How To Survive the Wealth Transfer

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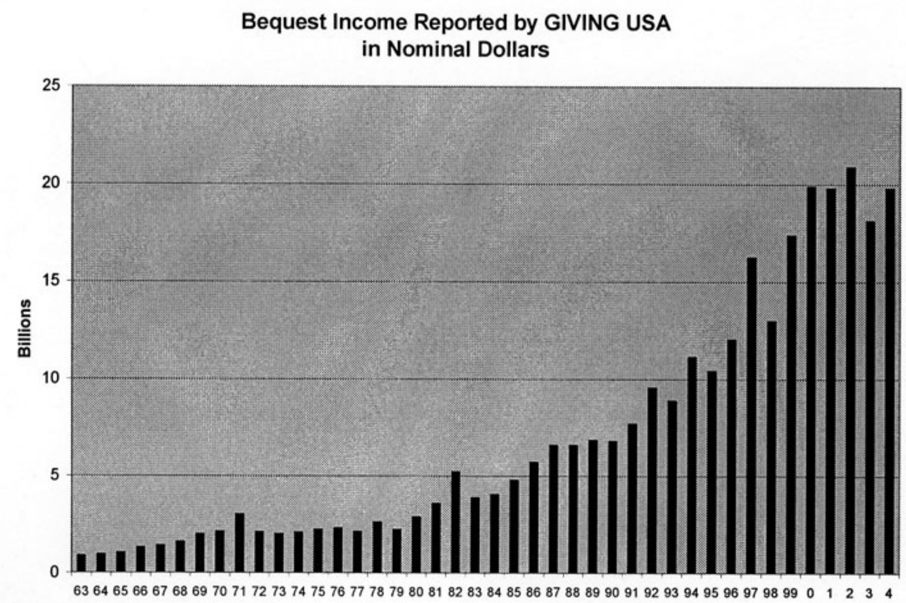
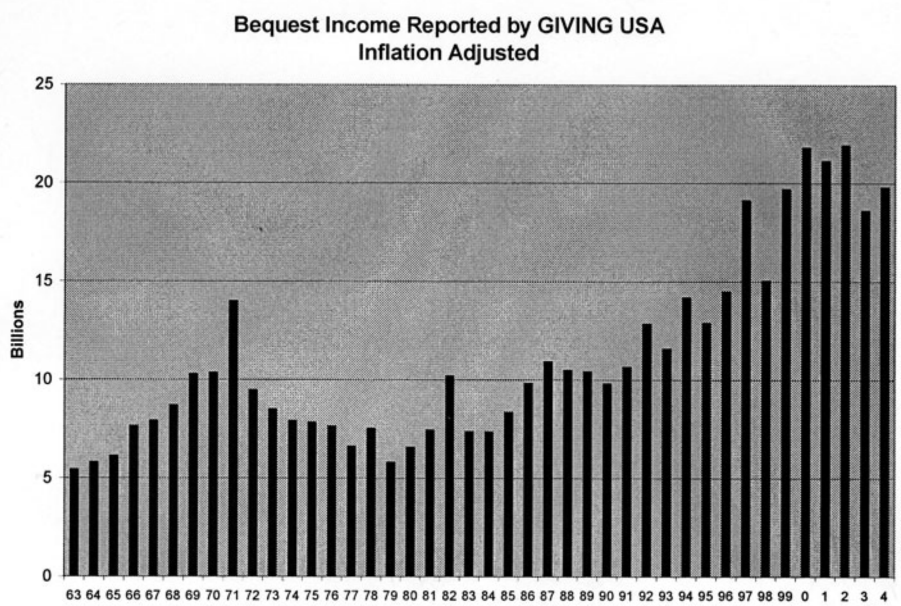
I. Introduction.

A. The much anticipated Intergenerational Wealth Transfer is underway.

1. Charities have been told that there will be a tremendous windfall in the form of bequests and other planned gifts.

2. Giving USA reports that, even after adjusting for inflation, charitable bequests more than doubled between 1990 and 1999.





3. Recent growth trends have slowed with bequest income in 2004 less than in 1999. We may or may not be entering a period such as the one we experienced in the wake of the 1969 Tax Reform Act.

4. But a renewed growth spurt last year was a major factor in increased giving overall.

   a. According to Giving USA report released in May, 2005, giving by living individuals was up 4% in 2004 while bequests were up 9%.

   b. The Council for Aid to Education (CAE) released similar findings based on a survey of a large number of America's educational institutions. Giving to higher education by individuals would have been down in 2004 were it not for a 10.1% increase in bequests.

All Giving To Higher Education by Individuals

2003	$9,409,000,000
2004	$9,607,000,000
Increase	$198,000,000
Percent Increase	2.1%

Giving To Higher Education By Bequests

2003	$2,225,000,000
2004	$2,450,000,000
Increase	$225,000,000
Percent Increase	10.1%

Giving By Individuals Other Than Bequests

2003	$7,184,000,000
2004	$7,157,000,000
Decrease	($27,000,000)
Percent Decrease	-0.4%

B. The wealth transfer is a real phenomenon and charities have definitely benefited already and will further benefit in the future.

   1. Charities will reportedly receive $6 trillion.

   2. It is important to note that the estimated amounts charities will receive are projected to be realized over a fifty year period.

3. The next decade will be a critical one for charities.

    a. Those who understand the dynamics of the wealth transfer will continue to succeed.

    b. Others may be disappointed.

C. Four primary areas of challenge.

1. Economics.

2. Politics.

3. Demographics.

4. Increased competition for bequests and other planned gift dollars.

II. Economic Conditions and the Wealth Transfer.

A. Some have raised concerns that economic conditions in recent years may have had an impact on the size of the wealth transfer.

1. Reduction in equity market values has reportedly reduced the size of many larger residuary estates. Older persons may not have participated in the recovery to the extent of younger persons due to reluctance to stay in equity markets.

