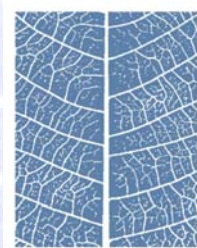


Arts & Business

The Maecenas Initiative:

A Review of Charitable Giving Vehicles and Their Use in the U. S. and Canada

October 2004



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Part 1

The Context for Individual Philanthropy in the United States, United Kingdom, and Canada

1. Introduction

- I.1 In March 2004, Arts & Business announced the launch of The Maecenas Initiative, a program whose aim is to increase individual philanthropic support of the arts in the U.K. The Maecenas Initiative is a project with three components: encouraging potential donors through stimulating discourse on arts philanthropy; improving the climate for individual giving by identifying successful models used in other countries to encourage individual giving to the arts; and developing education and training tools for professionals in small to mid-sized arts organisations that wish to increase their individual giving. In the spring of 2004, Arts & Business commissioned AEA Consulting to prepare a research report to constitute the second of these components.
- I.2 The objective of this study is primarily the creation of a practical glossary of charitable giving mechanisms – both the gift structures themselves, and the tactics that nonprofit arts organisations and professional fundraisers use to leverage them – that help to stimulate individual arts philanthropy in North America, particularly in the United States.
- I.3 Part One of the report outlines environmental conditions beneficial to individual arts philanthropy, including tax and legal frameworks, demographic, cultural and attitudinal factors, and aspects of arts organisations' fundraising infrastructure that either hinder or foster individual giving to the arts.
- I.4 Part Two of the report includes an actual glossary of charitable giving mechanisms that are used successfully by many charities in the U.S. The glossary defines each mechanism, outlines the benefits and caveats to both the donor and the recipient organisation, and indicates its relative popularity and applicability to both donors and charities. The glossary is presented in two formats, a narrative document and a Powerpoint presentation intended for easy reference and, potentially, as an educational tool.
- I.5 It is anticipated that this report will be complemented in the future by third part that will explore the applicability of these gift mechanisms to the United Kingdom, given the legal and tax frameworks, attitudes toward philanthropy, operating conditions of arts organisations, and fundraising practices and trends there. It will then suggest concrete strategies for navigating the change process at both the government level (adapting tax and legal structures) and organisational level (adapting fundraising infrastructure and practice). This third part of the research project will draw upon additional resources in the U.K., including primary research with U.K.-based arts fundraisers, policymakers and philanthropists.

- I.6 This report was prepared by Adrian Ellis, Elizabeth Casale and Uli Sailer of AEA Consulting. It is based upon extensive desk research into trends in general philanthropy and arts philanthropy in the United States, Canada and the U.K.; a web-based survey of members of the National Council on Planned Giving in the United States; and selected interviews with arts fundraisers in the U.S. and Canada.
- I.7 AEA Consulting extends its gratitude to the staff of Arts & Business, as well as to the staff and members of the National Planned Giving Council, Benjamin Margolis, and Linda Casale for their assistance in preparing this report.

2. The Rise of Private Philanthropy in Europe, Canada and the U.K.

Trends in Public Funding

- 2.1 Governments around the world, including in parts of Europe and Asia, as well as Canada and the United Kingdom, have implemented recently or are considering currently a variety of measures to encourage private support for social welfare and the arts, arenas that traditionally have been funded largely or exclusively by the state. These considerations are being driven largely by pressures on the public purse that began in the 1990s and stem from economic downturns, rising health and retirement costs, and an aging population and concomitant increased demand for services. France, Spain, Belgium, and Germany, for example, have all introduced legislation recently, mostly in the form of tax incentives, to stimulate private philanthropy, and all are relying more heavily on the nonprofit sector to fill gaps in the provision of services as they face declining public resources.
- 2.2 Even in the United States, which typically leads the world in terms of levels of philanthropic giving, individual giving continues to be stimulated at a federal level, as evidenced by former U.S. President George Bush's "Thousand Points of Light" campaign and recent passage of a Bill that extends tax deductibility for charitable gifts to taxpayers (typically in lower tax brackets) who do not itemize their returns. (It could be, and is sometimes argued, however, that these developments have been driven more by political and religious ideology rather than by an articulated, pragmatic response to a shifting long-term fiscal outlook.)
- 2.3 As public funding for social services decreases, the arts and cultural sector has reason to be particularly anxious. As government coffers shrink, demand for services rises and budget-cutting measures are implemented, the arts often suffer more severe reductions than other sectors. In the U.S., this scenario was played out in dramatic fashion to a worldwide audience recently when, in just one of many similar examples, the State of California moved to eliminate its entire arts budget and, along with it, the policy body that administers it. To policymakers who would cut arts funding first and furiously, the argument to do so is, notoriously, because arts and culture are seen as at best discretionary and at worst as a "luxury" for the elite. As the arts are not so critical to societal good as ensuring adequate health care, education and social security, the argument goes – and as the arts appeal largely to a well-heeled constituency – the sector can sustain more dramatic funding cutbacks, and perhaps *should* sustain them, to offset in part cuts in more critical areas.

- 2.4 While this controversial polemic – one that has taken root among many conservative U.S. policymakers who would eliminate not only state arts funding but federal arts funding as well – may not pick up steam in the U.K. and Canada, it is likely nonetheless that the trend to rely more on private funding for social welfare and the arts will continue.

Demographic Trends

- 2.5 In addition to the changing public funding landscape, demographic trends in the industrialised world such as increasing prosperity, age and an impending intergenerational wealth transfer are sparking interest in expanding fundraising in the U.K., Canada and Europe, as, it is hoped, the combination of an aging, wealthier population with estate planning needs will lead to more charitable giving, both in the form of outright and planned gifts.
- 2.6 The growth in the number of the wealthy, and the disproportionate contribution they make to the coffers of nonprofits, is generating increased interest in individual philanthropy. In the U.S. in 1997, for example, just 4.9% of households with a net worth of \$1 million or more accounted for fully 42% of all donations to charitable organisations. In terms of bequests, this concentration is even more marked, and explains the increased attention nonprofits are paying to developing planned giving programs: 58% of the value of all bequests in 1997 came from just 0.4% of the population with estates worth \$20 million or more. It is also interesting to note that in general, as the size of the estate rises, the proportion going to heirs shrinks and the share left to charity increases.¹

¹ Havens, John and Schervish, Paul. 2003. "Why the \$41 Trillion Wealth Transfer is Still Valid: A Review of Challenges and Questions." *The Journal of Gift Planning*. Vol. 7/1. January 2003. pp. 47-50.

- 2.7 Another factor driving redoubled attention to individual giving – and, in particular, planned giving – is the imminent intergenerational wealth transfer, one that has been spoken of mythically for more than ten years now. As has often been noted, the coming transfer of wealth between generations is expected to be the largest in history, as years of accumulated wealth in both Europe and the United States changes hands with the dying off of the post-War generation. This transfer which, according to a variety of estimates, is likely to have begun somewhere around 1998 and will continue to around 2050, has been projected at anywhere from \$41 trillion and \$136 trillion. Even the bottom end is a figure that is equal to four times the present size of the entire American economy and almost as large as the entire world's wealth today.² This impending transfer relates to philanthropy insofar as donors may seek to reduce the potential estate tax burden on their heirs, as well as to avoid leaving their entire estate to their heirs.³
- 2.8 Perhaps the most significant demographic factor underlying the case for increased philanthropy, however, is the fact of an aging population, which all industrialized countries are recognizing and planning for. Increases in longevity, fuelled by advances in health care, combined with declines in fertility rates are causing a pronounced shift in the age distribution worldwide away from the young and toward the elderly. In 2000, 6.9% of the world's population, or 420 million people, were aged 65 and over; by 2050, the 65+ population is expected to grow to nearly 1.5 billion people. In more developed regions, the 2000 median age of 37.4 years is expected to grow to 46.4 years, and the median age in Europe is projected to be even higher, almost 53 years. A disconcerting corollary is that between 2000 and 2050, the ratio of elderly persons to working age persons (aged 15-64) will double in more developed regions and *triple* in less developed regions. The implications of such accelerated aging are profound: by 2050, 60% of Europe's citizens could be in retirement, collecting state-funded pensions.⁴
- 2.9 As this aging population and accompanying growth in demand for health and social services is starting to stretch the capacity of the welfare state, the state is looking to nonprofit organisations to fill gaps in provision. However, these trends present a paradox for the nonprofit sector, as demand for their services is rising – requiring increased financial capacity – just as state support for their services is decreasing.

