Give & Take

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NEWS AND IDEAS FOR DEVELOPMENT EXECUTIVES OF NONPROFIT ORGANIZATIONS

What to Do When the Federal Mid-Term Rate Is Falling

by Barlow Mann

When discount rates are low, charitable lead trusts may have higher appeal.

Gift planners have become used to slight fluctuations in the results of the charitable gift calculation process caused by monthly changes in the discount rate prescribed by law for use in calculating such deductions. In February and March, the discount rate has dropped to 6.8%, continuing a long-term decline of 30% since the rate last peaked at 9.6% in February, 1995. What does this mean for gift planners and donors?

A short history lesson

Prior to adopting a floating rate based on 120% of the so-called "Applicable Federal Mid-Term Rate," the calculation process utilized tables based on a fixed rate. For many years that rate was 6%. As the economy changed, especially during times of high interest rates brought about by inflation and other factors, these tables often failed to reflect realistic rates of return.

In an attempt to react to the interest rate climate of the time, the fixed rate assumption was changed to 10% in the early 1980s. Before the change to 10%, there was a flurry of interest in gift planning arrangements such as the charitable lead trust, which benefited from the lower discount rate.

The subsequent adoption of the 10% tables resulted in the necessity for higher payout rates and longer payment periods for charitable lead trusts in order to result in elimination of estate and/or gift tax. As a consequence, there was less interest in the charitable lead trust. After the shift to "floating" rates in 1989, the rate subsequently floated as high as 11% in June, 1990. At this rate, a lead trust would have to specify a payment rate of 12.5 % in order to eliminate all tax on a trust with a 20-year time period. Thus, there were few "takers."

On the other hand, since the shift to monthly floating rates, there have been periods when the interest rates fell back to the 6%-7% level, making charitable lead trusts more attractive once again. At a 6.8% level, for example, an 8.5% payout from a charitable lead annuity trust for 20 years will result in a gift or estate tax deduction equal to 99% of the amount of the gift.

Former First Lady made lead trust "fashionable"

During one such period when the discount rate was less than 7%, numerous articles and seminars were devoted to the drafted, but never funded, Jackie Onassis charitable lead trust (see article on page 5). Excitement among non profit gift planners and advisors alike was soon replaced by

Continued on page 5

Pittsburgh will be the backdrop for "Major Gift Planning I" on July 20-21. Plan ahead for this excellent summer training opportunity. See page 7 for more information on the Sharpe seminars.

Inside

In the News . . .

News and notes of interest to gift planners.

Giving to medical causes sees healthy increase

Wealthy donors who have had a personal brush with serious illness are reportedly rethinking how to best use their fortunes. Many wealthy donors are now making large gifts to health causes as a result of their own life-threatening illnesses. Some donors "quietly admit that they hope to buy a little more time for themselves and their kin by underwriting scientists whose advances might translate into greater personal longevity."

Regardless of the reasons behind the gifts, private donations to health-related causes have increased 40% since 1991, making this the fastest-growing sector of giving. Donations to healthcare totaled $13.9 billion in 1996.

Source: *The Wall Street Journal,* January 6, 1998

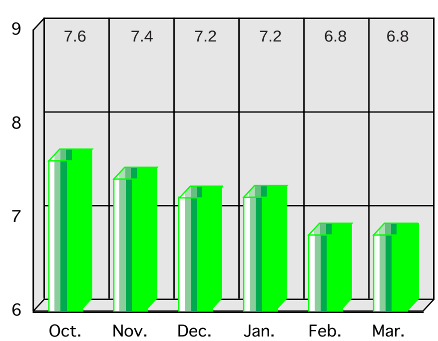
"High-profile" donor makes unusual request

When millionaire Evelyn Davis made a $100,000 gift to Duke University, there were strings attached—not only did she want a plaque bearing her name placed on campus, but the plaque must be kept polished and in a prominent spot. The unusual stipulation associated with Ms. Davis's gift is one to which Duke, as well as other recipients such as Northwestern and Penn State, has agreed.

Owner of stock in more than 110 companies and editor and publisher of a corporate business newsletter since 1965, Ms. Davis said, "I'm a high-profile person, and I want high-profile plaques." To make sure her plaque at Duke measures up to her standards, Ms. Davis plans to drop in for unannounced visits. And after her death, Ms. Davis has arranged for her executor to check up annually on all of her plaques to assure that they are shiny and visible.

Source: *The Chronicle of Higher Education,* January 23, 1998

Discount Rates



The trend in adjusted federal mid-term rates (AFMRs), which are used in calculating the benefits of split-interest gifts.

