phase. Ball State's campaign period will be seven years in duration. The beginning date is July 1, 2004 and ending date is June 30, 2011.

The advance gifts phase of the campaign is that period of time prior to public announcement of the campaign or the campaign's official goal, during which pre-empting gifts are sought from individuals and organizations (July 1, 2004 to September 30, 2009). Gifts shall be given for all gifts and pledges made during the advance gifts phase. The public phase of the campaign, following public announcement of the campaign, will run from September 30, 2009 to June 30, 2011.

III. Campaign Counting

Gifts and pledges shall be counted toward the campaign goal as follows:

- Charitable Gifts.** All gifts and pledge payments of cash and non-cash assets from individuals, corporations, foundations or other organizations subject to the guidelines stated below, will be counted as of July 1, 2004 through June 30, 2011. During the campaign, University Development will continue to solicit for the annual goal of raising cash, telephone contact and personal contact. These ongoing fundraising efforts will be conducted and reported according to customary guidelines. The annual solicitation totals will count as progress toward the campaign goal.
- Planned Gifts.** All planned gifts, subject to any exceptions stated below, will be counted as of July 1, 2004 through June 30, 2011. Planned gifts will be counted as follows:
 - Revolvable planned gifts (e.g., willtrusts bequeathing personal or commercial assets) bequeathing to the Foundation shall be counted as of the date of the bequest, or the date of the donor's death designation, etc.) shall be counted at face value for donors aged fifty-five and over.
 - Revolvable planned gifts shall be counted at present value for donors aged fifty-five and over.

- Irrevocable planned gifts (e.g., contracts or promissory notes accompanying a willtrust bequest, immediate or deferred charitable gift annuities, charitable remainder trusts, remainder interests in real estate, pooled income funds, life insurance policy ownership, etc.) shall be counted at face value for donors of any age except for the donation of this contract of a life insurance policy that is not paid up by donors (overseas) under the age of fifty-five. Donated life insurance policies that are not paid up by donors (overseas) under the age of fifty-five will be considered irrevocable planned gifts. The donor will be required to sign a pledge committing the donation of all future premium payments in order to count any gift of life insurance where ownership is transferred to the policy by the donor, regardless of the age of the donor.
- A campaign gift value will change from present value to current face value as a donor reaches age fifty-five during the campaign period.
- Pledges.** A pledge will count toward the campaign as long as it is made during the campaign (open/active). Unfulfilled pledge balances will be deleted from the campaign counts and reports. The unfilled pledge payment period, regardless of when the pledge is made during the campaign period, is five years or less. If a donor's circumstances change (e.g., donor's ability or willingness to fulfill the pledge, change in timing of the pledge payments, a change in the amount of fulfilling a pledge, etc.) it is the obligation of the donor to inform the development officer or Foundation staff of the change and the level of recognition can be adjusted accordingly. The following guidelines apply:
 - Written Pledges.** All pledges shall be in writing and should commit to a specific dollar amount that will be paid according to a fixed time schedule.
 - Formal Pledges.** Only verbal pledges made and documented through a notarial notary public campaign are to be counted and reported in totals.
 - Planned Gifts.** Pledges may be made or fulfilled with planned gifts. The documentation for planned gifts must be in writing and comply with the policies and procedures approved by the Ball State University Foundation Board of Directors.
 - Matching Gifts Expense.** The pledge amount is the obligation of the donor. Matching gift dollars can be applied toward their pledge, if allowed by the matching gift company. The donor is notified when a matching gift has been received.
 - Provision of Pledge by Third Party.** Pledges by a donor can be paid by a third party (e.g., corporate matching gifts, business affiliates, family members, etc.) unless prohibited by law (e.g., donor advised fund grants, private foundation grants on behalf of disqualified persons, etc.).
 - Challenges/Conditional Pledges.** Challenges/conditional pledges will be reported to the National Campaign Committee Policies and Procedures Subcommittee. These pledges may be included in campaign totals if there is a reasonable expectation that the conditions under which the pledge is made will be met during the campaign period and if there is appropriate documentation (including a dollar amount and payment schedule).
- Other Non-Charitable/Charitable Gifts.** In addition to counting charitable gifts made as pledges and irrevocable planned gifts that are not income tax deductible for the donor as a charitable contribution, the donor's gift will count as progress toward the campaign goal if the donor will be counted as long as the dollar value of the counted gift is readily ascertainable as verified by an independent qualified expert such as an appraiser.
 - Qualified IRAs charitable rollovers pursuant to the Pension Protection Act of 2006.
 - Grants from donor advised funds(ADF) designated by a donor. Note: Gift acknowledgment is sent to the non-exempt organization that holds the donor advised fund as official donor of record and a copy of the acknowledgment is sent to the donee.

- Gifts from private foundations(ADF) designated by a donor. Note: Gift acknowledgment is sent to the private foundation as official donor of record.
- Charitable and non-charitable gifts that are reported as follows:
 - Charitable and non-charitable gifts designated by a donor. Note: Gift acknowledgment is sent to the donee of the charitable lead trust for trust reporting.
 - Gifts of time and services such as those that would otherwise be paid for (e.g., the services of printers, doctors, attorneys, etc.) and that are displayed on the Foundation's financial statements pursuant to current Financial Accounting Standards Board (FASB) guidelines.

IV. Campaign Counting Exclusions

The following payments shall be excluded from campaign counting and reporting totals:

- Gifts or pledges, outright and/or planned, which have already been counted in previous campaigns, even if the gift is realized during the new campaign reporting period. The Divisio/Distribution campaign is considered a part of this campaign.
- Investment earnings, appreciation or interest earned on gifts, even if accrued during the campaign reporting period.
- Unpaid pledge balances that have been written off or deleted.
- Income earned on gifts.
- Surplus income transfers from ticket-based operations, except for any amount equal to that permitted as a charitable deduction by the Internal Revenue Service.
- Contract revenue.
- Tuition payments.
- The value of benefits or premiums received in exchange for gifts, except for those benefits allowed for purposes of the charitable deduction such as tokens and/or membership benefits. This includes, but is not limited to, 80/20 deductions for athletic priority seating.
- Payments received from local, state or federal government units.