² Havens and Schervish, 2003: 11

³ American billionaire investor Warren Buffett is a high-profile example of one who has stated explicitly his intention not to leave large sums to his children.

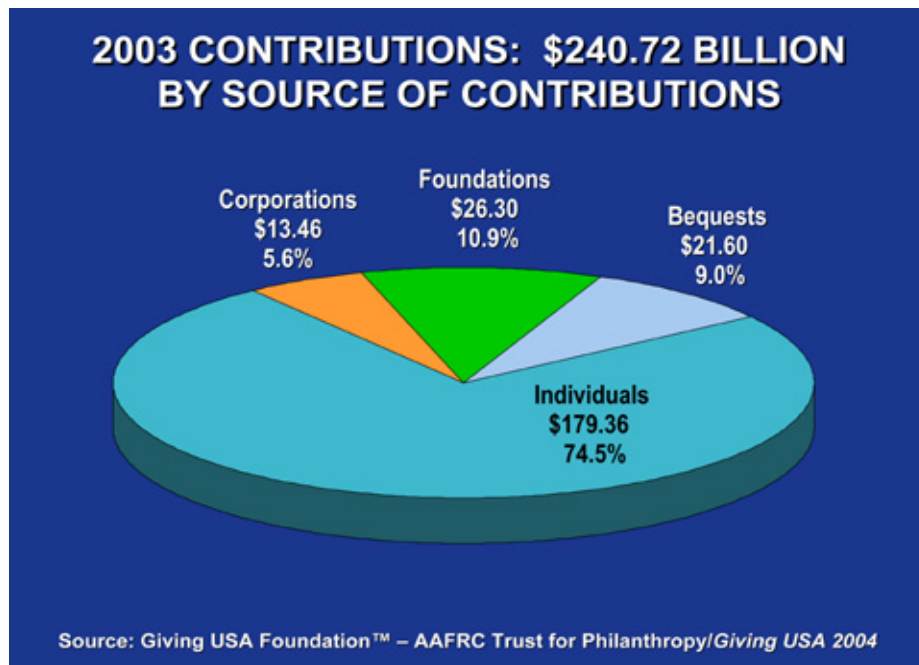
⁴ "World Population Prospects: The 2002 Revision," *United Nations Population Division Publication*, February, 2003. www.un.org.

2.10 From the perspective of governments, then, stimulating private giving and encouraging the growth of the nonprofit sector is a pragmatic response to the changing arithmetic underlying supply of and demand for services, and the ratio of workers to pensioners; while from the perspective of arts organisations, it is a pragmatic response both to the reality of reduced public funding, as well as to changing demographics that represent increased potential for philanthropic gifts. To both, it has spurred a concomitant increased interest in fundraising, particularly in ways to cultivate individual donors, who represent the greatest potential for giving, as well as in learning more about specific charitable giving mechanisms to market to them.

3. Overview of Philanthropic Giving in the U.S., U.K. and Canada

3.1 Notwithstanding the importance of private giving, worldwide it is still small relative to state spending. In the U.S., spending on social welfare accounts for 18% of gross domestic product; in Britain, 28%. According to Salaman, Sokolowski and List, writing for the Johns Hopkins Comparative Nonprofit Sector Project,⁵ charitable giving varies from around 1% of GDP in the U.S. (when excluding gifts to religion) to less than 0.1% in Italy.

3.2 The level of philanthropy in the United States indeed outpaces that of most other countries, particularly if gifts to religious organisations are included. According to *Giving USA 2004*, total charitable giving in the United States in 2003 amounted to almost \$241 billion, or roughly 2.2% of GDP.⁶ Of this amount individuals represent by far the largest source of contributions, as illustrated below:

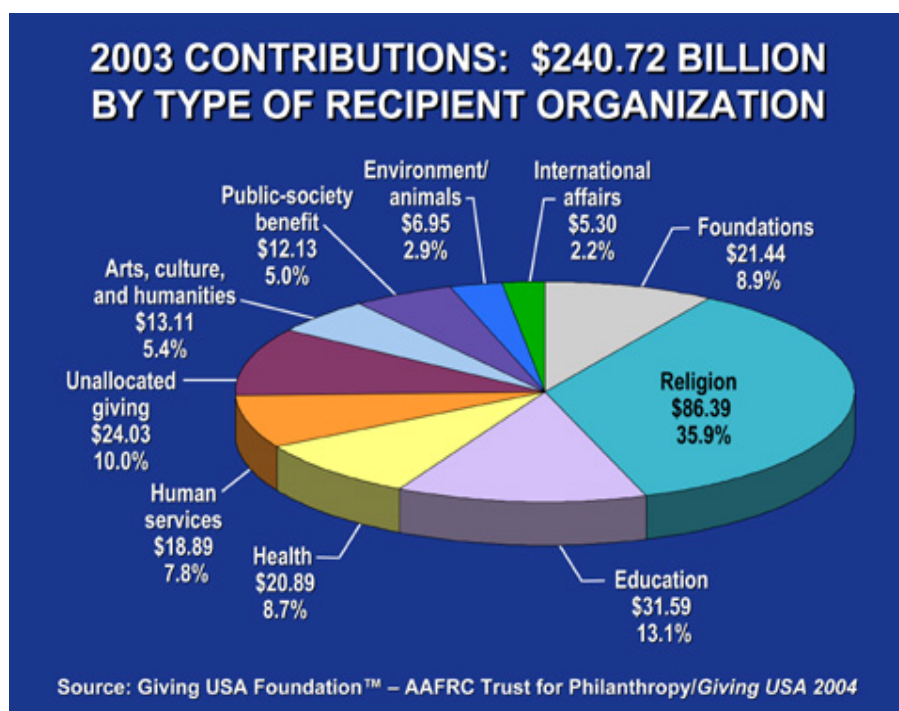


3.3 According to the same survey, in the U.S. religion accounts for the lion's share of total charitable dollars every year (36%), followed by health and human services (16.5%) and education (13.1%). At 5.4% of all contributions received, the arts rank toward the bottom, seventh out of ten categories defined by the survey.

⁵ Salamon, Lester M., "Global Civil Society: An Overview," The Johns Hopkins University Institute for Policy Studies/Center for Civil Society Studies, 2003. www.jhu.edu/~ccss/pubs/pdf/globalciv.pdf.

⁶ Giving USA Foundation. 2004. *Giving USA 2004*. The Trust for Philanthropy of the American Association of Fundraising Counsel / The Center on Philanthropy at Indiana University. Note that this figure, as opposed to Salamon's, includes gifts to religious causes.

- 3.4 According to Americans for the Arts, fully 45% of arts funding in the U. S. in 2002 came from the private sector, with individuals making up the largest single source of contributions, at 39%.⁷ By contrast, just 5% of overall arts funding in the U.S. in 2002 came from government sources at all levels. According to a 2000 report by the National Endowment for the Arts (drawing on data published by the Arts Council of England) comparing government spending on the arts in ten countries, per capita arts spending in the U. S. in 1995 was approximately \$6 – the lowest of any of the countries tracked – compared with \$91 in Finland, \$46 in Canada, and \$26 in the U.K.⁸
- 3.5 While the arts receive far less a portion of philanthropic dollars than do religious, educational, and health and human services organisations, the percentage and dollars it represents – \$13.11 billion – is by any standard a substantial amount of private giving to the arts:



- 3.6 In Canada, total charitable giving in Canada for the year 2000 was CAN \$2.2 billion, and more than 62% of Canadians contributed to charitable organisations.⁹

⁷ Americans for the Arts, www.artsusa.org.