Charitable deductions increased in 1995

According to Internal Revenue Service statistics, the total amount claimed on tax returns for charitable deductions rose 6.3% to $75 billion in 1995, up from $70.5 billion in 1994.

The average charitable deduction contribution claimed per return rose from $2,363 in 1994 to $2,455 in 1995. Ten years before in 1985, the average charitable contribution deduction per return was $1,326.

The number of persons who itemized their charitable contributions increased 2.3% from 29.8 million to 30.5 million. This increase, combined with a 4% increase in the average amount deducted, resulted in the total increase of 6% in itemized contributions. This information underscores the importance of reminding donors to make gifts before year-end in order to qualify for full tax benefits this year. G&T

Source: *The Chronicle of Philanthropy,* January 29, 1998

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Can You Pass a Charitable Bequest Quiz?

Check yourself to see how much you know about charitable bequests.

How much do you know about charitable bequests? Test your knowledge of bequests with the following quiz:

☐ True ☐ False **1. Donors receive income tax benefits when they make a charitable bequest provision.**

FALSE. Because bequests are revocable until death, no income tax benefits are available at the time they are made. For this reason, bequest development programs need not be affected by "flat tax" and other income tax reform proposals.

☐ True ☐ False **2. Donors enjoy increased income following the decision to make a bequest by will.**

FALSE. When a donor makes a provision in his or her will, no property changes hands and no changes are made in the way the donor's assets are invested. There is thus no effect on the current income flow to the donor.

☐ True ☐ False **3. Most charitable bequest donors are wealthy persons who are acting out of a desire to reduce or eliminate estate taxes.**

FALSE. Recent IRS studies show that of some 2,400,000 people who die each year, only about 60,000, or 2.5%, die with estates of $600,000 or more which require the filing of a federal estate tax return. Of this group approximately 19% use the charitable deduction. Thus, just over 11,000 wealthy persons per year die and make charitable gifts that have the effect of reducing the tax burden on their estate.

Publicly reported statistics on overall bequest giving would indicate that there are between 100,000 and 150,000 other charitable estates each year that are providing a very large portion of charitable bequest dollars. It appears, therefore, that 90% or more of charitable bequests and a large percentage of bequest dollars are realized from the estates of lower and middle income persons who are seeking to make their "gift of a lifetime" for motivations that are not driven in any way by estate tax planning considerations.

☐ True ☐ False **4. The typical bequest donor is seeking recognition and will notify a charitable beneficiary of a bequest in advance in order to assure that he or she is thanked, enjoys membership in a bequest recognition society, and is otherwise appropriately acknowledged.**

FALSE. Programs that track advance notifications of bequest intentions typically find that prior to active bequest development efforts, perhaps only one in ten bequest donors will notify charitable recipients in advance of a bequest. After a number of years of active communications efforts, this figure can sometimes be raised to as many as one in four or five. It is vitally important, however, to discover the relatively small percentage of persons who *will* notify charitable beneficiaries of their estates in advance, as these persons often prove to be both desirous and appreciative of efforts to thank and recognize them in appropriate ways.

☐ True ☐ False **5. Bequest dollars cannot really be influenced as they just come in "over the transom."**

FALSE. Virtually all organizations occasionally benefit from charitable bequests whether or not they have been actively encouraged. This can lead to the belief that this source of income is inevitable and cannot, in fact, be influenced. Nothing could be farther from the truth. In most cases, as noted above, the charitable bequest is motivated almost entirely by charitable intent. A certain number of very charitable persons among your constituency will decide to leave assets at death to an average of four to seven charitable interests. They will have typically given to many more organizations and institutions during their lifetime, but only a special few are singled out for what in many cases will be the "gift of a lifetime."

Continued on page 4

Quiz . . . *Continued from page 3*

Through systematic efforts, it is possible to dramatically increase the number of persons who decide to include your organization or institution in their will. In this respect, the process of encouraging charitable bequests is not unlike other types of fund-raising activity. Those entities that ask most often and most effectively enjoy the greatest success over time.

☐ True ☐ False **6. It usually takes many years to see results from proactive bequest development efforts.**

FALSE. Studies show that wills including charitable bequests are most often completed by persons in their mid to late 70s who execute their wills some three to five years prior to death on average. These funds can actually be influenced and received in a shorter period of time than the pledge payment periods allowed in some campaigns for current gifts.

Note on the graphs at left the number of years that passed from the time people finalized their wills until death. These statistics are based on bequests received by four organizations with entirely different missions.