V. Campaign Reporting

Campaign reporting may include totals and/or subtotals of the following dollar amounts for the general campaign goal as well as for other specific objectives within the overall goal:

- The total of outright gifts.
- The total of pledge balances.
- The total of planned gifts.
- Other gifts as approved by the Policies and Procedures Subcommittee.
- The grand total.

VI. Campaign Donor Recognition

Annual Donor Recognition. University Development annual donor recognition guidelines will apply to all gifts and pledges. Individuals whose gifts are eligible for recognition include:

- Individuals whose gifts are potentially deductible and non-deductible contributions such as outright gifts, matching gifts, donations directed from donor advised funds or bequests and pledge balances.
- Organizations. Recognition for corporations, foundations and other organizations will include unsecured and potentially deductible and non-deductible outright gifts, matching gifts, donations directed from donor advised funds or private foundations and pledge balances.

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- **Cumulative Lifetime Gift Recognition.** University Development cumulative lifetime gift society guidelines will apply.
- **Planned Gift Recognition.** Ball State University Foundation planned gift recognition guidelines will apply.
- **Naming Opportunities.** The Ball State University Board of Trustees policy on naming of University Facilities and Programs will apply.
- **Additional Recognition.** Special recognition may be recommended and approved by the Ball State University Board of Trustees, Foundation Board of Directors or University Advancement and Development offices.

VII. Campaign Counting and Reporting Standards Exceptions


Exceptions to these standards may be approved by the National Campaign Committee's Finance and Procedures Subcommittee on a case-by-case basis or considered appropriate, fair and ethical under the circumstances.

References: These campaign counting and reporting standards incorporate recommendations by the Council for the Advancement and Support of Education (CASE) and the National Committee on Planned Giving (NCPG). Campaign programs may appear differently when reporting to these outside agencies as their definitions may vary.


Approved: _____ Date: _____

Amendments: _____


Approved: _____ Date: _____



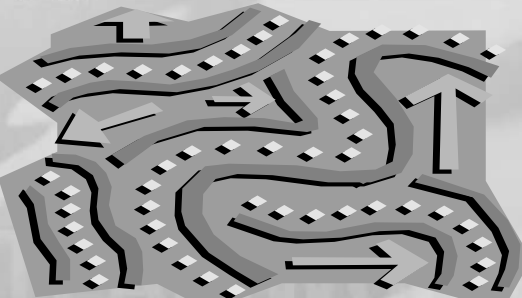

The CASE for Support



Build your case to all constituencies: board, donors, volunteers, and general public!




Connecting the Dots

Case Statements: Connecting the DOTS

- Documented needs that your charitable mission aims to address.
- How your programs and services effectively and efficiently address these needs.
- Outright and planned gifts provide essential support to pay for these programs and services now and later.
- Serving the interests and philanthropic goals of donors.




Maximizing Integrated Philanthropy




Blending Proposals






Semantics?

Is a "planned gift" a "major gift"?

- In the eyes of your organization?
- In the eyes of your board?
- In the eyes of your donor(s)?

Are "planned gifts" only "deferred"?

- Endowments.
- Lead trusts.
- Non-cash gifts.
- Current use of deferred gifts.



Support for Blending

- High correlation of loyal annual giving and planned giving.
- Major givers are invested – and may consider a planned gift to enhance endowment, assist established program, maintain building, etc.
- Note: For many planned gift donors, it will be their largest gift.
- See Appendix for sample ways to incorporate the planned gift "ask"!

Ball State University and Foundation
Ways to Incorporate Planned Gifts into Major Gift Solicitation Plans


1. Pledge accepted for asked amount to a new or existing fund (scholarship, etc.).
At an appropriate time: "Would you consider a planned gift, such as a bequest (will, trust, retirement plan, or life insurance) or a life income plan (that pays you and/or loved ones income) to ultimately supplement your fund? This will help Ball State achieve its campaign goal – and offers you many tax and financial benefits."

2. Pledge accepted for less than asked amount to a new or existing fund (scholarship, etc.).
At an appropriate time: "Would you consider a planned gift, such as a bequest (will, trust, retirement plan, or life insurance) or a life income plan (that pays you and/or loved ones income) to ultimately supplement your fund? This will help Ball State achieve its campaign goal – and offers you many tax and financial benefits."

3. Pledge accepted for asked amount – not to a fund.
At an appropriate time: "Can we also share with you the tax and financial planning benefits for you of a planned gift, such as a bequest (will, trust, retirement plan, or life insurance) or a life income plan (that pays you and/or loved ones income)? This will help Ball State achieve its campaign goal – and offers you many tax and financial benefits."

4. Pledge accepted for less than asked amount – not to a fund.
At an appropriate time: "Would you also consider a planned gift, such as a bequest (will, trust, retirement plan, or life insurance) or a life income plan (that pays you and/or loved ones income) to ultimately assist or supplement a fund? This will help Ball State achieve its campaign goal – and offers you many tax and financial benefits."


5. Pledge declined.
At an appropriate time: "Would you consider a planned gift, such as a bequest (will, trust, retirement plan, or life insurance) or a life income plan (that pays you and/or loved ones income) to ultimately assist or supplement a fund? This will help Ball State achieve its campaign goal – and offers you many tax and financial benefits."
*If appropriate



Too Much in the Blender?

Objections:


1. Too confusing.
2. Diminishes the current gift.
3. Creates delay.
4. Planned gifts are only for retirees.
5. "Either/or".



Too Much in the Blender?


Responses:

1. Use a simple format.
2. Planned gifts rarely come from current income (annual gifts) or have different motivations from major gifts.
3. Format of pledge allows for quick action followed by details.
4. Most bequests -Age 45-60 (Bank of America/Center on Philanthropy Study)
5. "And"!