⁸ National Endowment for the Arts, "Research Division Note #74: International Data on Government Spending on the Arts," January, 2000.

⁹ Canadian Centre on Philanthropy, *National Survey of Giving, Volunteering and Participating*, 2000. (Note: 2002 figures were unavailable.)

- 3.7 In that same year, more donations were made to religious organisations than to any other type of charitable or nonprofit organisation, a pattern that mirrors the U.S. Canadians gave CAN \$2.42 billion, or 49% of the total value of all donations, to religious organisations. Health organisations received the second largest portion of donations (20%); followed by social services (10%); philanthropy and voluntarism organisations (7%); education and research (3%); and the arts (3%).¹⁰
- 3.8 In terms of support for the arts, the Canadian government is still the predominant funder, while private philanthropy is still relatively low. In 2001, government support for the arts totalled CAN \$6.8 billion,¹¹ while support from private sources comprised 3% of total philanthropic giving, or CAN \$66 million. Most private giving to the arts in Canada is contributed by large corporations and high-net-worth individuals.
- 3.9 In the U.K., according to the National Council for Voluntary Organisations and Charities Aid Foundation, total individual giving in 2001/02 is estimated at £7.3 billion, and more than 67% of U.K. taxpayers made a charitable contribution through a combination of friends' schemes, charitable trusts set up by individuals, legacies and bequests, donations, gifts of shares and payroll giving. In marked contrast to North American philanthropy, the types of recipient organisations receiving the most private support in the U.K. that year were medical research, which received 16.8% of all donations, followed by youth (14.4%); and animal causes (9.5%). The study indicates that arts and heritage received just 1.8% of total gifts that year.¹²
- 3.10 The same studies showed that street and door-to-door collections are the most popular ways of giving (20.9% and 15.6% of donors gave these ways, respectively), while just 1.9% used payroll deductions and even fewer, 0.1%, gifted shares. These figures correlate poorly with the fact that 58.6% of those surveyed said they are aware of tax-efficient giving, Gift Aid (41.1%), payroll giving (33.4%) and share giving (13.9%).
- 3.11 According to Arts & Business' 2003 Annual Survey, the arts received 3.2% (or £236 million) in 2001/2002, increasing to £256 million in 2002/3. Individual giving outpaces corporate giving by almost two to one.¹³

¹⁰Ibid.

¹¹Statistics Canada: *Survey of Federal Government Expenditures on Culture, Fiscal Year 2001/2002*.

¹²"Charitable Giving in the U.K. 1995 - 2002," *National Council for Voluntary Organisations*, www.ncvo-vol.org.uk.

¹³Arts & Business, "Private Support for the Arts, Survey 2002/2003."

4. Factors that Influence Individual Charitable Giving to the Arts

- 4.1 It has been demonstrated both through research and the experience of donors and fundraisers that a variety of drivers affect individual charitable giving to the arts. These factors can be categorized broadly as those external to a charity, (such as the political, economic, tax and legal environment, and geography); those that lie with the donor (such as age, gender, wealth, and attitude toward philanthropy); and those internal to the charity (such as resources committed to fundraising, the fundraising calibre of board and staff, the effectiveness of the “ask”).
- 4.2 To generate healthy levels of contributed income, arts organisations need to keep continually abreast of changes in their external operating environment that affect charitable giving, and commit adequate resources to fundraising as a long-term endeavour. In this way, charities can both exploit positive external developments (such as a booming economic cycle and tax and legal changes favourable to philanthropy) and compensate for adverse ones (by cultivating a reliable cadre of donors who will support an organisation through thick and thin, even stepping up support during hard times).

Tax Frameworks

- 4.3 In the United States, one of the most important legislative initiatives to affect philanthropy – and that is responsible in large part for the success of planned giving in that country – was the Tax Reform Act of 1969. This watershed piece of legislation revamped significantly federal income tax deductions for gifts to nonprofits and private foundations as well as tax exemptions for those organisations. It was this legislative reform that created the context for the development of new planned giving devices – such as charitable remainder trusts, charitable lead trusts, and pooled income funds – and changed the tax treatment of others. Congress has made modifications since that time, but the basic structure of the Act is unchanged.
- 4.4 The Federal Job and Growth Tax Relief Reconciliation Act of 2003, enacted May 23, 2003, is a more recent legislative change that may affect individual philanthropy, as it represents the most significant reductions in income tax rates since 1986, and has affected many of the frameworks related to giving.

4.5 These frameworks, differences among which may account in part for differences in the levels of individual giving in the U.S. versus the U.K., generally relate to federal income tax, estate tax, capital gains tax, and gift tax.¹⁴ Following is an overview of these frameworks in the U.S., while more detailed information as to tax schemes underpinning specific charitable giving vehicles is included in Part Two, the Glossary of Charitable Giving Mechanisms.

- *Federal Income Tax* – According to some theories, lower federal tax rates may be correlated to higher levels of individual philanthropy, to the extent that they foster the creation and retention of wealth, and wealth is highly correlated to giving. Others would argue that higher taxes provide incentives to giving as a way to reduce taxes. In the U.S., the federal income tax brackets for individuals are currently 35%, 33%, 28%, 25%, 15% and 10%, and were lowered as of January 1, 2003.
- *Deductibility of gifts* – For any gift over \$75, donors must deduct the fair market value of any tangible benefits received in exchange for the gift from the total gift amount in order to determine the tax deductible portion. Gifts over \$250 require a written receipt from the charity stating the value of such benefits and the total deductible amount of the gift.
- *Capital Gains Tax* – Avoidance of capital gains taxes is another potential driver of charitable gifts. Tax rates on long-term capital gains (those made on securities held for at least 366 days, or more than one year) have also been reduced in the U.S. recently, from 20% to 15% for taxpayers in the four highest tax brackets. Taxpayers in the lowest tax brackets, 10% and 15%, pay only 5% on long-term capital gains. For all taxpayers, short-term gains (gains made on stocks held for less than one year) are taxed like ordinary income. The tax rate for the sale of *appreciated real estate*, however, is currently 25%, and two categories of capital gains are subject to 28% tax rate: sales of *small business stock* and *collectibles* (art, antiques, gems, stamps, precious metals, wine).
- *Dividend Rate Reduction* – Qualified dividend income received by individuals is now taxed at the reduced long-term capital gains tax rate (15%). This represents an enormous reduction from the prior rate of 38.6%, and, some argue, additional opportunities to make charitable gifts.

¹⁴ www.irs.gov/publications.

- *Estate Taxes* – Currently, the top estate tax rate in the U.S. is 48%, and will decrease by 1% per year to 45% in 2009. For 2004, the unified credit is \$555,800 toward an applicable lifetime exclusion of \$1,500,000. However, the federal estate tax is scheduled to be phased out entirely by 2010, to the concern of many charities that fear it may eliminate a primary driver of planned giving.
- *Gift Taxes* – The gift tax applies to the transfer by gift of any property. Individuals make a gift when giving property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. Individuals may make tax-free gifts to other persons of up to \$11,000 per annum; gifts larger than \$11,000 are taxable, and count against the lifetime gift exemption of \$1 million for federal estate tax purposes. Gifts to spouses, political organisations, charities, and tuition or medical expenses paid on behalf of another, are exempt from gift taxes.