2. Studies have shown that some programs saw a sharp reduction in larger residuary estates in 2003, with some recovering in 2004.

3. Lower interest rates have resulted in older persons of moderate means taking steps to annuitize their assets in order to produce more spendable income. This has led to increased interest in charitable gift annuities as well as commercial products that pay higher rates for the same amount exchanged for an annuity.

4. Rising medical costs and other economic factors may have also had an impact.

B. In January 2003, Paul Schervish and John Havens reported that despite downturns in equity markets and other economic conditions, the wealth transfer they predicted was still valid.

"Following a thorough review of our 1999 report "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy," we conclude in our new report "Why the $41 Trillion Wealth Transfer Estimate is Still Valid: A Review of Challenges and Questions," that its projections have not been significantly affected by recent and prevailing economic conditions."

Source: Boston College Center on Wealth and Philanthropy
See **http://www.bc.edu/research/swri/features/wealth/**

III. The National Political Climate And The Wealth Transfer.

A. Some have predicted dire consequences for bequests and other planned gifts if the estate tax is eliminated or drastically reduced as some have proposed.

1. A July, 2004 Congressional Budget Office report predicted a repeal in the estate tax would decrease bequests by up to 28%. Note that there was a prediction of up to 14% decline when the $2 million per person exemption goes into effect in January of 2006.

Table 4.

Estimated Effects on Charitable Bequests in 2000 from Changes in the Estate Tax

Alternative Tax Law	Percentage Change
$2 Million Exemption	-8 to -14
3.5 Million Exemption	-8 to -15
Repeal of the Estate Tax	-16 to -28

Source: Congressional Budget Office.

Note: For each change in the exemption, the range represents a margin of error of plus or minus 3 percent; for repeal, plus or minus 6 percent.

Source: "The Estate Tax and Charitable Giving", Congressional Budget Office, July, 2004

2. The Independent Sector has predicted decreases of up to one-third in charitable bequests.

3. Others have dismissed these concerns, believing they are based on economic models that do not take into consideration the true motivations for charitable bequests.

4. Many charities report the vast majority of their bequests come from estates that are not currently subject to estate tax. One charity, for example, reported $95 million in bequests in 2004 from 2,700 bequests averaging $35,000 each.

5. The argument can be made that the wealthy decide how much they want their families to receive, pay the tax on that amount and leave the rest to charity – if they are charitably inclined. If not, they leave all their assets to their families and do what they can to reduce the taxes paid.

6. Schervish and Havens have concluded based on various studies that wealthy individuals may actually give more if the estate tax is eliminated. Note results of a study they conducted in 2000.

Estate Planning

Not surprisingly, nearly all (89%) of the respondents have a written estate plan. They by-and-large expect their assets to pass on to their heirs and to go for taxes, with a smaller portion going to charity. If they had their way, most would allocate more money to charity and less to taxes, though not all the wealth holders were in favor of eliminating estate taxes altogether.

Expected and desired distribution of estates

	Expected Distribution	*Desired Distribution*
Children and grandchildren	42%	58%
Other heirs	5%	6%
Taxes	37%	9%
Charity	16%	26%
Other	0%	1%

Source: ***Bankers Trust Private Banking*** *– "Wealth with Responsibility – Study 2000"*

7. Tax policy has combined with economic conditions to reduce the attractiveness of certain types of planned gifts.

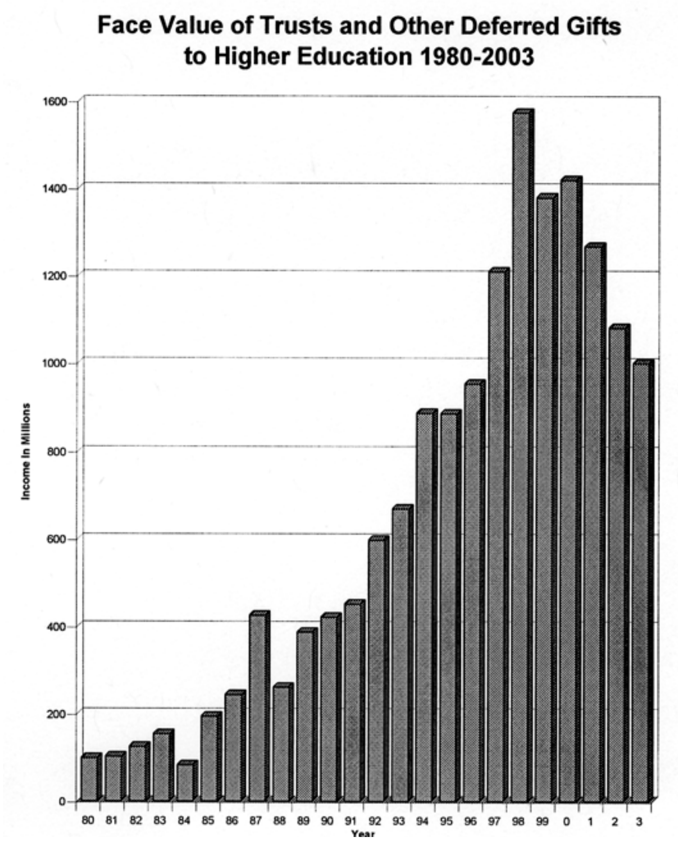
   a. Reductions of capital gains taxes in 1997 and 2000.

   b. Minimum deduction percentages for CRTs in 1997.

   c. Elimination of overfunding provisions for retirement plans in 1997.

   d. Diminished growth expectations and lower interest rates.

8. Note trends in planned gifts other than bequests to higher education in the wake of these and other changes. Figures are not available for 2004 because CAE no longer reports face value; only present value is now reported for trusts and other deferred gifts.



9. Proposed legislation would further reduce the benefits of gifts of appreciated property other than publicly traded securities.