Blended Proposals

- **The "double ask":**
 1. Annual Gift or Multi-Year Pledge
 2. Planned Gift (Documentation required)
- **The "triple ask":**
 1. Annual Gift or Multi-Year Pledge
 2. Major Gift/Pledge in addition to Annual
 3. Planned Gift (Documentation required)



Blended Proposals

- **The “quadruple ask”:**
 1. Annual Gift/Pledge
 2. Major Gift/Pledge
 3. Revocable Planned Gift
 4. Irrevocable Planned Gift



Motivations


<p>Major Gifts:</p> <ol style="list-style-type: none"> 1. Motivation: Help Now! 2. Ability to Give. 3. Use of Assets. 4. Pledging. 5. Endowments (Link to Planned Giving). 	<p>Planned Gifts:</p> <ol style="list-style-type: none"> 1. Motivation: Help Now and/or Later! 2. Ability Enhanced by expanded time. 3. Use of Assets (Link to Major Gifts). 4. Pledging. 5. Endowments.
--	--



Donor-Centered?




- Major and Annual Gifts: Organization Centered?
- Planned Gifts: Donor Centered?




Key Incentives for Planned Gift Support

- To fulfill a personal or campaign dollar goal that is not possible with annual or major gifts.
- To achieve naming rights.
- To create a named endowment.
- To provide a hedge against long-term inflation.
- To generate enhanced personal benefits: lifetime income, tax savings, etc. available with certain planned gifts.




Format for Blended Proposal

1. Cover Letter from Key Contact
2. Statement of Case (Specific Purpose such as Capital Need, Program Support, Endowment, Unrestricted)
3. Proposed Annual Gift Support
4. Proposed Major Gift Support
5. Proposed Planned Gift Support



Planned Gift Proposal

- Cover letter.
- Consider options.
- Summary or matrix of options.
- Begin with general descriptions: How it Works, Benefits for You, Benefits for Charity.
- Follow with specifics: Financial Illustration, Sample Forms, Brochures.
- Donor recognition.



Pledge Format

- Identification of purpose and use of gift.
- Commitment of outright gift: dollar amount and timeframe.
- Commitment of planned gift(s): dollar amount (estimate, if possible) and technique(s).
- Statement that planned gift documentation will be shared within reasonable time.
- See Appendix for sample pledge letter and gift plan worksheet.

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Sample Pledge Letter

Dear President Cox,

I am very proud of the students, faculty and alumni of Ball State University!

I am delighted to support a Ball State education for promising students with my pledge to the Ball State BOLD campaign!

I pledge \$_____ payable to _____ annual installments for a total of \$_____ I understand that my pledge may be paid in cash, stock or other assets.

Optional (especially for large pledges):

Any unpaid balance of my pledge should I pass during the BOLD campaign will be paid as provided in my will or other estate plan. I will provide a copy of my estate pledge document for my confidential file at the Ball State University Foundation.

Optional (to be personalized with correct planned gift type):

In addition to my current outright gift pledge, I also pledge a planned gift to the Ball State BOLD Campaign with as:

- Request from my will or revocable living trust
- Beneficiary designation of my life insurance policy or commercial annuity
- Beneficiary designation of my retirement plan
- Beneficiary designation of my mutual fund
- Residual of my charitable remainder trust
- Residual of my charitable gift annuity
- Income from my charitable lead trust
- Remainder of my personal residence or farm

The current estimate of my planned gift is \$_____. I will provide a copy of my planned gift document for my confidential file at the Ball State University Foundation.

Optional:

My gift(s) will be designated for the following: _____

I join you and all supporters to ensure a bright and bold future for Ball State!

Sincerely,

(Name of Institution)
GIFT PLANNING WORKSHEET

Prepared for: _____

This document assists in planning gifts to (Name of Institution). It is not a binding pledge, but rather a simple tool for beginning a conversation about your wishes for possible gifting. For assistance or information call (Name of Institution) Advancement Office at (Telephone #).

In recognition of (Name of Institution) Campaign, I/we are considering the following gifting opportunities:

ANNUAL GIVING - Gifts to support the current operations of the institution, providing important, ongoing operational support of (Name of Institution) (fiscal year July 1 - June 30) if you choose to designate your annual support.

2009-10	\$ _____
2010-11	\$ _____
2011-12	\$ _____
2012-13	\$ _____
2013-14	\$ _____
ANNUAL GIVING TOTAL	\$ _____

CAPITAL - Gifts to a capital project, such as _____ or other capital project as discussed with a member of the Campaign Leadership or staff

2009-10	\$ _____
2010-11	\$ _____
2011-12	\$ _____
2012-13	\$ _____
2013-14	\$ _____
CAPITAL TOTAL	\$ _____

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GIF Planning Worksheet Page - 2

ENDOWMENT - Gifts to establish an endowed fund to provide support in perpetuity for the institution as discussed with a member of the Campaign Leadership or staff.

The endowment fund that I/we may have interest:

Establishing an endowed (Type of endowment) (Gift of \$1,000,000 or more) _____

Establishing an endowed (Type of endowment) (Gift of \$50,000 or more) _____

Establishing an endowed (Type of endowment) (Gift of \$25,000 or more) _____

2009-10	\$ _____
2010-11	\$ _____
2011-12	\$ _____
2012-13	\$ _____
2013-14	\$ _____
ENDOWMENT TOTAL	\$ _____

PLANNED GIVING - Gifts made through a life income agreement and/or other estate mechanism to provide important future gifts to the institution.

I/we are interested in learning about:

- Naming (Name of Institution) as part of my/our will or Revocable Living Trust Request
- Charitable Remainder Trusts
- Charitable Gift Annuities
- Beneficiary of (Name of Institution) as a beneficiary of an IRA or Pension Fund
- Designation of (Name of Institution) as a beneficiary of Life Insurance Proceeds
- Designation of (Name of Institution) as a beneficiary of Life Insurance Proceeds
- Retaining a Life Estate with real-estate property (with the asset ultimately going to (Name of Institution).