4.6 In Canada, the charitable sector has also sustained significant reduction in government funding in recent years, and in 1996 and 1997 the Canadian government enacted changes designed to encourage more gifts to charities from individuals and corporations by increasing tax incentives for donations. The most significant reform was the reduction of capital gains taxes on charitable gifts of publicly traded securities by half, from 75% to 37.5%). This move has been seen by many as the greatest incentive undertaken in recent history by the Canadian government to promote charitable giving. This measure was introduced on a five-year experimental basis, and was reviewed and endorsed in 2000. However, under present rules, these reductions apply only to donations to a *public* foundation or charitable organisation, but not to donations to *private* foundations. Furthermore, the preferential treatment of capital gains on publicly-traded securities has not been applied yet to other types of assets, such as real estate. The Canadian Centre on Philanthropy is one organisation that has lobbied for extending tax reform in these two critical areas, among others.¹⁵

¹⁵ Canadian Centre for Philanthropy, "Pre-Budget Submission to the House of Commons Standing Committee on Finance," September 8, 2003, http://www.ccp.ca/Files/lettersubmission/federal_budget_2004.pdf.

4.7 While some advocate for deeper reform, the changes since 1997 have made an impact. According to Ontario-based attorney Arthur Drache, who specializes in nonprofit law and strategies for charitable giving in Canada, among the beneficiaries of these reforms have been arts groups, who have seen increases in the number of major gifts, and the frequency with which they are noted in the press. In an interview, Drache asserted that: "In 1994, if you gave \$1 million to any charity it was front page news. Now, we have had CAN \$10, 20, 50, 100 million gifts as a result of new legislation." He also cited the CAN \$300-400 million being raised for a new opera house, and the financial success of the Art Gallery of Ontario's campaign, both of which are derived largely from private sources. While this money has "always existed," he continued, since 1996 "the wealthy have become more generous."¹⁶

4.8 Following is a summary of important tax frameworks in Canada presently¹⁷:

- *Federal Income Tax* – In Canada, the 2004 federal income tax brackets for individuals are 29% on the first \$35,000 of taxable income; 22% on the next \$35,000; 26% on the next \$43,804; and 29% of taxable income over \$113,804.
- *Deductibility of gifts* - For gifts made after December 20, 2002, donors must deduct the fair market value of any "advantages," or benefits, received in exchange for the gift, from the gift amount in determining the tax deductible portion. As long as the FMV of the advantage does not exceed 80%, the Canada Revenue Agency is satisfied that the intention to make a donation is clear.
- *Capital Gains Tax* – Presently, the tax on capital gains of appreciated securities made to a public foundation or charitable organization is 37.5%.
- *Estate and Gift Taxes* – Another notable aspect of Canada's tax framework is the fact that there are neither estate nor gift taxes in that country, a situation that may hinder charitable giving (although this has not – and perhaps cannot be – proven conclusively). Many fundraisers and experts in charitable giving in the U.S., for example, hold that estate and gift taxes serve as a stimulus to philanthropy, especially planned giving, and worry that the planned repeal of the estate tax in particular might adversely affect charities' fundraising efforts.
- *Gifts of Certified Cultural Property* – Under the *Cultural Property Export and Import Act*, taxpayers can claim a credit for donating property that is of "outstanding

¹⁶ Interview with Arthur Drache, May 12, 2004.

¹⁷ Canada Revenue Agency, "P113: Gifts and Income Tax," http://www.cra-arc.gc.ca/E/pub/tg/p113/p113-e.html#P94_3022.

significance and national importance" to Canadian institutions and public authorities that have been designated by the Minister of Canadian Heritage.

Demographics, Culture and Attitude

- 4.9 While tax incentives are critical to philanthropy, demographics, differences in culture and attitudes toward philanthropy, along with knowledge of and commitment to professional fundraising are also important drivers that account largely for disparities in individual giving worldwide. Age, gender and income levels are the most relevant demographic characteristics of charitable donors worldwide, and in the U. S., U.K. and Canada they are broadly consistent. According to a 2003 survey of charitable donors in all three countries,¹⁸ charitable donors are more likely to be women than men (71% in the U.S., 71% in the U.K., and 64% in Canada.); older (in Canada, 70% of charitable donors are 65 or older; in the U.K., 68%, and the U.S., 56%); and wealthier (in all three countries, higher levels of giving are also correlated with higher levels of education and income).
- 4.10 Attitudes toward and comfort levels with philanthropy are also a significant factor, one that affects both the donor and the solicitor, yet one that is harder to measure and, probably because of this, has been studied less. Nonetheless, it is broadly held that in the U.S., charitable giving is a deeply engrained tradition. The creation of privately funded and governed nonprofit organisations (in particular in the arts/cultural sector) was shaped by the desire of private individuals to enlarge their sphere of influence vis-à-vis government.¹⁹ Partly a product of this history, many people today espouse a philosophy that hold the individual can distribute capital more effectively than government, especially federal government. Americans tend to be very proud of their philanthropic tradition – even thinking they invented it – and most schoolchildren learn early on about the philanthropic deeds of 19th century industrialists such as Rockefeller, Morgan and Carnegie.
- 4.11 Furthermore, philanthropic giving is often regarded as an obligation in the U.S. on the part of high-net worth individuals, particularly in the corporate community, where at higher management levels participation on nonprofit boards and payroll giving to United Way campaigns, for example, are practically involuntary.

¹⁸ Lang Research, "Report on Surveys of Direct Mail Charitable Donors in the United States and Canada," March, 2003.

¹⁹ Di Maggio, Paul. 1982. "Cultural entrepreneurship in nineteenth-century Boston: The creation of an organisational base for high culture in America." *Media, Culture and Society*. Vol. 4/1. Winter 1982.

- 4.12 The depth of experience and comfort level with fundraising and giving – whether it be courting donors, asking for sums of money, knowing how and how much to give, and being recognised publicly for one’s philanthropy – are important cultural factors at work as well. An article last summer in *The Economist* offers that “many Europeans feel uneasy with the idea of competing to demonstrate public generosity” because “being very rich still carries faint implications of impropriety.”²⁰ The author goes on to cite examples of donors in Britain being unsure about how much to give, and uncomfortable acknowledging their giving publicly. Another article from 2004, this time in *The Chronicle of Philanthropy*, quotes an American fundraiser working in the U.K.: “I noticed right away how different fund raising is here.... People here are much more reserved when it comes to asking for money, even a little nervous.”²¹

Professionalization of Fundraising

- 4.13 Another critical factor driving the differences in levels of individual philanthropy to the arts between the U.S. and the U.K. – and the use of planned giving vehicles underpinning it – is the difference in the levels of sophistication in nonprofit development departments, and, indeed, in the extent of professionalization of the fundraising field as a whole.
- 4.14 Fundraising as a profession is much more evolved in the United States than in the U.K., where serious fundraising began only in the 1990s. As evidence of the growth of the sector, the Association of Fundraising Professionals, the U.S. professional association for development professionals founded more than 40 years ago, has seen its membership grow from 2,500 in 1980 to more than 26,000 today, a more than ten-fold increase. Similarly, the number of AFP chapters has more than tripled, from less than 50 in 1980 to more than 172 today.²²

²⁰ “Doing Well and Doing Good,” *The Economist*, July 29, 2004.

²¹ “Navigating Protocol and Courting Big Donors,” *The Chronicle of Philanthropy*, March 18, 2004.

²² Association of Fundraising Professionals, www.afpnet.org.