B. Also in the political arena, the national debate over social programs serving the growing number of older Americans also has implications for charitable bequests and other planned gifts.

1. Reductions in social security benefits and/or the use of means testing may result in further erosion of the estates of middle class individuals.

2. Generous prescription drug programs may have an opposite and ultimately beneficial effect.

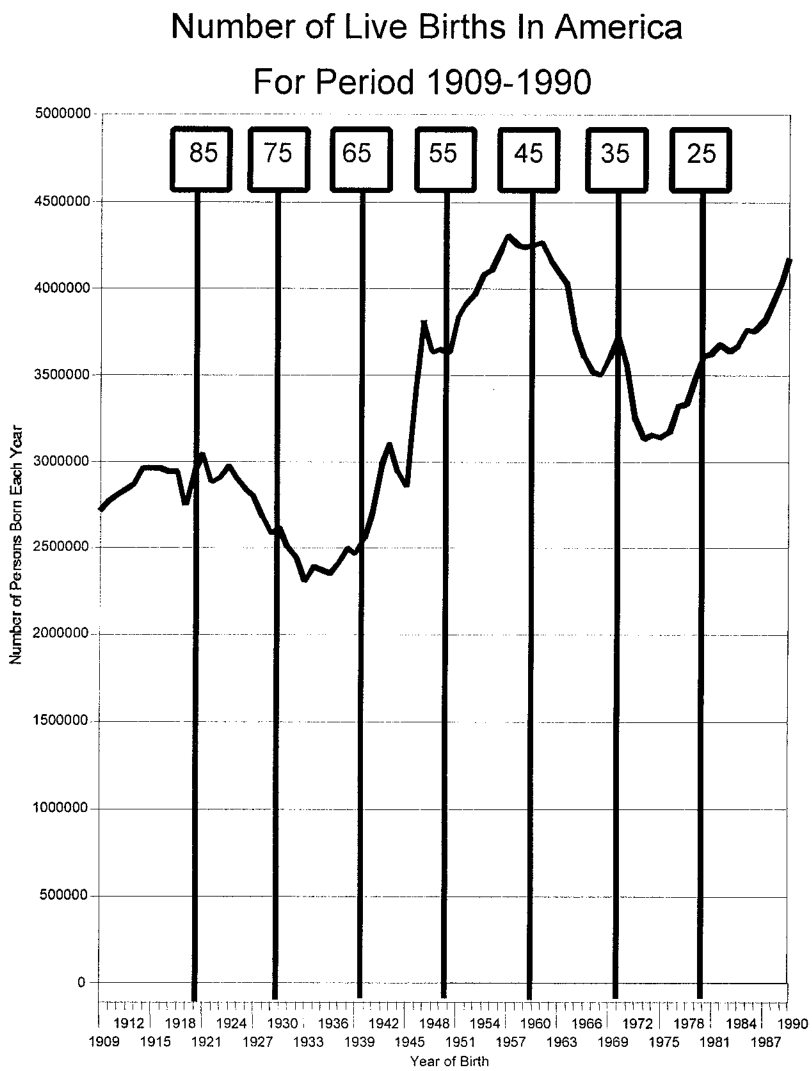
3. These issues can be expected to have the greatest impact on planned gifts from middle-income individuals.

4. The asset protection elements of gift annuities and other irrevocable planned gifts may ultimately take on greater importance than income and/or estate tax benefits.

IV. Demographic Trends Unfavorable to Wealth Transfer in Near Term.

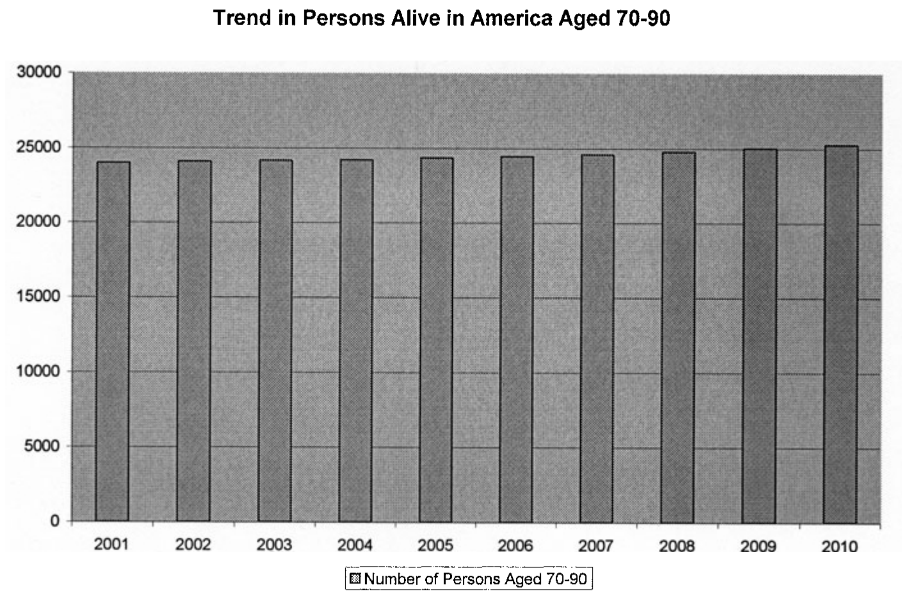
A. Many have been aware for a decade or more that demographic shifts might one day have an impact on bequest income.