ESTIMATED VALUE OF PLANNED GIFT(S) \$ _____

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Gif Planning Worksheet Page - 3

Sample Request Wording

Below is a sample of wording you could use for your will or trust, should you desire to make a request to (Name of Institution). The blank should be filled with a specific amount, a percentage, or "the remainder."


I give, devise and bequeath _____ to (Name of Institution), nonprofit corporation of the state of _____ located at (Address), to be used in such a manner as the Board of Trustees thereof may direct. (If you desire, the bequest may be designated for a specific purpose as discussed with a member of the Campaign Leadership or staff.)

TOTAL GIFT COMMITMENT TO (Name of Campaign)
(Add totals from previous pages) \$ _____

POINTS TO CONSIDER - when planning your gift to the (Name of Campaign):


- ◆ Gifts of appreciated assets can often be a better vehicle than cash when making a gift because of specific tax advantages.
- ◆ Many companies have matching gift programs through which your gift may be leveraged.
- ◆ Gifts to the Campaign may be made over a 2, 3, 4, or 5-year period.
- ◆ Members of the staff of the Advancement Office will assist you and your financial advisors in designing a gift and a gift plan that will suit your philanthropic desires and financial situation.

FOR MORE INFORMATION - contact any of the following staff:
(Fill in contact information for institution and appropriate staff)




Example #1 of Blended Gift

- Annual gifts to award scholarships, support programs, fulfill pledge, etc.
- Additional annual gift (or deferred gift) restricted to build new endowment designated for same purpose.
- Endowment reaches goal and spending from endowment replaces annual gifts.
- Planned gift will supplement endowment to provide hedge against inflation and market loss.




Example #2 of Blended Gift


- Major gift pledge for building, equipment purchase, establish endowment, etc.
- Any pledge due and owing at death to be satisfied from testamentary planned gift (e.g., bequest in will or trust).
- Assures naming opportunity.



Three Ways to Identify Prospects




1. Staff and Volunteer Leads.
2. Prospect Identification.
3. Self-Identification.




Staff and Volunteer Training

- Led by planned giving officer or other planned gift "point person".
- Carefully use volunteers (board, etc.).
- Regular in-house training/social time.
- Paid consultants or seminars.
- Regular sharing of periodicals , emails, and other updates on planned giving.
- Membership in PPP and local council.



Staff and Volunteer Coordination



- Access to current planned gift information.
- Process/acceptance forms for all types of gifts: Planned, Endowment, Non-Cash, Stock, IRA Rollover.
- Contact sheets to review cues and clues.



Donor Prospecting


Are you looking for the cues and clues to all types of gift potential?

- Linkage
- Ability
- Interest


Cues and Clues: Estate Planning

- Currently planning estate
- Writing will/trust
- Advisors' names
- Investigating life insurance
- Concerned about providing for loved ones
- Asks about will, living will, living trust, power of attorney, executors




Cues and Clues: Personal Assets/Income

- Owns business
- Plans to sell business
- Retirement plan
- Owns collection(s)
- Recently received inheritance
- Personal residence(s)
- Appreciated real estate (commercial, farm, etc.)
- Appreciated stock
- Depreciated stock
- Government bonds (tax-free?)
- Savings bonds
- Corporate bonds
- Commercial annuities
- Mutual funds
- High Income \$_____




Cues and Clues: Tax Concerns

- Income tax
- Capital gains tax
- Estate tax
- Gift tax
- Taxes on retirement plan



Cues and Clues: Personal Information

- Single
- No or few children
- Concern for income for spouse or children (special needs?)
- Moved or planning to move
- Retired or planning to retire soon




Cues and Clues: Charitable Interests

- History of experience with your charity: Served? Volunteer? Family served?
- Giving history
- Linkage to similar charities
- Interest in specific programs
- Interest in naming opportunity for self or loved ones
- Interest in perpetual endowment

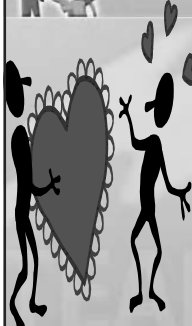



Needles in the Haystack!

Annual Appeal Integration


- Correlation of Annual and Planned Giving
- The Magic Box
- Coordinated Promotion Schedule
- Integrated Information in Publications
- Phone Calling Programs
- Personal Visits





The Magic Box

- ✓ *I have included a gift to _____ in my estate plans.*
- ✓ *I would like more information on how to include a gift in my estate plans.*




Coordinated Promotion Schedule




- Newsletters
- Target Mailings
- E-mail Blasts
- Facebook Ads
- Flyers
- Event Announcements



Integrated Publications

<u>What?</u>	<u>Where?</u>
■ Segment by Age	■ Fundraising Brochures
■ Advertisements or Testimonials.	■ Newsletters
■ Descriptions of Techniques	■ Magazines
■ Contact Information	■ Website
■ Recognition	■ Annual Report
■ Donor Lists	■ Campaign Reports



Phone Calling

- Consider targeted planned gift calling.
- Consider differences: Older and experienced callers, script, follow-up.
- Be prepared for efficient and effective responses and follow-up when donors mention planned gifts during an annual appeal call.
- Vendors: RuffaloCODY, Legacy Leaders



Personal Visits




- Maximize time with donors.
- Scripted.
- Role of Volunteers, Board, Others. The Blended Proposal.
- The Blended Thank You.
- Follow-Up.




Integrated Donor Recognition





Policies/Procedures

- Gift Acceptance Policies and Procedures: On-going or campaign-specific.
- Campaign Policies and Procedures:
 1. Campaign Counting and Reporting.
 2. Donor Recognition.




Integrated Donor Recognition

- Recognition Acceptance Protocol: Forms
- Planned Giving Societies
- Annual/Loyal Giving Societies
- Cumulative Giving Societies: Adding Planned Gifts at Face or Present Value
- Campaign Recognition
- Naming Recognition for Buildings
- Perpetual Endowments




Integrated Donor Recognition

- Annual Lists (Annual Report)
- Plaques on Public Display
- Website Display
- Special Gifts
- Coordinated Recognition Events




Is Your Board "On Board"?