- 4.15 As government scales back its support for cultural, educational and charitable organisations, demand for fundraisers has never been higher, especially major gift fundraisers with experience in building long-term donor relationships. Across the U.K and especially in arts and cultural institutions, additional fundraisers are being hired and new development practices are being implemented or expanded, some already with impressive results, including the capturing of major U.S. donors. Signs that the field of fundraising is professionalizing are evidenced by the founding of the European Fundraising Association (EFA) in 2002, and the launch of GuideStar U.K., a comprehensive database of U.K. charities.²³ Moreover, Arts & Business' Development Forum, an organisation comprised of people raising money for the arts, has seen its membership more than treble in the past decade, from 300 members in 1994 to almost 1,000 today.²⁴
- 4.16 This is a welcome development for some who would place the blame for low levels of giving in the U.K. squarely on charities themselves. In the case of universities, notes one observer bluntly, "the biggest failing lies with the universities themselves," universities whose vice-chancellors are "ill-suited ... to schmoozing," employ "drab" fundraising appeals," have not worked to integrate donors into university life, and employ paltry numbers of fundraisers compared to "America's armies."²⁵
- 4.17 However, not many Brits have extensive fundraising experience, so many charities are filling slots with American imports. According to James Abruzzo, executive vice president and managing director of a nonprofit search firm, DHR Executive Search, speaking to the *Chronicle of Philanthropy*, this trend represents a "knowledge transfer" symbolic of a larger one to come, as the transformation of British culture "from direct government funding to private funding comes with a need for stronger management."²⁶
- 4.18 All of this underscores the fact that, while tax incentives are a critical component necessary to stimulate individual philanthropy in the arts at a macro level, they need to be complemented with strategies to educate both donor and charity, and, importantly, to link donor to charity and market the gift mechanism that will best facilitate a meaningful gift.

²³ Eugene R. Tempel, "Across the Pond: European Giving Takes Formal Shape," *Nonprofit Times*, Dec. 1, 2003, p. 26.

²⁴ Source: Arts & Business London, internal data.

²⁵ "Grotty Givens," *The Economist*, April 17, 2004, p. 28.

²⁶ "Fund Raisers Face Obstacles in Britain," *The Chronicle of Philanthropy*, March 18, 2004, p. 27.

Fundraising Tactics

- 4.19 This section presents an overview of some of the strategies and tactics U.S. fundraisers employ to cultivate and recognize individual donors to the arts. As the subject is vast and not the primary focus of this paper, it is necessarily brief, but could be fleshed out with additional, deeper research in the future as another component of The Maecenas Initiative. It is intended primarily to demonstrate the wide variety of tactics employed by arts fundraisers, and which among them are deemed most successful. The full results of the survey can be found at Appendix B.
- 4.20 Ultimately, the success of most charities' ability to garner individual gifts is a function of the calibre of its fundraising program, both in strategy and execution. It is what happens at this "micro," tactical level that tends to distinguish successful fundraising organisations. U.S. arts fundraisers employ a variety of tactics to cultivate and develop their donors, tactics that are becoming increasingly sophisticated, and require an investment on the part of both the charity and the fundraiser to reap benefits to both.
- 4.21 Arts organisations in the U.S. who are successful raising individual gifts exploit advantageous tax frameworks and demographic trends by investing in fundraising. According to the 2003 Museum Financial Information, published by the American Association of Museums, fundraising expenses represented a median of 6% of total operating budgets of art museums, more than the 4% spent on marketing, and close to the 9% allocated for collections care.²⁷
- 4.22 Successful individual fundraising requires a combination of strong board leadership, trained professional fundraisers, and adequate resources to support the effort, yet professional development staff are responsible for the lion's share of development work. A recent survey by the Urban Institute and the Center on Philanthropy at Indiana University found that, while nearly 75% of organisations report using volunteers for fundraising, 53% said volunteers are responsible for less than one-tenth of all fundraising. Staff bear the brunt of the fundraising burden, and, ironically, the survey found that organisations that characterize their staff, executive director, and board members as "highly involved" with fundraising have executive directors even more involved with fundraising than their development staff.²⁸

²⁷ Elizabeth E. Merritt, ed. *2003 Museum Financial Information*. American Association of Museums, 2003, pp. 74-85.

²⁸ "Who Raises Contributions for America's Nonprofit Organisations?", *Nonprofit Overhead Cost Project: Brief No. 2*, Center on Nonprofits and Philanthropy, Urban Institute, Center on Philanthropy, Indiana University, July 2004, p. 3.

- 4.23 AEA Consulting launched an online survey of arts fundraisers in the U. S. who are members of the National Committee on Planned Giving. The survey, which was administered to 151 NCPG members working for a mixture of performing arts, museums and heritage organisations, received a response rate of 23% to questions about the levels and types of fundraising activity at their organisation, especially regarding tactics they employ to cultivate individual donors in annual and planned giving.
- 4.24 In terms of the division of fundraising duties between staff and board, the survey revealed broadly the same conclusion that the Urban Institute/Center on Philanthropy survey reached, i.e. that staff members are responsible for most of their organisation's fundraising. This applies both for annual and for Planned Giving fundraising.