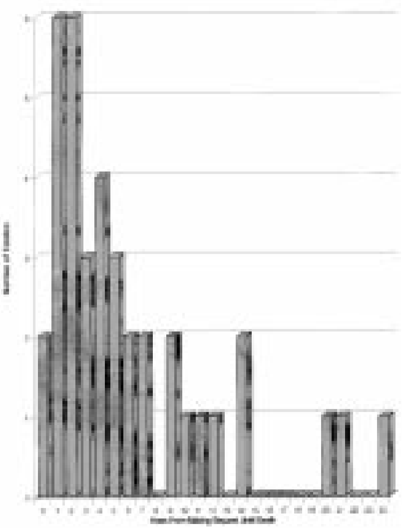
Because of the short period of time between the completion of wills and the receipt of bequests, it is possible to influence bequest income in a relatively short period of time, usually 2 to 5 years.

☐ True ☐ False **7. The most sophisticated planned giving programs realize most of their results from charitable trusts and other irrevocable plans while bequests are a relatively unimportant component in their programs.**

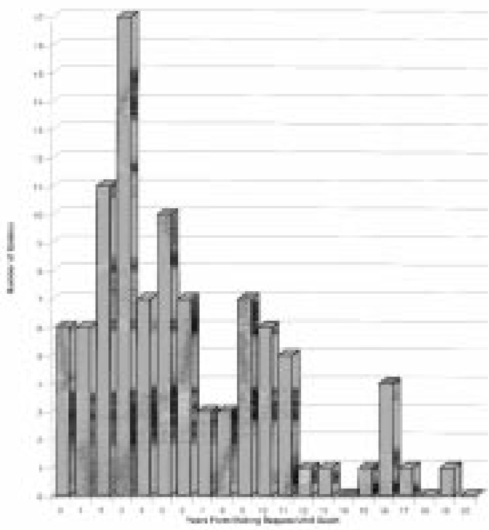
FALSE. It is rare for charitable bequests to comprise less than two-thirds of total planned gift receipts for even the most long-term, sophisticated programs. For many programs, bequests will consistently generate 90% or more of planned gift income.

If you would like more information on wills and bequests, please see page 6 or complete and return the card enclosed in this issue of *Give & Take.* G&T

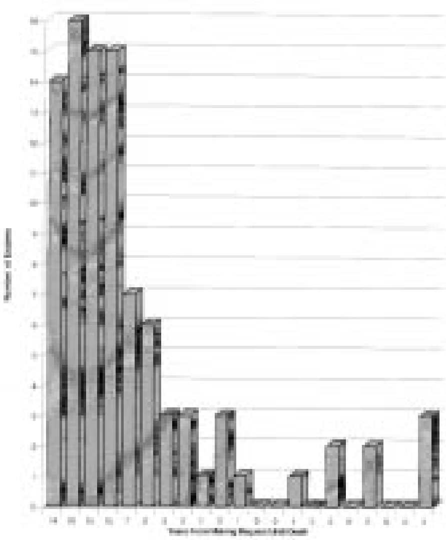
Organization A



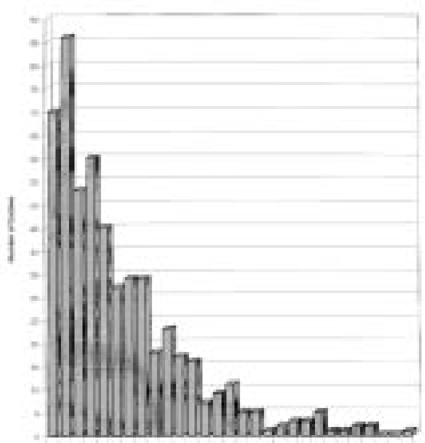
Organization B



Organization C



Organization D



Falling Mid-Term Rate . . .

Continued from page 1

disappointment as interest rates quickly climbed, leaving donors no longer able to achieve the same results that were available to the Onassis estate. At the time of Mrs. Onassis's death in 1994, the executors of her estate were able to select a favorable 6.4% federal mid-term rate for calculation purposes.

February brings "valentine" for gift planners

In February, 1998, the discount rate dropped to 6.8%, very close to the same percentage that was used in the Onassis lead trust example. And, the rate remains at 6.8% for March.

Interest rates could drop even lower in the coming months, which might mean that it's time to pull out lead trust proposals that may have been "on hold" pending lower interest rates.

Consider a marketing initiative

A major university recently presented the concept of charitable lead trusts to a group of 2,000 of its wealthiest alumni. A brief newsletter format was used featuring a story describing a lead trust that had been received by the university. A hypothetical example of a $1 million gift was used as part of the piece. Within two weeks the university received over 30 requests (1.5% response) for lead trust proposals. The gift planning staff is now engaged in the exciting process of working with those who responded.