Show Me The Money!

Is Your Board "On Board"?

- Boards play an important role to assure program integration.
- Committee involvement.
- Comprehensive budget.
- Goal-setting.
- Donor identification, cultivation, proposals and stewardship.
- Personal giving 100%!



Focusing Your Board

- Board of directors self-evaluation of its fundraising performance.
- "Commission" or job description for each board member to sign.
- Job description for development or planned giving committee of board.

**Sample Board of Directors
Fundraising and Planned Giving Evaluation Form**

Please rate the board on each of 2 levels: 1 indicating that the board is well prepared and is functioning that the board needs to implement actions to improve more direction in fundraising for planned and outright gifts.

Area of Responsibility:	Scale
Knowledge	
1. The board understands the organization's mission.	_____
2. The board is committed to the mission.	_____
3. The board understands the importance of fundraising in supporting the mission.	_____
4. The board understands what planned giving is and recognizes its key role in fundraising.	_____
5. The board receives adequate reports on fundraising in general, including planned giving.	_____
Interest	
1. The board asks questions about fundraising in general, and planned giving in particular.	_____
2. The board seeks more information about fundraising including planned giving.	_____
3. Board members serve as spokespersons on behalf of the organization and committee with participants and staff.	_____
4. The board understands the fundraising in general, and planned giving in particular is	_____
5. The board understands the role of planned giving in fundraising and planning.	_____
6. The board participates in many aspects of the fundraising process by helping to identify and qualify participants, sign appeal letters, write testimonials in various publications and represent the organization.	_____
Evaluation	
1. The board interacts positively with staff and staff in fundraising activities.	_____
2. The board is willing to take specific action items.	_____
3. The board regularly reviews and sends fundraising (including planned giving) reports.	_____
4. The board receives recognition for its efforts in fundraising.	_____
5. The board participates in planning for fundraising including planned giving.	_____
Action	
1. The board is willing to make personal calls on fundraising and planned gift prospects (if appropriate) along with other volunteers or staff.	_____
2. The board develops fundraising, planned giving and related matters with peers.	_____
3. The board actively solicits, identifies and recruits donors relative to fundraising and planned giving.	_____
4. The board serves as ambassadors to constituent groups.	_____
Performance	
1. The board believes in fundraising, including planned giving, and not only acts on that performance activity.	_____
2. The board has an active planned giving committee or a development committee that	_____
3. The board has an active planned giving committee or a development committee that	_____
4. The board assumes responsibility for specific fundraising and planned giving tasks.	_____
5. The board covers the financial liability for the organization.	_____

Sample Committee for Board of Directors

General Commitments:

All directors of the board are charged with fulfilling the essential legal duties including:

- Duty of care to exercise all responsibilities in good faith and with the diligence, prudence, attention, care and skill.
- Duty to exercise prudent duty of care required by applicable state or federal law on fiduciary and business matters in management and investment of charitable endowments, ownership of charitable trust, charitable gift security administration and disposition of long-term gifts such as real estate.
- Duty of obedience to certain laws that may, when "violated" represent a process as required in the articles, certificate and all other documents in such a manner that does not harm the corporation. This duty requires directors to avoid using their position to obtain impermissibly a personal benefit or advantage. The interests of the corporation come ahead of personal interests and directors must be made objectively, avoiding inappropriate conflict of interest.

Specific Duties:

1. Regularly attend board meetings and important related meetings.
2. Agree to serve on at least one board committee.
3. Make serious commitment to participate actively in board and committee work.
4. Volunteer for and willingly accept assignments and complete them thoroughly and on time.
5. Stay informed about board and committee matters, prepare well for meetings, and review and comment on minutes and reports.
6. In an active participant in the board's and committee's annual evaluation and planning efforts.
7. Participate in fund raising for the organization by assisting with the identification, qualification, invitation, solicitation, close and stewardship for all types of gifts, including annual gifts, grants, major and planned gifts.
8. Support the organization with its annual gift, major gifts, no budget and related projects, plus an appropriate planned gift. All gifts are relative to receive and held in complete confidentiality unless prior release of the information is approved.

Signed: _____ Date: _____
 Board President: _____ Date: _____

**Sample Description for
Development of Planned Giving Committee
of Board of Directors**

General Commitments:

The development (planned giving) committee is charged with planning and implementing the organization's work program for planned giving (or just planned giving) in concert with the organization's professional fund raising staff. This committee is a standing committee of the board and is staffed by the organization's professional fund raising staff. The committee acts as an advisor to the board members and other volunteers are engaged with the fundraising (planned giving) process.

The development (planned giving) committee is charged with planning the organization and its board of directors on important elements in the following areas including planning giving, well as:

- ensure attention to the relevance of the organization's activities, services and user requests,
- the way the organization fulfills its responsibility to its constituents,
- the development of committees with the organization,
- maintaining the mission required to carry out the organization's mission,
- assisting with the raising of funds for planned gifts, and
- demonstrating good stewardship on behalf of the gifts.

Committees:

1. The chair of the development (planned giving) committee is appointed by the president of the board of directors.
2. The development (planned giving) committee is composed of the chair and three other board members appointed by the president of the board of directors.
3. The development (planned giving) committee shall include other qualified volunteers not on the board, as determined by the president of the board of directors.
4. All subcommittees (e.g., planned giving) chairs shall serve on the development committee.

Duties:

1. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.
2. Identify and recruit qualified volunteers to participate in the organization's mission and goals in coordination with staff and other board committees.
3. The development (planned giving) committee shall include other qualified volunteers not on the board, as determined by the president of the board of directors.
4. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.
5. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.
6. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.
7. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.
8. The development of policies and procedures to be approved by the board relative to gift solicitation and acceptance, and planned gift identification.