Chart 1

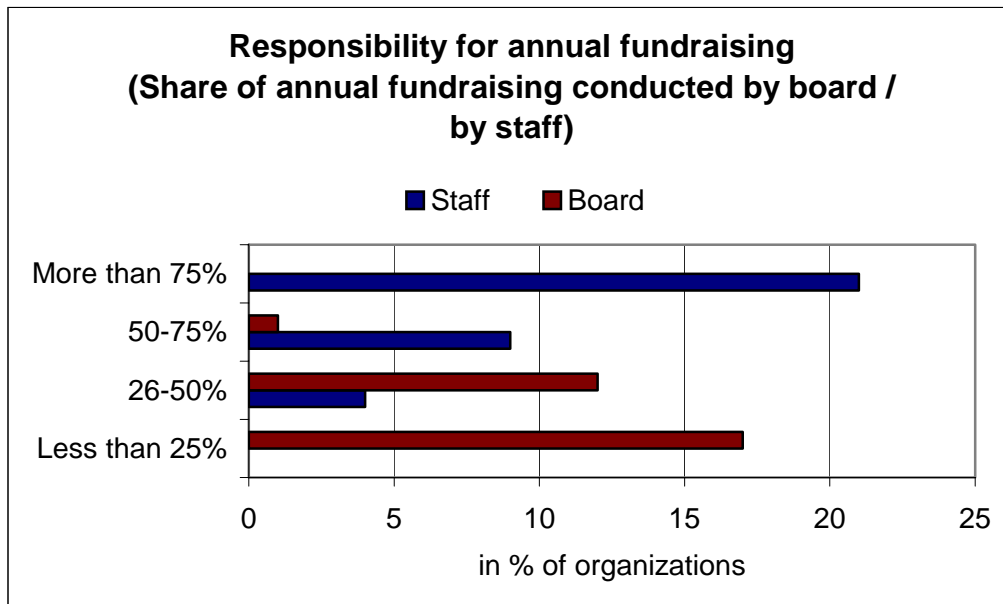


Chart 2

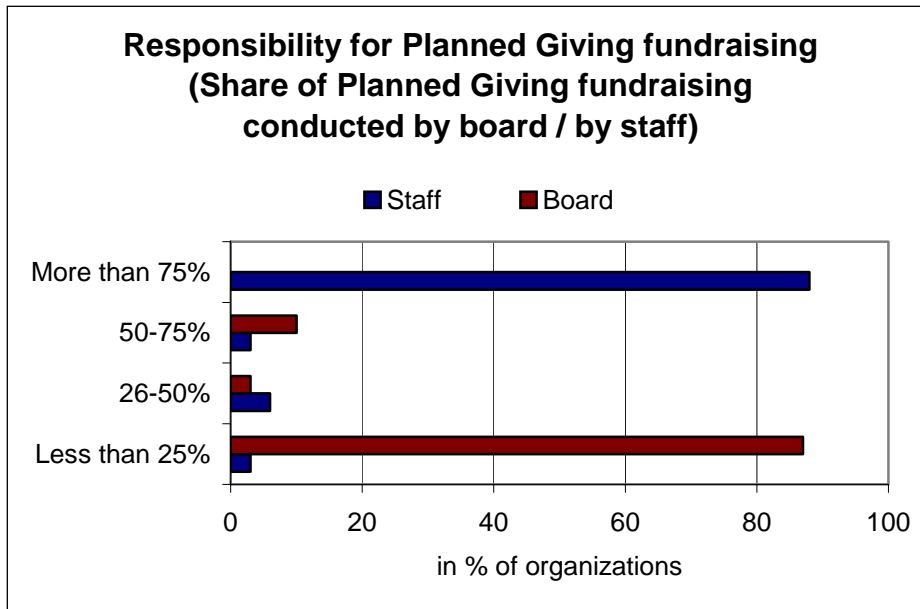
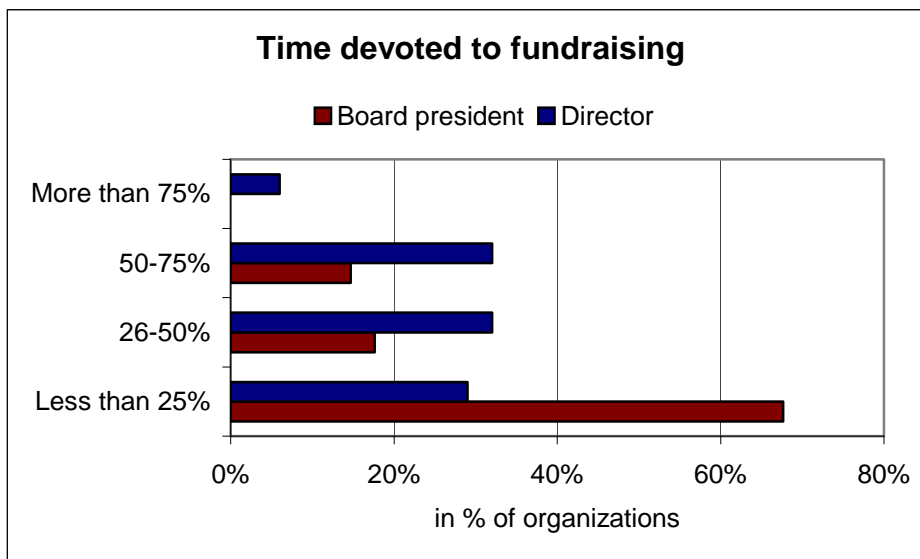
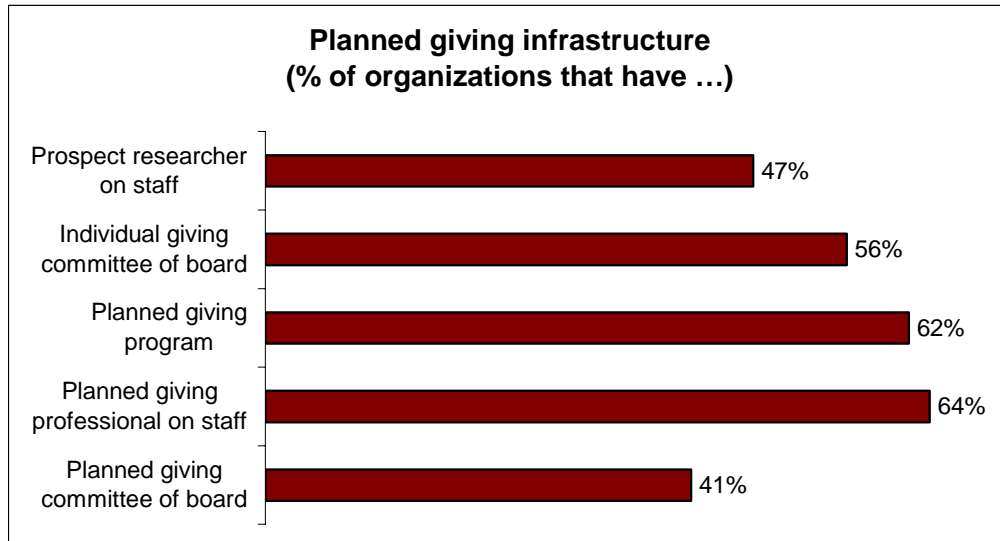


Chart 3



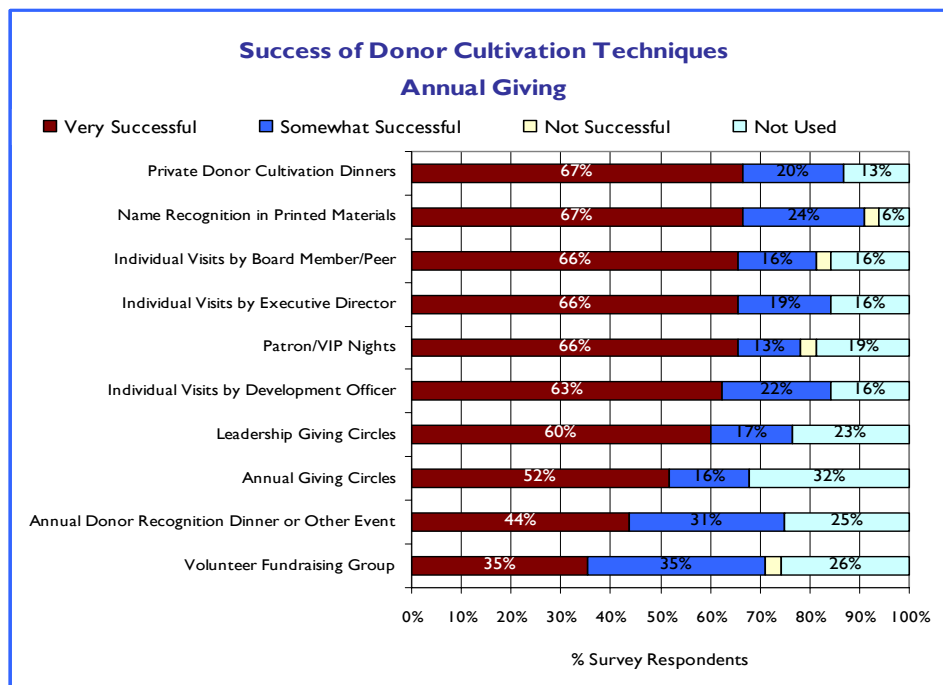
4.25 The survey also asked questions about the level of internal investment in fundraising resources dedicated to individual and planned giving, and revealed a majority have invested in tools such as formal planned giving programs, prospect research and planned giving staff, and committees of the board devoted specifically to individual giving.

Chart 4



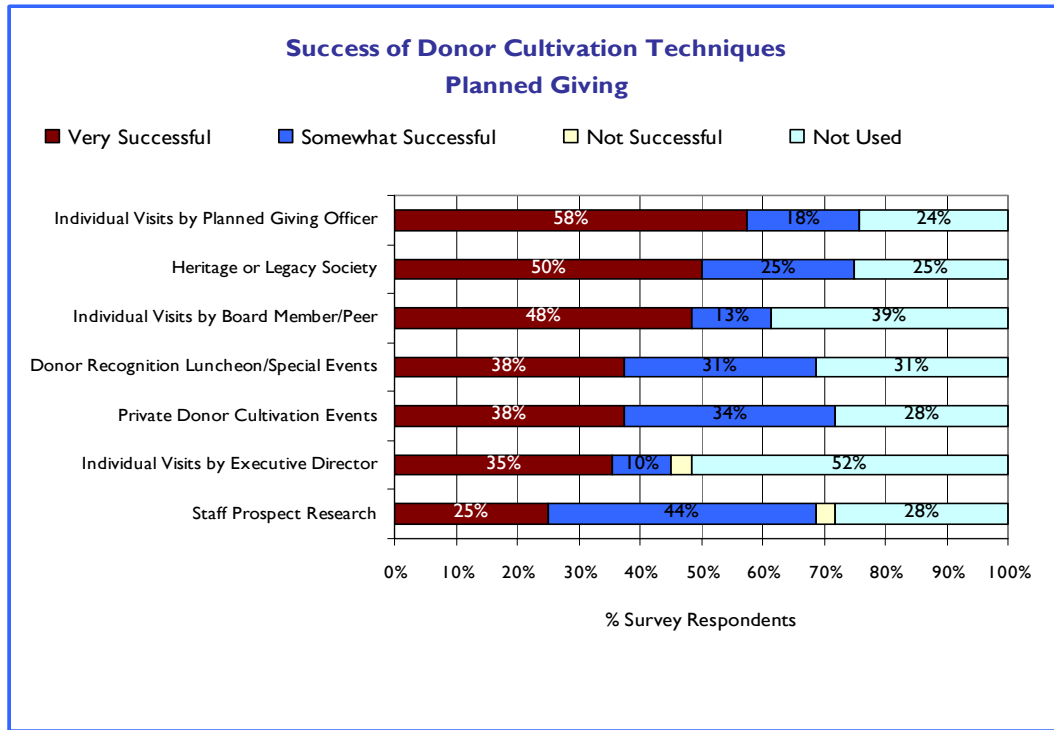
4.26 The survey also revealed the variety of tactics used by arts development professionals in the U.S. to secure individual donations, both annual and planned gifts. In asking respondents to rank the success of such techniques, it is noteworthy that for both annual and planned giving five out of the top six most successful tactics employed involve personal contact with the donor or prospect:

