The Other Five of the Top Ten Lessons Learned from the Front Lines of Client Services

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In March, we published our article ***Five of the Top Ten Lessons Learned from the Front Lines of Client Services***, in which we listed five examples of important lessons learned over PG Calc's 37 years in business. Here's a brief recap of what we discussed:

1. CGAs and other life income gift arrangements are split-interest gifts – part gift and part investment;
2. The value of the non-charitable portion is as important as the amount of the charitable deduction;
3. CGAs are expected to lose money; charities do well to receive remainders above 50% of original gift amounts;
4. Changes in the IRS discount rate can have significant effects on charitable deductions in some cases; and
5. Life income donors don't escape capital gains, but they can reduce the amount of tax and spread it over many years.

Now we get to address another five lessons. Of course, these are arbitrary choices on our part. It is difficult to narrow down all our collective experiences into just ten items, but we thought that understanding these other five examples would be helpful.

6. **Confusion between using IRAs to fund charitable gifts.**

In recent years, there has been a lot of confusion about if and how charitable split-interest gifts can be made using funds from IRAs (or other traditional qualified retirement plans). Much of the confusion has stemmed from the so-called "IRA Rollover" or

“Charitable IRA Rollover,” the correct name for which is the Qualified Charitable Distribution (“QCD”). The QCD originated in the Philanthropy Protection Act of 2006, and after several years of limited extensions, this special tax provision was made permanent. It allows owners of traditional IRAs who are 70 ½ years or older to transfer up to $100,000 in each calendar year directly to a qualified charity. The amount does not yield a charitable income tax deduction for the donor, but it is excluded from the donor’s taxable income that would normally come from a distribution from one’s IRA. From all reports, it appears that the QCD has resulted in enormous amounts of transfers from IRAs to the charitable arena.

One of the most common questions about the QCD is whether or not the transfer can be used to establish a life income gift arrangement, and the answer is NO. The tax rules specifically require the transfer to function as a direct and complete outright gift to charity; there can be no split-interest provisions applied to the transfer.

This sometimes leads to another question – whether or not there can be ANY split interest gifts funded with IRA money, and the answer to that question is YES. Owners of IRAs – and other qualified retirement plans as well – may take regular distributions from their retirement accounts and use the money to establish gift annuities and charitable remainder trusts. We even published an article on this subject a few years ago, **www.pgcalc.com/support/knowledge-base/pg-calc-featured-articles/gifts-from-iras**, but the results may not be what the donor expects or wants.

We will talk more about IRAs and charitable gifts in our webinar in June, which will be based on all ten of these: “The Top Ten Lessons Learned from the Front Lines.”

7. **Beware gifts of real estate!**

Who doesn’t love the idea of receiving a gift of real estate from a generous donor? They usually involve larger amounts than cash or appreciated securities, and in some cases, the property is sold almost as quickly as it is received by the charity. But real estate by its very nature can be complicated and troublesome. Just the environmental review required by a charity nowadays can be enough to kill the deal. Once the environmental review is completed successfully, the actual transfer needs to happen, which can be cumbersome. And once the charity has assumed complete ownership and control of the property, it will need to move as quickly as possible to liquidate the property. There are always risks involved in owning real estate, such as natural disasters, fires, and flooding. And if the property is held for a significant amount of time, the charity runs the risk of declining market value.

The gift of real estate as an outright gift is tricky enough, but real estate in conjunction with a split-interest gift arrangement raises the charity's risk to a whole new level. If a gift annuity is funded with real estate (many charities won't even consider it), the charity alone bears the brunt of any damage or loss of value to the property. The gift annuity will be based on the appraised value on the official date of transfer, but the sales proceeds might be dramatically lower. Remember that disposing of real estate will involve – at a minimum – a combination of fees that can easily exceed 5% or more of the total value.

There are also many examples of charitable remainder trusts being funded with real estate. In particular, there are many examples of the so-called "Flip CRUT," which starts as a net income trust and converts to a standard unitrust with an event such as the property being sold. Situations involving real estate funding a CRT can raise serious questions about who is going to serve as trustee, both initially, and after the property is sold.

In addition, we see a number of Retained Life Estates, whereby the donor transfers the property to the charity but reserves the right to live in the home for the rest of his or her life. That brings up all kinds of additional issues, because the charity must hold the property for many years – perhaps even decades. We warn to "beware," not necessarily to run away, since for many donors their real estate is their greatest asset. There's much more to cover on this subject, and we'll talk more about gifts of real estate in our June webinar.