Team:

1. Meetings will be approved on an annual basis.
2. Meetings may occur less frequently than per year.



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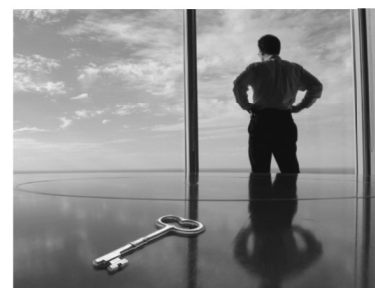
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11 Martine Avenue • 12th Floor
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ON TRACK FOR TOMORROW
The 30th ACGA Conference... A conference on planned giving

Update on Elder Law—Medicaid

Presented by:

Lisa Newfield

Partner

McCarthy Fingar, LLP

11 Martine Avenue

White Plains, NY 10606

P: 914-385-1032

E: lnewfield@mccarthyfingar.com

Presented by The American Council on Gift Annuities

1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546

P: 770-874-3355

W: www.acga-web.org

E: acga@acga-web.org

AMERICAN COUNCIL ON GIFT ANNUITIES

30TH ANNUAL
AMERICAN COUNCIL ON GIFT ANNUITIES CONFERENCE

April 20, 2012

Update on Elder Law

Lisa Newfield, Esq.
McCarthy Fingar LLP
11 Martine Avenue
White Plains, New York 10606
(914) 946-3700
lnewfield@mccarthyfingar.com

Medicaid Update and Elder Planning

The Deficit Reduction Act of 2005 (S. 1932) (DRA) was signed into law on February 8, 2006. Most sections were effective upon enactment. It substantially changed and restricted planning steps that can be taken to protect assets and achieve Medicaid eligibility for skilled nursing facility services, in particular. These changes affected the treatment of annuities, residences, the look back period, periods of ineligibility flowing from gifts and contracts with continuing care retirement communities. While DRA's provisions are relatively clear, implementation at the state level has been sporadic and inconsistent. Thus, just because you understand the DRA's provisions doesn't mean you also understand how your jurisdiction implements the DRA. You must be familiar with how your jurisdiction interprets and applies to DRA be it by legislation, regulation or other state Medicaid program process.

This outline will focus on the specific changes made under DRA Sections 6011 – 6016, which address the changes to Medicaid asset transfer rules, and review current planning options under the DRA.

A. REFORM OF ASSET TRANSFER RULES

1. Extension of Look-Back Period

Assets transferred for less than fair market value during the “look-back period” before an individual applies for Medicaid are added to the applicant's countable resources. The individual's eligibility for Medicaid for long term care will be delayed for a penalty period; the length of the penalty period is calculated by dividing the uncompensated value of the transferred assets by the monthly cost of private nursing facility care in the state.

DRA: The look-back period is increased from 36 months to 60 months.

Prior Law: Look-back period was 36 months; and 60 months for transfers to certain trusts.

The penalty period cannot begin until the expiration of any existing period of ineligibility. Once the penalty period is imposed, it will not be tolled (i.e. interrupted or suspended) even if the individual stops receiving institutional level care.

2. Change in Start Date of Penalty Period

DRA: The date that a period of ineligibility, or penalty period, begins will be the later of:

- (a) The first day of the month during, or at the State option, the month after which, assets are transferred for less than fair market value; or

- (b) The date on which the applicant is eligible for Medicaid and is receiving institutional level of care services (nursing home care), based on an approved application for such services that, were it not for the imposition of the penalty period, would be covered by Medicaid. The imposition of a penalty period requires a denial notice from Medicaid. (i.e. must submit an application for Medicaid.)

Prior Law: Prior to DRA, the period of ineligibility or the penalty period would begin in the month of transfer or at the State option, in the month following the month of transfer.

3. Calculation of Penalty Period

DRA: Requires states to impose penalty periods even in the case of smaller asset transfers, where the period of ineligibility would be less than a full month. In imposing penalties on such transfers, if the calculation of the penalty period produces a fractional amount, the penalty must include a partial month disqualification based upon the relationship between that fractional amount and the monthly nursing home rate used to calculate the penalty period.

Prior Law: States were permitted to round down and disregard the additional partial month penalty. In states that elected to impose no penalty period for such partial month transfers, individuals were able to transfer amounts less than the average monthly cost of nursing facility services in successive months, but never incur a penalty.

4. Aggregation of Multiple Transfers

DRA: States have the option to determine the penalty period by treating the total of all uncompensated transfers as one transfer and impose one penalty period beginning on the earliest date applicable to any of the transfers, or apply multiple penalty periods.

Prior Law: When a number of assets are transferred during different months, then the rules varied based on whether the penalty periods overlap. If a penalty period for each transfer overlaps with the beginning of a new penalty period, then states had the option of either adding together the value of the transferred assets and calculating a single penalty period or imposing each penalty period sequentially. If the penalty period for each transfer does not overlap, then states were required to treat each transfer as a separate event and impose each penalty period starting on the first day of the month in which the transfer was made.

5. Annuities

DRA: Purchase of an annuity by an applicant or by an applicant spouse, or annuity related transaction made by an applicant or an applicant spouse on or after February 8, 2006 will be treated as a transfer for less than fair market value unless the State is named as the remainder beneficiary. The State may receive up to the total amount of state payments for medical assistance for the annuitant. However, the applicant or applicant spouse may name a spouse or minor or disabled child as the first remainder beneficiary; if the state is named as second remainder beneficiary.

Beginning with purchases or certain transactions by or on behalf of applicant annuitant, on or after the date of enactment of DRA, annuities will be treated as transfers for less than fair market value assets unless the annuity meets any of the three following conditions:

- (a) The annuity is held by an IRA; or has been purchased with the proceeds of
 - i. an IRA;
 - ii. a simplified employee pension plan; or
 - iii. a Roth IRA, **or**

- (b) The annuity is
 - i. is irrevocable and non-assignable; and
 - ii. is “actuarially sound” i.e. term is less than or equal to life expectancy of annuitant; and
 - iii. provides for equal periodic payments without deferral and without any balloon payment.