Chart 5



4.27 Results of the same question asking with regard to marketing planned giving vehicles are broadly the same:

Chart 6



*Note: "Heritage or Legacy Society" here refers to a membership in a "society" or group of individuals who have made estate gifts to a charity. In the U.S., such a circle is often labeled a "heritage society." The use of the word "heritage" is not to be confused with the U.K. meaning of "heritage," as in cultural heritage.

5. Conclusion

- 5.1 The drive to stimulate individual philanthropy in general and for the arts in the U.K. in particular is a sound and timely one. The combination of demographic trends and concomitant projections for public funding for the arts provides the context for stimulating private philanthropy, particularly from individuals.
- 5.2 While the U. S. unquestionably outpaces the U.K. and Canada in terms of both overall philanthropy and individual giving to the arts, the high level of private support for the arts in the U.S. has not necessarily translated in a healthy arts sector there. Notwithstanding such support, most observers would agree that presently the sector is struggling, as relentless growth in fixed costs combined with increasing competition, higher expectations from patrons, in some cases overexpansion, and decreased public funding has taken a toll.
- 5.3 It is only with appropriate levels of support from both individuals and government – combined with an advantageous tax framework, organisational investment in fundraising, educated donors, and well-trained development professionals – that the arts in any country might ever be properly capitalized. Britain’s funding model is, if not perfect, certainly one that should be regarded with respect for the pragmatic balance it strikes between the public and private funding. If Britain can increase private support for the arts while sustaining healthy public funding levels (a level that, while perhaps lower than present but ideally higher than the U.S.), the future looks promising.
- 5.4 As to how to stimulate more individual giving, tax incentives are critical, and the U.K. should look to emulate those that have worked successfully in the U.S. and elsewhere around the world. It is a necessary first step, designing and laying forth the framework that might serve to catalyze private giving. It is also necessary to look in depth not only at the tax framework, but the charitable gift mechanisms created out of such a framework that might serve individual giving to the arts.
- 5.5 Part Two of this report is a glossary of such mechanisms, in a detailed Word document and a summary Powerpoint presentation.

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Arts & Business: The Maecenas Initiative

Part Two: A Glossary of Charitable Giving
Mechanisms

1. Introduction

Charitable giving mechanisms utilise legal provisions that provide donors to charity with tax deductions. The main principle behind charitable giving is that a charitable gift lowers the value of the asset base on which taxes are calculated. As a result, the donor saves taxes while also making a gift to a supported cause. As a nonprofit organisation, the charity usually is not liable for any taxes on the gift. The taxes that are most important in the context of charitable giving in the United States are income, estate, capital gains and gift taxes.

Charitable gift mechanisms are not created in tax legislation itself, but rather evolve through practice in financial, legal and charitable organisations over time. The mechanisms (or “vehicles”) organise the transfer of assets and distribution of income from these assets between a donor, a charitable organisation and, potentially, additional beneficiaries. They range from a single immediate cash gift to contract-based agreements that involve a decades-long relationship among the donor and a charity.

A few distinctions are important to bear in mind. The types of *assets* that can be transferred as a charitable gift through giving mechanisms are distinct from the *mechanisms* themselves (except, perhaps, in the case of cash gifts). Gifts are typically classified as either *outright* or *deferred*, and deferred gifts can be defined further as either *life income* or *estate* gifts. The phrase deferred giving is used to refer to a type of giving whereby the charity must wait one year or more before being able to use the gift assets. In the U.S., it is often used interchangeably with “planned giving.”

Gifts to charitable organisations comprise a variety of asset types as well as mechanisms through which the asset is transferred to the charity. Assets that may be gifted range from the most liquid, such as cash, to securities to property such as real estate or art work. The number, diversity and flexibility of giving vehicles enable charities to accommodate prospective donors of various ages, levels of wealth, and types of asset bases.

Fundraisers or development officials in charitable organizations employ a range of *marketing tactics* (for example friendship schemes) aimed at soliciting donations from donors. These tactics take various shapes, depending on the level of the donation expected, however, they are ultimately a component of a fundraising infrastructure that aims to build deep and long-lasting relationships between the organization and individual donors. Several ties help attach donors to an institution, including, in most cases, a social tie (sense of social belonging or even peer pressure through association with other

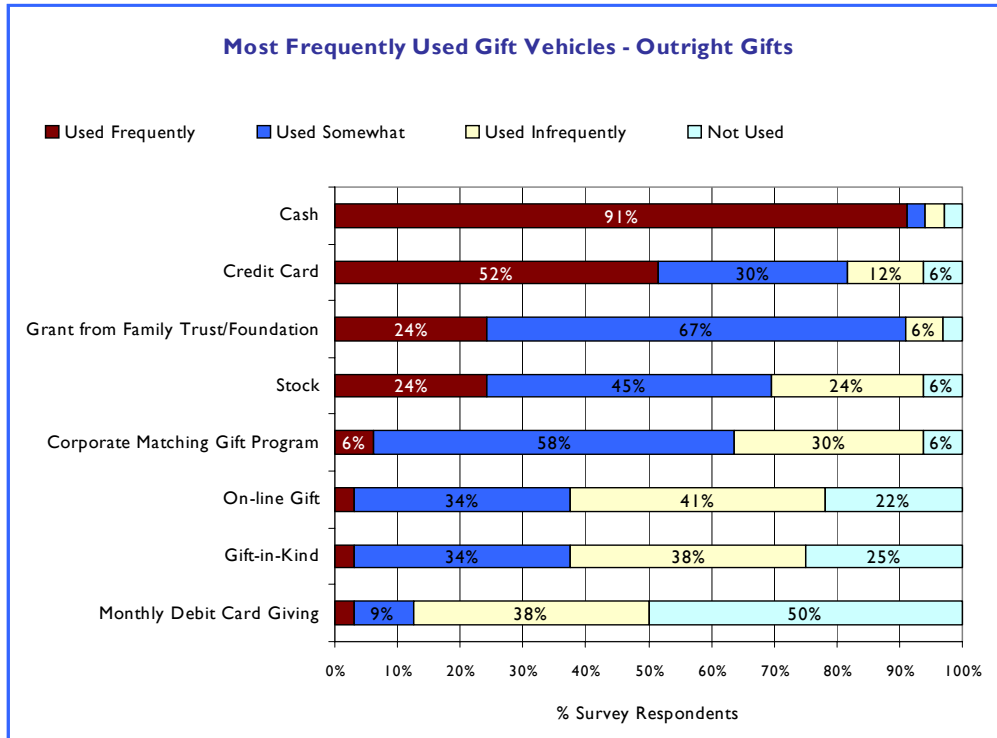
donors), an artistic-aesthetic tie (sense of identification with the art form and with individual artists) and a civic tie (sense of ownership of or responsibility for the institution).