8. **The three critical CRT questions.**

The possibility of a new charitable remainder trust can be appealing to planned giving officers; they tend to be for larger amounts than CGAs, and they take the risk of the payment obligation away from the charity. For many charities the remainders from CRTs far outweigh those from CGAs, no matter how many CGAs they have. But there are certain keys aspects of CRTs that can render any speculative conversation moot. Here are the three questions a gift officer should raise when a donor proposes establishing a CRT:

A) Who will serve as trustee of the CRT? The charitable remainder trust is established by the donor with the assistance of legal counsel. The charity does not create the trust and should not substitute as legal counsel for the donor. Some larger organizations will serve as trustee, but what does the donor do if that is not an option?
B) Who will manage the assets of the trust? The practice of managing the investments in a charitable remainder trust is not necessarily the most advanced

form of investing, but it should not be attempted by asset managers who are unfamiliar with the particular nuances of CRTs.

C) Who will handle the administrative tasks? This part is the least glamorous and potentially the most challenging aspect of a CRT. Somebody – or some entity – needs to handle the overall accounting for the trust; they need to make payments to the beneficiary, produce timely reports on the assets and activities in the trust, and handle all tax reporting requirements.

These three questions are critically important and must be answered before any serious discussion takes place.

9. **Nobody ever dies on schedule.**

Let's get one thing settled before we go any further: *Nobody ever dies on schedule*. To put it more accurately, no one ever dies precisely at the specific point in time representing the average life span for all persons who are the same age. The real issue here is mortality tables and how they affect so much of what we do in planned giving. Let's take the simplest example: suppose a donor contacts her favorite charity and says she is going to leave $100,000 to the organization upon her death. Of course, the gift officer sends a nice letter thanking her for her generosity and assuring her that the gift will be formally recognized when it is received, but how is the business office going to record that gift?

For starters, the business office probably isn't going to record anything until the death occurs and the money is received. But the development side wants to record something for the future gift. That gets us into the question of when the gift will be received. We don't know exactly when this donor is going to pass, so we must attempt to estimate something. When it comes to life spans, we must resort to so-called mortality tables. There are all kinds of them out there, but in planned giving, we typically deal with only a handful. We could look at a mortality table produced by the federal government, based on census data; the data in the 2000CM table predict that a typical 72-year-old person will live 12.9 additional years. Please note: we are beginning the process of transitioning to a new mortality table from the federal government; see more details about the 2010CM mortality table here.

But wait – if we use a different table – the 2012 IAR table, which is produced by the insurance industry – the average life expectancy for a 72-year-old female is 19.6 additional years. That's a huge difference! When we take the future amount of $100,000 and discount it to present value using the current 3% IRS discount rate, we get a present value of $69,744 based on the 2000CM table, and $57,673 based on the 2012 IAR table. So, which one do we use? Which one is correct? More importantly, *is there ever really a* *correct amount?* Plus, as every good planned giving officer knows, as soon as a donor enters into a life income arrangement with at least one charity, his or her life expectancy goes up by three years!

10. **Hey, I've got a lead trust that's about ready to close!**

If we had a dime for every time we've heard that, we'd have a bunch of dimes! In all seriousness, we're not saying that this lesson is any more important than the other nine we've discussed, but this one seems like the right one to end on. The possibility of a significant Charitable Lead Trust can send anyone working in development into a downright frenzy. They are almost always for large amounts, and the payments to charity start right away – within the next 12 months. The prospect of a donor setting up such a trust – remitting payments of six-figure amounts – or even seven-figure amounts – to one's charity each year for 10 or 20 years is enough to get anyone excited.

While it's great to get excited about this highly unusual opportunity, the reality is that lead trust discussions rarely turn into something concrete. Most often, we see a donor coming to the charity to discuss the *possibility* of a lead trust. The gift officer provides information that will be helpful in the donor's determination of whether or not to create the trust, and the gift officer will prepare calculations in an attempt to quantify the charitable and non-charitable benefits. In most cases, the donor will thank the gift officer and go on their way – and the subject of the lead trust will never come up again.

On rare occasions, the donor will come back to the gift officer after a period of time and request updated information to share with family and advisors. But again, in most cases, that is the end of the discussion with the donor. Out of the very small number of lead trusts that actually get created, the charities are almost never involved in the actual execution of the trust. Donors with significant wealth almost always collaborate with their own advisors to bring the trusts to fruition, and charities will only hear back if they are named as beneficiaries. The chances for success are probably one in 100 – rather like winning the lottery, but the concept is titillating!

In summary, these are the other five of the top ten lessons in our somewhat arbitrary collection of case studies. We hope that these examples will help you better understand some of the dynamics in planned giving that are unspoken but that silently govern many of the relevant discussions.

We hope you can join us on June 30 for our webinar. "The Top Ten Lessons Learned from the Front Lines."