1. Note birth trends in America in 20th century.

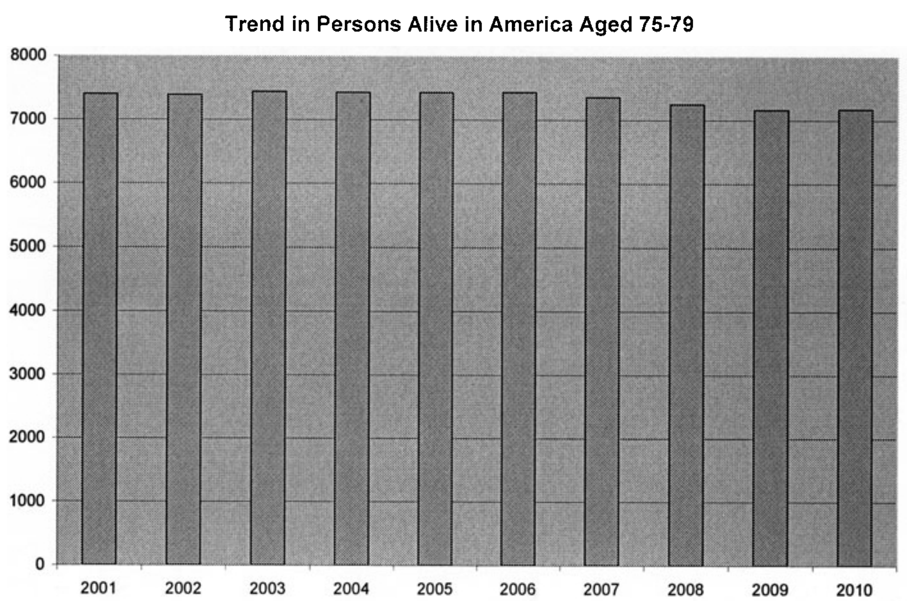


2. Lower infant mortality rates and longer life expectancy have served to lessen the impact of reduced birth rates in the first third of the 20th century.

a. Nevertheless for the first time in many years, there is no growth projected by the census bureau in the 70 to 90 age group that is critical to success in planned giving. *(see census.gov for additional information)*

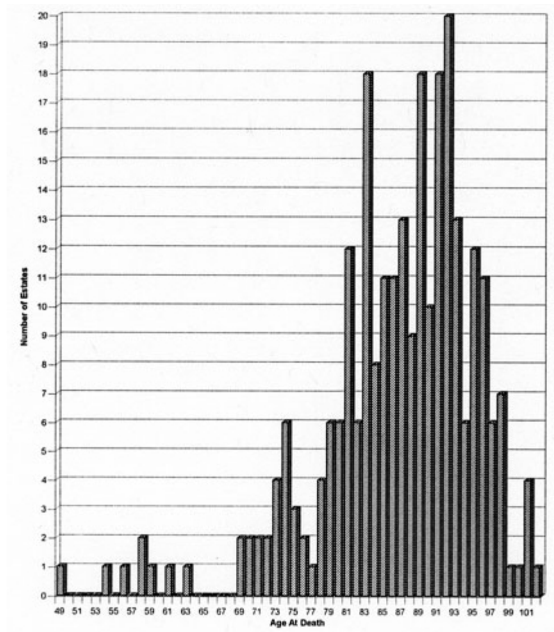


b. According to the American Council on Gift Annuities (ACGA), the average age of gift annuitants is just over 78. The number of persons in the 75 to 79 age range will actually be declining during the next five years.



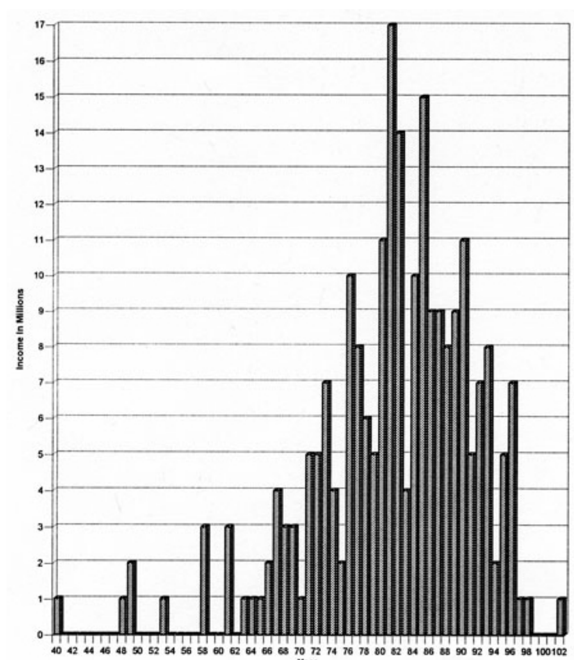
c. In the case of charitable bequests, numerous studies reveal that most persons who leave bequests to charity die in the 75-90 age range. Note the data from one of the top planned giving programs in America for over 300 estates.

Age At Death for Bequest Donors



d. Insofar as influencing these bequests, these same persons made their will that left funds to charity on average about five years prior to death.

Age At Will for Bequest Donors



e. These figures do not vary much from organization to organization.

	Type of Organization	Age At Will	Age At Last Gift	Age At Death
1	Educational	77	81	83
2	Educational	77		86
3	Educational	77	80	83
4	Educational	79	80	83
5	Environmental	79	77	81
6	Health/Advocacy	78	81	83
7	Health	80	82	86
8	Health	79	81	85
9	Health	79	82	85
10	Health	81	83	86
11	Political Action	77	79	82
12	Religious/Relief	81	86	86
Average		**78**	**81**	**84**

f. It will be ten years before there is renewed growth in the 80 and older age range.

V. Growth in Planned Gift Development Efforts.

A. There has been a large increase in for profit and nonprofit entities engaged in various aspects of planned gift development.

1. In 1986, there were approximately 13 planned giving councils with 400 members.

2. Today, there has been a nearly thirty-fold increase in membership to 11,000 members and ten-fold increase in councils to a total of 130.

B. During the same time the amount of planned gift income has tripled.

1. Until recently, most programs were experiencing at least moderate growth.

2. Over the past five years, there has been little or no growth in funds received from estates while during that time more and more organizations have entered the field.