Beware the effect on other plans

It is also important to note, however, that the falling discount rate can make certain charitable remainder trusts and gift annuities somewhat less attractive. As the discount rate drops, the amount of the charitable deduction for remainder-type gifts will fall as well. More important, there is also an increased possibility that trusts for relatively young beneficiaries may fail to pass the long-standing 5% probability test and/or the new 10% minimum remainder requirement included in the Taxpayer Relief Act of 1997. (See the chart above and www.rfsco.com for more information on these requirements.)

Annuity Trust Payout Rate With 6.8% AFMR

Couple Age	5%	6%	7%	8%	9%	10%
50	OK	OK	Fail/5	Fail/5	Fail/5/10	Fail5/10
55	OK	OK	OK	Fail/5	Fail/5	Fail5/10
60	OK	OK	OK	Fail/5	Fail/5	Fail/5
65	OK	OK	OK	Fail/5	Fail/5	Fail/5
70	OK	OK	OK	OK	Fail/5	Fail/5
75	OK	OK	OK	OK	Fail/5	Fail/5
80	OK	OK	OK	OK	OK	Fail/5
85	OK	OK	OK	OK	OK	OK

Fail=greater than 5% probability of corpus exhaustion (5) and/or remainder is less than 10% of value (10).

Conclusion

Whether discount rates continue to drop or rise in the future, keep in mind that donors will still be motivated to give out of generosity and belief in a cause. The manner in which they give can, however, be greatly affected by factors as mundane as changes in interest rates paid by the federal government. G&T

Barlow T. Mann is an attorney and chief operating officer of the Sharpe company. He designs planned giving programs for a number of America's nonprofits, presents seminars, and authors many articles on gift planning.

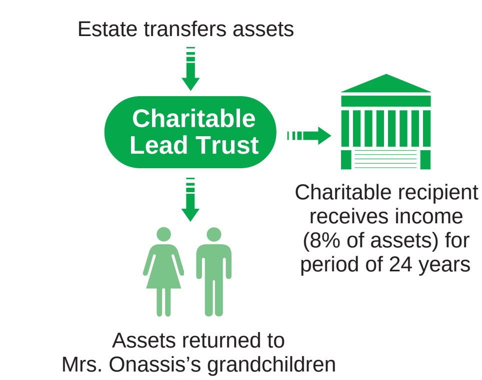
A Closer Look at the Onassis Lead Trust

When Jacqueline Kennedy Onassis died in 1994, a charitable lead trust known as The C & J Foundation was established in her will. The lead trust, which was scheduled to last 24 years, was named for her children, Caroline and John, using the generic term "foundation."

Although her children exercised their option not to fund the trust, each year the lead trust would have made gifts totaling a sum equal to 8% of the value of the assets used to fund the trust initially. At the end of 24 years, the remaining assets in the trust would have been distributed to Mrs. Onassis's grandchildren.

Mrs. Onassis's estate would have benefited greatly from a charitable estate tax deduction. Assuming quarterly payments from an 8% lead trust for 24 years and the 6.4% discount rate which was applicable to her estate, the estate tax deduction would have been 99.1% of any amounts contributed to the trust. G&T

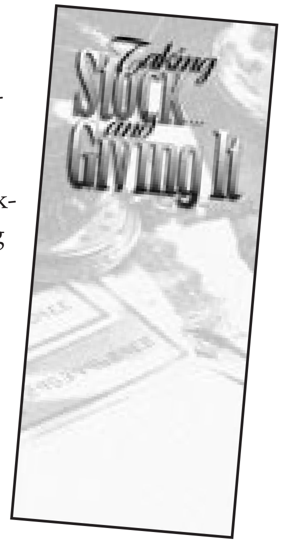
How the Onassis Trust Would Have Worked



Footnotes for Gift Planners

News and ideas about Robert F. Sharpe and Company's services and publications. For more information, join us on the Web at **www.rfsco.com**.

The stock market has been setting records again...



Making now the perfect time to inform your donors of the potential tax-saving benefits of stock gifts. With the booklet "Taking Stock...and Giving It," your donors will learn about how their gifts of appreciated securities can result in maximum tax benefits. Plus, this booklet shows donors how and why it is better to consider giving stocks that they have held for certain periods of time and how they may plan a "balanced sale" that results in a gift which completely offsets tax due on the portion of an investment that is sold. Plan now to provide "Taking Stock" to your higher-interest donors. This booklet may also be particularly helpful for professional advisors who may be assisting their clients with gifts of stock for the first time since the Taxpayer Relief Act of 1997.