Prior Law: If an annuity was actuarially sound, it was not a disqualifying transfer, and there was no requirement to name the state as a beneficiary.

6. Purchase of Life Estates

DRA: States must treat funds or assets used to purchase a life estate in another individual’s home as a transfer for less than fair market value, unless the purchaser resides in the home for at least one year after the date of purchase. If an individual does satisfy the requirement, the entire funds used for the purchase must be included in the applicant’s countable assets.

Lisa Newfield, Esq.
McCarthy Fingar LLP

The rules pertaining to the purchase of life estates add a criterion for evaluating whether a transfer of assets has occurred, but does not replace existing rules in determining the value of life estates. Use of life estate tables published by SSA for SSI program must be used. If the payment of a life estate exceeds the fair market value of the life estate as calculated in accordance with the SSI tables, the difference between the amount paid and fair market value is treated as an asset transfer.

Finally, unless a state has a provision for excluding the value of life estates in its Medicaid plan, or the property in which the individual has purchased the life estate qualifies as the individual's exempt home, the value of the life estate should be counted as a resource in determining Medicaid eligibility.

The DRA provision pertaining to life estates does not apply to the retention or reservation of life estates by individual transferring real property. In such cases, the value of the remainder interest, not the life estate, would be used in determining whether a transfer of assets has occurred and in calculating the period of ineligibility.

Prior Law: No prior law with respect to purchase of life estate.

7. Homestead

DRA: a) Minimum Amount:

Requires states to consider the equity in an applicant's home in determining eligibility for Medicaid for long term care in or out of a nursing facility and disqualify any applicant with home equity exceeding \$500,000, or up to \$750,000 at state's option. As of 2011, this amount was increased by the percent of increase in the consumer price index. Effective January 1, 2012, the minimum home equity limit is \$525,000 and the maximum home equity limit is \$786,000.

b) Exempt Family Members

If a spouse, minor child or disabled child continues to live in the home, the applicant will not be disqualified.

c) Reverse Mortgage

Individuals are permitted to reduce their home equity through a reverse mortgage or home equity loan.

Prior Law: No cap on home equity.

8. Spousal Impoverishment Rules

DRA: Requires states to determine eligibility by examining and allocating the couple's income before allocating resources. If the income of the community spouse is less than the state's monthly income allowance, income or assets of the institutionalized spouse may be transferred to the community spouse to make up the difference. This is known as the "income first rule".

Prior Law: States had the option of using the "resource first rule", where the resource allowance was increased to generate enough income to meet the minimum monthly maintenance needs allowance ("MMMNA") for a community spouse; or the "income first rule", where the applicant's income was first allocated to the community spouse in order to meet the MMMNA.

9. Waiver of Penalties due to Hardship

DRA: State Medicaid agencies now may grant waivers if applying the penalties for transfers would deprive the beneficiary of:

- a) medical care, endangering the beneficiary's life or health, or
- b) food, clothing, shelter or necessities of life.

States must include in their state plans:

- a) notice to recipients that an undue hardship exists;
- b) a timely process for determining whether a hardship exists; and
- c) a process for appeal of an adverse determination.

Prior law: No prior statutory law. These same criteria and procedural requirements were contained only in CMS Guidance.

10. Continuing Care Retirement and Life Care Communities

DRA: a) Admission Contracts

May include requirement that residents spend down their resources declared on admission to the CCRC before applying for Medicaid.

b) Entrance Fees

Entrance fees are countable resources to an applicant if:

- (i) if applicant/resident may use entrance fee to pay for care, or the contract so provides;

Lisa Newfield, Esq.
McCarthy Fingar LLP

- (ii) if part or all of entrance fee is refundable when the resident dies or terminates contract; and
- (iii) if resident does not acquire any ownership interest in the community by paying the entrance fee.

Prior Law: Social Security Administration prohibited Medicaid certified nursing facilities from requiring that individuals provide them with oral or written assurance that the resident is not eligible for or will not apply for Medicaid benefits.

B. ESTATE RECOVERY

OBRA 93 mandated that states pursue a recovery from the estate of a deceased Medicaid recipient who was age 55 or older when he or she received Medicaid benefits or whom regardless of age, was permanently institutionalized. OBRA 93 also provided states with the option to expand estate recoveries to include assets that pass outside the probate estate and which the decedent had an interest in prior to death.

C. PROHIBITIONS ON RECOVERIES

1. Deferral Of Recovery

Medicaid estate recoveries are prohibited:

- (a) During the lifetime of a surviving spouse;
- (b) During any period in which the recipient has a surviving child under the age of 21 or a blind or certified disabled child; (This prohibition applies to all assets covered by the expanded definition of estate, including assets that pass directly upon the decedent's death to individuals other than a surviving spouse or minor, blind or disabled child).
- (c) As to the home of deceased Medicaid recipient, recovery is prohibited when one of the following relatives is residing in the home:
 - (i) Surviving Spouse;
 - (ii) Sibling with an equity interest (1 year immediately prior to institutionalization with an equity interest);
 - (iii) Caretaker child (adult child in home for at least 2 years immediately prior to institutionalization and provides care).

If the prohibited period ends, for example, spouse dies, minor child reaches age 21 or with respect to the recipients home, the sibling or adult child no longer resides in the home or the home is sold, recovery can then be pursued.

2. Hardship Exception

No recovery of Medicaid correctly paid will be pursued against all or a portion of the estate if it will result in undue hardship for example; family farm or family business and income produced by it are the only assets of the estate.

Undue hardship is not considered to exist based on the inability of the beneficiaries to maintain a pre-existing lifestyle or when the alleged hardship is the result of Medicaid or estate planning methods involving the divestiture of assets.

3. Deferral of recovery may also be considered on real property subject to a post death lien if:

- (a) undue hardship has not been found to exist;
- (b) heir or survivor has lawfully and continuously resided in the real property commencing prior to death of the recipient and is unwilling to sell the real property;
- (c) Medicaid claim can't be paid in full unless the property is liquidated;
- (d) heir or survivor is able to demonstrate inability to obtain financing to pay the estate claim;
- (e) agreement with Medicaid and the dependent, heir or survivor where Medicaid holds lien and heir, etc., agrees to pay the amount of claim pursuant to reasonable payment scheduled and interest.