3. Note that the American Council on Gift Annuities reported that the number of organizations issuing gift annuities has doubled over the past ten years and increased by one-third over the past five years.
See acga-web.org.

a. 1994 - 2,000 issuers

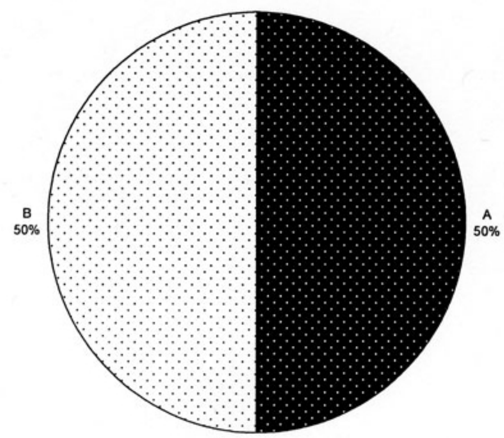
b. 1999 - 3,000 issuers

c. 2004 - 4,000 issuers

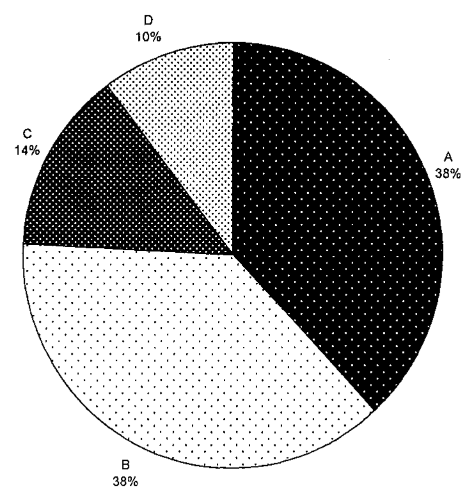
4. Recall that the number of persons in America in the key gift annuity age range of 75-85 is static or declining.

5. Note the following time line and chart the progress of organizations A & B.

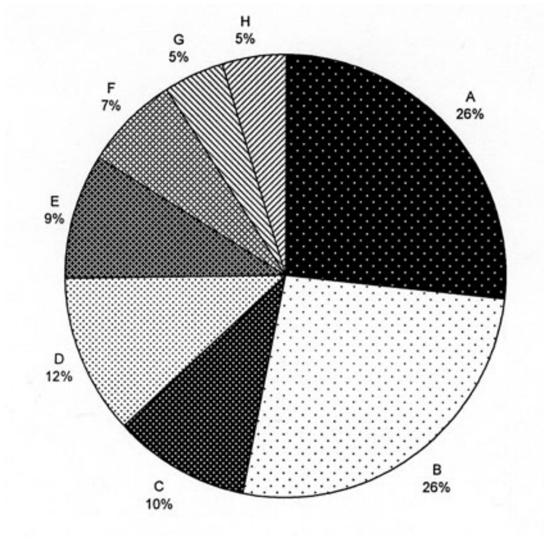
   a. In 1985 assume two organizations were splitting $4.7 billion in bequests.



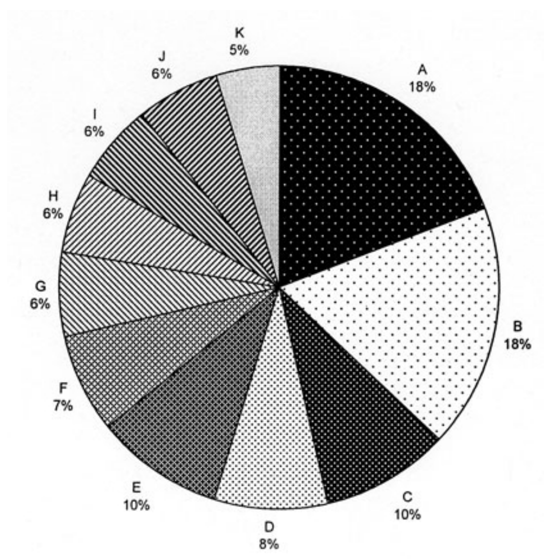
   b. By 1990, C & D enter the field when bequest income has grown 42% to $6.8 billion. A & B continue to grow while market share declines.



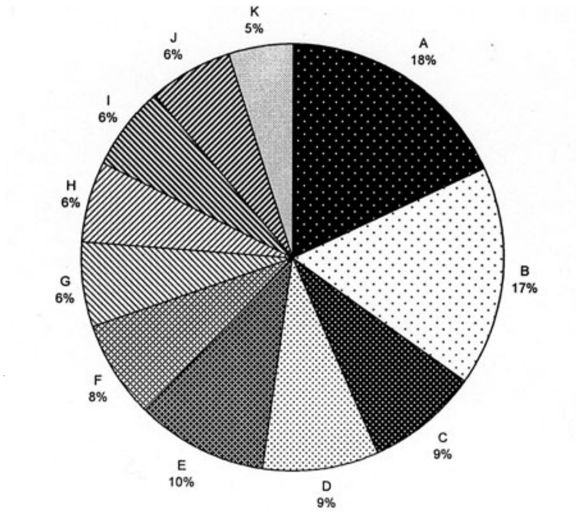
c. In 1995, bequests had grown 52% to $10.4 billion. A, B, C, & D are joined by other organizations. While shares are falling, absolute dollars continue to grow.



d. By the year 2000, rapid growth in bequests continues with 92% growth to $19.88 billion. Even the older, more mature programs continue to grow as new entries also grow.