Call 1-800-238-3253 for more information.

Updated publication serves as an organizer for donors

If you are searching for another way that your organization can assist donors with their planning, consider the newly designed "Personal Financial Affairs Record." Complete with an attractive full-color cover, this 5½" by 8½" publication contains 20 pages of user-friendly forms that help your donors organize and list important personal information, such as:

- The location of a will, trusts, and other estate planning documents.
- The whereabouts of life insurance policies, investment documents, and retirement account information.
- Funeral instructions.
- Charitable organizations and institutions that may be important to the donor.

With this publication, your donors can organize their personal and financial affairs in one easy-to-follow document. This can be especially helpful for loved ones as a guide to your donor's intentions.

You may want to consider sending the "Personal Financial Affairs Record" to your better donors and prospects, using the booklets as handouts at your next estate planning seminar, or leaving them with donors following personal visits. Your organization's name and other pertinent information may be overprinted on the back cover. Please call 1-800-238-3253 for more information.

Establishing a strong bequest program

Building an awareness about wills and bequests among your donors can lead to significant charitable gifts for your organization. With the estimated $11 trillion intergenerational transfer of wealth in upcoming years, it makes sense for gift planners to educate their donors now in order to reap benefits in the future.

Sharpe wills brochures can help you reach donors on a regular basis to promote planned gifts as part of their overall estate plans. Consider using these informative and motivational brochures:

- In bequest marketing mailings to a broad list of donors and potential donors.
- As enclosures with gift receipts.
- As handouts at seminars and during personal visits with donors.

If you would like to learn more about wills and bequests mailing programs, please fill out and return the enclosed card. G&T

Training Update

Major Gift Planning I - Options and Opportunities

In two concentrated, information-packed days, presenters Robert F. Sharpe, Jr., and Jonathan G. Tidd, Esq., discuss the most important facts gift planners need to know to successfully guide their organizations into the 21st century. By linking their knowledge and over 40 years of combined experience, Sharpe and Tidd lead participants through the most comprehensive training available.

Make sure you are prepared to meet your donors' needs in the future by attending this popular seminar. Registration is always limited to allow for more interaction between participants and instructors.

Major Gift Planning II

For the more experienced gift planner there is "Major Gift Planning II," which focuses on applying various planning tools to help donors meet multiple goals while making significant gifts. A working knowledge of various gift planning vehicles is assumed. Special emphasis is placed on the impact of recent tax legislation.

Instructors Robert F. Sharpe, Jr., and Jonathan G. Tidd, Esq., pay particular attention to the practical challenges facing today's fund gatherers.

Planned Giving When That's Not All You Do

If you're responsible for more than planned giving, this one-day seminar will help you focus your efforts. "Planned Giving When That's Not All You Do" is designed to broaden the knowledge of gift planning throughout your organization, from your CEO or president to the support staff who may be first on the phone with donors. Your co-workers will become some of your best planned giving advocates once they understand its benefits for your donors and your institution. G&T

Seminar Training Dates

Major Gift Planning I

Pittsburgh
July 20-21

Major Gift Planning II

San Francisco
June 1-2

Tampa
June 11-12

Chicago
August 3-4

Planned Giving When That's Not All You Do

San Francisco
June 3

Multiple registration discounts are available.
For more information or to register, please contact the Sharpe company.
Call 1-800-238-3253, ext. 360 • Fax (901) 761-4268
Web site www.rfsco.com • E-mail seminars@rfsco.com

A Bucket of 'Tiers'

In IRS Notice 98-20, the U. S. Treasury has provided guidelines for the treatment of long-term capital gain (LTCG) income contained in distributions from qualified charitable remainder trusts (CRTs) under the "four-tier" distribution system provided under IRS Section 664(b).

Continuing what has been described by some as the "worst in, first out" approach, the IRS provides that all gain that would be taxed at 28% will be deemed to be distributed first, followed by any amounts that would be taxed at 25%, and finally any gain that would be taxed at the 20% tax rate.

In a sense, therefore, the Notice announces that the four-tier system has, for practical purposes, been expanded to a six-tier approach, with the addition of the two new "subtiers" of capital gain income.

In a surprise move that may be beneficial to some CRT beneficiaries, and will be welcome news to trust administrators, all pre-1997 LTCG will be treated as 20% gain, regardless of whether it would have been subject to a higher tax rate at the time the gain was realized.

For complete text of IRS Notice 98-20 along with an analysis of the overall impact of the Taxpayer Relief Act of 1997, visit our Web site at www.rfsco.com. Special attention will also be given to the effect of this Notice in "Major Gift Planning II" (see dates above). G&T