D. ELDER LAW PLANNING

1. Countable Resources For Medicaid

Countable resources for Medicaid are defined as property of all kinds: personal, real, tangible and intangible, liquid and non-liquid. Liquid resources are cash, including bank accounts, stocks, bonds and cash value of life insurance. Non liquid assets are assets which are not readily converted to cash, such as real property.

- (a) Exempt Assets.

Lisa Newfield, Esq.
McCarthy Fingar LLP

2. Retirement Assets

Retirement accounts of the applicant may represent a significant assets when a Medicaid plan is being developed. A transfer of a retirement account to a spouse or disabled child, while exempt for Medicaid transfer purposes, will result in an income tax liability of the applicant. However, if the applicant retains ownership of the retirement account and is receiving the maximum available periodic payment* for that individual, then the principal of the retirement account is exempt and not a countable resource. For Medicaid purposes, a countable income stream will be created, but the principal will be protected.

ROTH IRA are treated as fully available for Medicaid purposes.

3. Planning Options

- (a) Irrevocable Trust
- (b) Life Estates
- (c) Gifts

* Need to review state Medicaid regulations regarding computation of maximum period payments, which may differ than current amounts being paid to account owner.



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The 30th ACGA Conference... A conference on planned giving

What Every Donor Would Like you to Know

Presented by:

Dan Garrett
Vice Chancellor & President
Abilene Christian University
Hunter Welcome Center
ACU Box 29200
Abilene, TX 79699-9200
P: 800-979-1906
E: garrettd@acu.edu

Presented by The American Council on Gift Annuities
1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546
P: 770-874-3355 W: www.acga-web.org E: acga@acga-web.org

ACGA Conference – April 18-20, 2012

“What Every Donor Would Like You to Know” – Dan T. Garrett

Introduction

I hope you share my interest in the assigned topic:

“What Every Donor WOULD LIKE YOU TO KNOW.”

This is a topic that has been a growing interest for me personally for some time. For too long we fundraisers have been or appeared to be more interested in “picking the pockets” of our donors or at least raising as much money as we possibly could from our donors and prospective donors for projects and campaigns that were of interest to us or our institutions. We have set appointments seeking both large and small gifts to balance the budget, build or remodel a facility, establish an endowment, help with a comprehensive campaign, etc. Each ask has been designed more around WHAT WE NEED than Why and How the donor might like to/or not participate in helping fund our mission.

That topic interests me because most fund raisers in my acquaintance are far more interested in what **THEY WANT** to know about the donor.

After 39 years and many and varied experiences with donors, I am more convinced than ever before that long-term, fruitful donor relationships are largely dependent upon the ability of the fund raising officer and the institution to connect with the values, motivation, and emotions of the donor.

So, think with me from a donor’s perspective on Motivation, Cultivation, Appreciation, Recognition, and Sustained Relationships. What are their Passions? What might they like us, “the fund raisers,” to know about what they like or dislike about our institution? About what or who they would like to recognize or fund? What can I do to help uncover or determine what motivates them? What do I need to do to help determine their interest and if appropriate, cultivate that interest? What should I (my institution) do to recognize and express appreciation for a completed gift? What is appropriate recognition? Is it something I want for them or is it something they would prefer? Is there more than one way to say “Thank You?”

We will explore these and other questions as we discuss a number of real cases.

WHAT DO DONORS WANT YOU TO KNOW:

About Motivation - “It’s not about the money”

Values – Making a difference

Experience – Paying it forward

Family - Legacy

Control – It is my money

Trust/Credibility – Can I trust you/your organization? What’s your history? Will you (your organizations) be there or be the same when my estate/trust matures?
How do I know you will use my gift(s) for the purposes I am giving them?

Passion – What matters to me (the donor); for my reasons

About Cultivation - “I have a choice”

Three places my money can go. Why should your organization/institution be included?

Keep it

Spend it. Consume or Fulfill passion.

Give it to someone else

Pass it on

About Appreciation/Recognition - “Somebody cares”

Remember the song from the musical 1776, “Is anybody there? Does anybody care? Does anybody see what I see?”

Thank you – The Fund Raiser

Thank you – The Administrator

Thank you – The Board

Thank you – The User

Thank you – The Recipient

About Stewardship - “Somebody remembers”

What have you done for me lately?

Appreciation reminders – plaques, books, art work, birthday/anniversary cards,
sculptures/models: Oak Leaf, Prayer Tower, Gutenberg Press Model, hash knife.

Gifts that keep on giving. Reminders of significance, impact, influence.

DONORS I HAVE KNOWN

As time allows, the cases below will be discussed in detail. Participants will be invited to analyze each case in the context of motivation, cultivation, appreciation and stewardship.

Case by Case

Case 1. Buie – It is/is Not about You!

Reluctant relationship - Acceptance/Credibility/Trust/
Confidence/Friend/Caregiver

Case 2. Garrison – A Case of Mistaken Value!

A Referral
Discovering passion and motivation

Case 3. Masten – A Lovers' Quarrel!

Friendship/alienation/reconciliation/dependence

Case 4. Edwards – Who Cares! Referred by a Stranger!

Interest/friendship/interest in HIS goals.
Gift or business deal?
Outcomes

Case 5. Woodward –You Never Know Who's Watching!

59 years from 1st to Ultimate Gift
The value of mentoring. From mother to son

Case 6. Burns – A Friend of a Friend!

The value of a referral from a trusted friend.

Case 7. G1 – G4 – From Generation to Generation!

Case 8. Seventy-Five Years of Support – A Lifetime Relationship

Conclusion

Our donors and prospective donors want us to listen as much or more than they want us to talk. What does your typical donor visit look like? What should it look like? What I asked donors in the past vs. what I ask today.

A parting story.