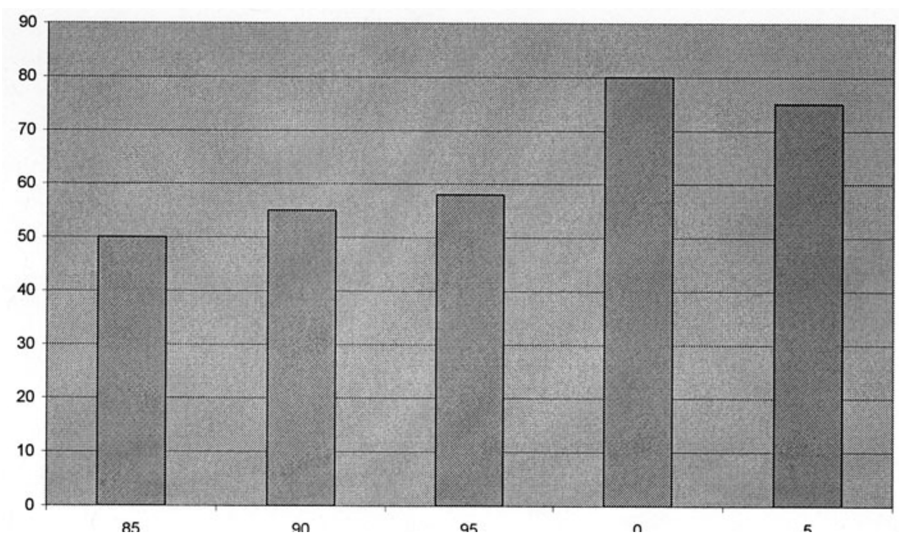


e. Over the past five years, however, bequest income has dropped by .4% to $19.8 billion. While many smaller programs continue to grow, the more mature programs have seen declines in some cases. It is entirely possible for planned giving revenue to continue to grow overall with most programs showing little or no growth.

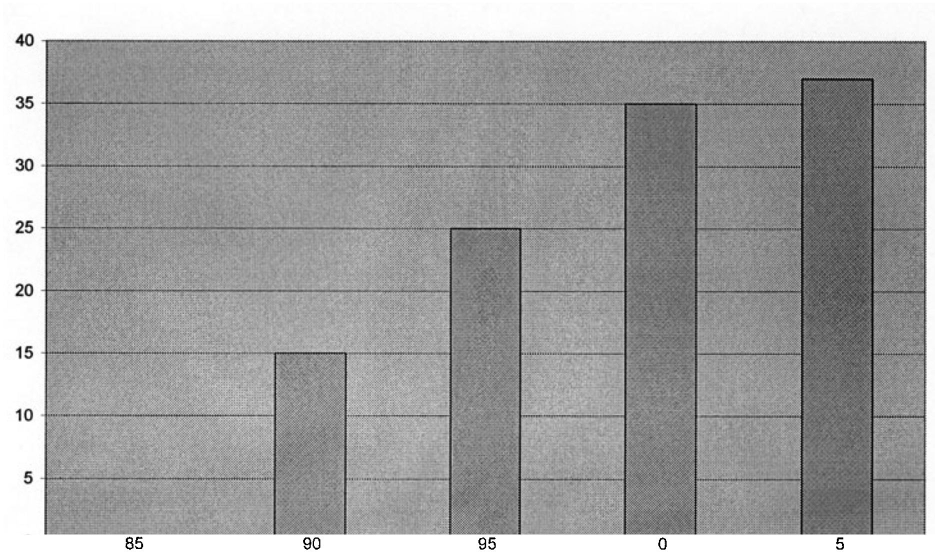


f. Here is what the picture looks like from the perspective of Organizations A & D.

Trend In Organization "A" Bequest Income



Trend In Organization "D" Bequest Income



VI. Suggested Action Steps to Succeed in Coming Years.

A. Some are experiencing continued growth in bequests and other planned gifts.

1. Double digit increases over the past decade.

2. This will continue for some.

B. Take steps to better nurture the age group that is the prime source of bequests and other planned gifts.

1. Acquire more donors in the appropriate age ranges if possible.

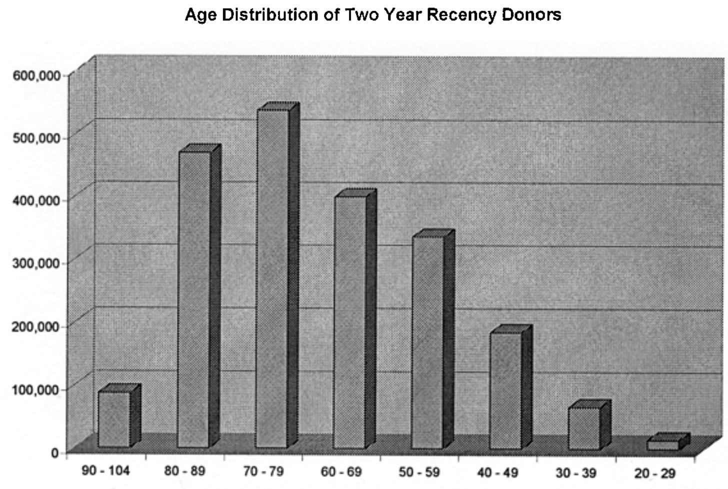
2. Retain the ones you have through improved acknowledgement and recognition efforts.

3. Emphasize bequests and gift annuities with this group.

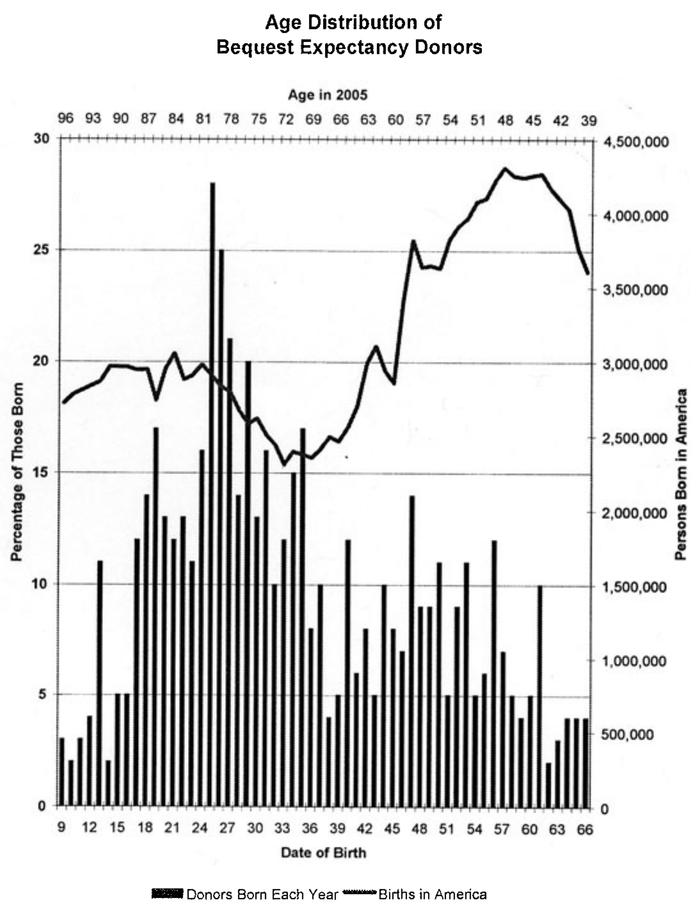
C. Do all possible to acquire and retain donors among the ranks of the "new old" in the 60+ age range, a smaller contingent for many. This will be the role of others on staff in most cases.

1. Early indications are that this group is not as generous as the generation that preceded them and the baby boomers who will follow them.

2. Note age distribution of donors by ten year segments to one organization.



3. But see the "hole" in the bequest expectancy group for those in their 60s.



4. The persons in this age group who are charitable have tremendous resources because of fewer numbers splitting a larger "pie."

D. Work with leading edge of baby boomers to encourage gifts that will come to fruition beginning in ten years to help plug the possible hole.

1. Oldest baby boomers are too young for "death gifts."

2. Bequest marketing is still appropriate to find those with greatest donative intent for outright gifts.

3. Build bridges to retirement with term of years trusts.

4. Encourage term-of-years trusts for other purposes, like funding education expenses.

5. Lifetime CRTs with assignment of income in near term.

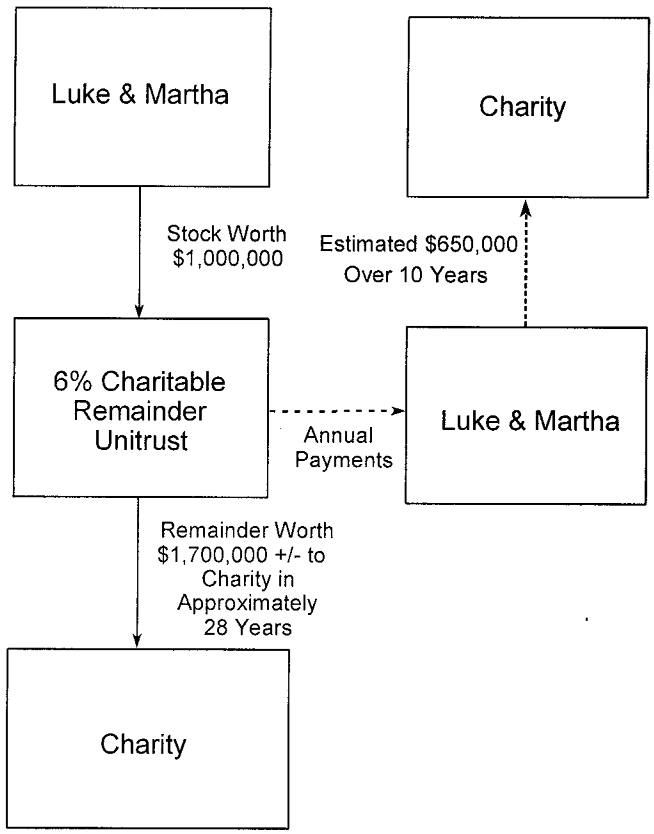
Example:

Luke and Martha, both age 60, have indicated their desire to make a lead gift to a capital gift development effort. They have been asked to make a gift of $1 million, payable over a five-year period. They are worth $15 million and the organization is counting on them to complete this gift.

After reading a planned giving newsletter from the organization announcing that planned gifts were being counted in the campaign and inviting them to visit the gift planning website, they did so. They were intrigued by the idea of funding a deferred gift annuity with $1 million worth of appreciated stock that paid no dividends. They call the planned giving office and express interest in a deferred gift annuity that would begin making payments of 9.5% per year to them for life beginning in ten years at age 70. Their charitable deduction would be $356,000.

The campaign leadership is not pleased with the prospect of this gift, that is not expected to terminate for 28 years (under today's life expectancies). They do not want to do the gift at all and are adamantly opposed to giving credit for $1 million toward the campaign goal even though their policies require this. The donor's advisors are also not pleased because they will no longer be able to manage the $1 million used to fund the deferred gift annuity.

The planned giving officer is asked to come up with a better solution that the donor might see as a compromise. After careful consideration, the planned giving officer suggested that the donors create a 6% charitable remainder unitrust. The donors' advisors believe they can earn over time 8% on the trust assets, the same as the institution is projecting for the return on its endowment.



The donors agree that they will make a pledge of the first ten years of income from the trust. This should result in an income flow to the organization of some $656,000. The donors will report this income each year and it will wash out as a charitable deduction. They have already indicated by their desire for a deferred gift annuity that they don't need the income from the assets for ten years in any event. No capital gains tax will be due at the time of the gift on the increased value of the assets used to fund the trust and they will be entitled to a charitable deduction of some $228,000 as a result of making the gift in this way.

Note that the payments that Luke and Martha will transfer to the charity will grow gradually over the years, along with the assets in the unitrust.

Principal	$	1,000,000						
Earnings	8%							
Payout %	6%							
Year		Principal	Earn		Growth	Pay		Payment
0	$	1,000,000	8.00%	$	80,000	6.00%	$	60,000
1	$	1,020,000	8.00%	$	81,600	6.00%	$	61,200
2	$	1,040,400	8.00%	$	83,232	6.00%	$	62,424
3	$	1,061,208	8.00%	$	84,897	6.00%	$	63,672
4	$	1,082,432	8.00%	$	86,595	6.00%	$	64,946
5	$	1,104,081	8.00%	$	88,326	6.00%	$	66,245
6	$	1,126,162	8.00%	$	90,093	6.00%	$	67,570
7	$	1,148,686	8.00%	$	91,895	6.00%	$	68,921
8	$	1,171,659	8.00%	$	93,733	6.00%	$	70,300
9	$	1,195,093	8.00%	$	95,607	6.00%	$	71,706
10	$	1,218,994	8.00%	$	97,520	6.00%	$	73,140

If the trust performs as anticipated, the donors will enjoy an income stream of some $1,670,000 over their remaining 18-year joint life expectancy when they begin to keep the payments at age 70. Note that the first year they would receive just under 10% of the $1 million amount originally used to fund the trust. That is more than the 9.5% the deferred gift annuity would have started paying at age 70 and there is potential for growth in their income over time.

11	$	1,243,374	8.00%	$	99,470	6.00%	$	74,602
12	$	1,268,242	8.00%	$	101,459	6.00%	$	76,095
13	$	1,293,607	8.00%	$	103,489	6.00%	$	77,616
14	$	1,319,479	8.00%	$	105,558	6.00%	$	79,169
15	$	1,345,868	8.00%	$	107,669	6.00%	$	80,752
16	$	1,372,786	8.00%	$	109,823	6.00%	$	82,367
17	$	1,400,241	8.00%	$	112,019	6.00%	$	84,014
18	$	1,428,246	8.00%	$	114,260	6.00%	$	85,695
19	$	1,456,811	8.00%	$	116,545	6.00%	$	87,409
20	$	1,485,947	8.00%	$	118,876	6.00%	$	89,157
21	$	1,515,666	8.00%	$	121,253	6.00%	$	90,940
22	$	1,545,980	8.00%	$	123,678	6.00%	$	92,759
23	$	1,576,899	8.00%	$	126,152	6.00%	$	94,614
24	$	1,608,437	8.00%	$	128,675	6.00%	$	96,506
25	$	1,640,606	8.00%	$	131,248	6.00%	$	98,436
26	$	1,673,418	8.00%	$	133,873	6.00%	$	100,405
27	$	1,706,886	8.00%	$	136,551	6.00%	$	102,413
28	$	1,741,024	8.00%	$	139,282	6.00%	$	104,461

At the death of the donors, the charity should receive $1,741,024. The campaign committee agrees to a value of this amount of $340,000, based on NCPG Valuation Standards with a negotiated discount rate of 6%. They agree to give full campaign credit for the $656,000 in cash payments over the first ten-year period. The donors are thus credited with a $1 million gift to the campaign.

At the end of the ten year period, the donors can decide to keep the income for the remainder of their lives or, as is likely to be the case, if they continue to not need the income, they could renew the pledge for some period of time, or they may decide to terminate the trust and let the charity have the funds earlier than anticipated.

In any event, the charitable remainder trust operates in much the same way as a lead trust for the first ten years, while the donors keep the option of enjoying the income for a period of time before an endowment is eventually funded.

6. Gift annuities for parents.

Example:

Mary and Bert, age 59 and 57, have recently sold their home for $650,000. They paid $250,000 for the home twenty years ago. After expenses they netted $350,000. This was at least $100,000 more than they ever expected to realize from the sale of their home. They are also pleased that in the wake of 1997 tax law changes they will owe no federal capital gains tax on the sale proceeds. The funds are now invested in relatively short-term, fixed income investments yielding 3%.

Bert's mother, age 87, has now exhausted her savings. Bert has been giving her on average about $800 a month from his after-tax income. He has been asked to make a gift of $50,000 to a charitable interest that is conducting an endowment campaign. He doesn't see how he can do both.

After consulting with representatives of the charity and his advisors, he decides to use a portion of the cash from the home sale to fund a $100,000 gift annuity that will pay his mother 10.2%, or $10,200. This amounts to $850 per month in spendable income for his mother.

The gift will result in a charitable income tax deduction of $54,000, saving him income taxes of about $18,000. The remaining $46,000 represents a taxable gift to his mother. He has not used any of his $1 million gift tax exemption amount so he will owe no gift tax.

If the charity earns 6% on the gift annuity funds for the six years his mother is expected to live, there will be approximately $65,000 remaining at the end of her life. The value of this amount discounted at 4% is $53,000. Under the gift crediting guidelines of the charity, Bert is offered and he accepts recognition for a gift of $50,000.

7. Lead trusts for wealthy to avoid gift taxes that may continue even after the estate tax is phased out.

E. Structuring gifts from the wealthy among the "young old" will require strong cooperation with major gift programs.

1. Cross training is key.

2. "Quality control" will be an issue.

F. Begin to prepare your leadership today.

1. Staff may have to work just as hard or harder and management may have to continue to commit budget in an era of little or no growth.

2. This will be happening at a time when major gifts and donor acquisition are booming as boomers become empty nesters. May be difficult to command necessary budget resources.

3. Many of the programs started in the past ten years may be cut back as a contraction takes place. Programs that may be vulnerable should begin to position for survival.

4. Many organizations are being encouraged to "outsource" their planned giving to financial services providers and consultants. In some cases that may make sense. In others it makes more sense to more fully integrate with other funding sources in order to protect continuity of relationships and quality of programs, etc.

VII. Conclusion.

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