Following is a glossary of the most commonly used charitable giving mechanisms in the United States, including a definition, outline of the tax scheme on which it is based, primary benefits and caveats for both the donor and the charity, an indication of its relative popularity as well as whether the vehicle is most often used for outright or planned gifts. A summary of this glossary is contained as a Powerpoint presentation as Part 3 of this report. Appendix A provides a Glossary of Terms.

2. Outright Gift Mechanisms

Outright gifts are gifts made during the donor’s lifetime whereby the donor maintains no interest in the donated asset. Outright gifts provide immediate, direct assistance to a charity. The vast majority of charitable gifts are outright gifts, which can be made with a variety of assets, including cash, securities, real property, and personal property.

The chart below reflects responses to a question posed to arts fundraisers by AEA Consulting¹ regarding the most common way donors make outright gifts to their organisation. Not surprisingly, cash is by far the most common gift form; perhaps more surprising is the fact that 24% mentioned stock gifts as being “used frequently,” much more so than online or committed giving:



A. Cash

Description

Cash is described as currency, check, or electronic bank transfer. Variants include credit card giving, online giving, and monthly debit-card or “committed giving.” Cash is

¹ An online survey of members of 151 members of the National Planned Giving Council was administered in May 2004 and received a response rate of 23%.

by far the most popular asset transferred to charities in the United States.

Tax Scheme

Cash gifts are deductible in the year of the gift up to 50% of the donor's Adjusted Gross Income ("AGI"). The donor can claim Fair Market Value ("FMV") of the gift, less any benefits received in return. Any excess can be carried forward for up to five future tax years.

Benefits for the donor

- The main benefit to the donor is an *immediate income tax deduction* for the full amount of the gift for the year in which the gift was made.
- The cash gift results in a *lowering of assets for estate tax purposes*.
- Giving cash is *very convenient* for the donor.

Benefits for the recipient

- The gift is immediately transferable.
- The charity receives an immediate liquid asset.
- If the cash gift is through Electronic Transfer of Funds, the charity saves resources through efficient gift processing.
- Large market.

Caveat for the donor

- This may be a less tax-effective way of giving, because cash used to make a charitable gift represents after-tax earnings for most donors.

Caveat for the recipient

- None

B. Monthly Debit Card Giving

Description

Monthly debit card giving is another way to transfer cash to a charity through the mechanism of a credit or debit card. With monthly debit card giving, donors make gifts to a charity each month, instead of the more common once per annum, and the gifts, which are withdrawn automatically from the donor's checking account or charged to his or her credit card, are often relatively modest, usually \$10 or 20. Alternative payment

methods include Electronic Fund Transfers, i.e., direct transfer from the donor's to the recipient organisation's bank account.

Monthly committed giving is enjoying rising popularity in the United States, however it is still far more common in Canada, Europe and the U. K. (where, for example, the Art Card – a (loyalty) credit card – has had success).

Tax Scheme

- The tax scheme is the same as for cash.

Benefits for the donor

- Paying by debit card allows flexibility, both in terms of deferring payment and by paying a pledge in instalments over time.



Benefits for the recipient

- Efficient, and saves resources for processing checks or cash.
- Provides a steady income stream. This is particularly important for organisations whose earned income schedule is seasonal, such as performing arts organisations.
- Fundraising costs are reduced, which is particularly attractive to small non-profit organisations with little staff capacity for fundraising.
- Organisations have had better results retaining monthly givers than annual givers, and attracting special gifts from them.
- Research has shown that monthly givers are also more likely to make bequests.
- Organisations have found it relatively easy to upgrade monthly donors to a higher category of donations.

Caveats for the donor

- It is easy for the donor to overlook this monthly obligation.

Caveats for the recipient

- Some donors (such as some elderly donors) remain attached to check-based giving; they should not be alienated in an attempt to take advantage of the benefits of debit card based giving.

C. Credit Card

Description

Credit card gifts are a different form of a cash or debit card-based gift whereby the gift is drawn from the donor's credit card by the recipient organisation. In paying back the credit card company, the donor usually has the choice of settling the full newly-accrued balance each month or to commit to a pre-determined monthly/annual payment schedule (thus paying interest on any balances). Credit Cards can be used for a single annual gift or for monthly giving (as described above). Credit card giving is extremely popular in the United States; survey respondents indicated credit card gifts as the second most popular form of giving.

Tax Scheme

- The tax incentives for credit card gifts are the same as those for cash gifts.

Benefits for the donor

- Same as for Debit Card giving.
- In addition, the donor may be able to take advantage of non-taxable benefits or incentives offered by different credit card companies, such as airline frequent flyer miles.

Benefits for the recipient

- If the credit card is used for monthly payments: Same as for Monthly Debit Card giving.
- Otherwise: same as for cash.

Caveats for the donor

- Same as for Monthly Debit Card Giving.
- In addition: Interest charges levied by the credit card company may increase the total cost of the gift (if the donor leaves a balance at the end of each month).

Caveats for the recipient

- Same as for Monthly Debit Card Giving.
- Credit card companies charge an administrative fee, usually between 2.5% and 5% of the value of the donation, to the charitable organisation receiving the gift.

D. Online Giving

Description

Online giving is essentially credit-card-based giving through the Internet. Given that internet-based banking is still fairly new in the US – compared to Europe, online checking (i.e. electronic transfer payments that are scheduled online) are not yet common.

Tax scheme

The tax scheme for online giving is the same as for cash.

Benefits for the donor

- The benefits of online giving are the same as for credit card gifts, plus convenience.

Benefits for the recipient

- Using the Internet for fundraising can reach new “highly-wired” market segments.
- Other benefits are the same as those for credit card gifts.

Caveats for the donor

- Possible security concerns.

Caveats for the recipient

- Effectiveness depends on donor’s comfort level with Internet.
- Security concerns
- Requires adequate investment in overall website, plus security, online payment technology.
- Organisations *may lose some donors* if traditional methods of payments are not maintained.
- Credit card companies assess *administrative charges* (see above).

E. Securities

Description

An outright transfer to a charity in the form of stocks, bonds, or mutual funds, typically ones that have appreciated in value. Separate rules govern gifts of securities, depending on whether they are publicly traded, closely held, bonds, mutual funds and so on.

Securities can be used to fund both outright and deferred gifts, including bequests, charitable remainder and charitable lead trusts, charitable gift annuities, and pooled income funds (described below).

Tax Scheme

For publicly traded stock and mutual funds, if the securities were held for a short term (one year or less), the income tax deduction is equivalent to the purchase price of the shares. If held for the long-term (more than one year), the donor may claim an income tax deduction equivalent to the securities' market value, up to 30% of the donor's AGI. To determine the FMV, the mean value of the shares on the date of the gift is used. The gift date is the date of postmark on envelope (if securities are sent through the mail), or the date of personal delivery to the charity or the charity's agent.

For gifts of securities, donors also avoid paying capital gains tax on the appreciated portion. As in the case of gifts of cash, unused deductions may be carried forward into five future tax years. If securities have decreased in value, it is advisable to sell the stock, deduct losses against capital gains incurred in the same year and donate the proceeds.

Besides outright gifts, securities may also be used to fund a variety of charitable gift mechanisms, such as gift annuities, pooled income funds, and trusts.

Benefits for the donor

- If the gifted securities were held long term and have appreciated substantially, the cost basis of the gift is low, resulting in a *highly-leveraged gift*.
- Easy to administer.

Benefits for the Recipient

- The gift is in a *very liquid form*.
- *Marketing appeal*, as tax benefits are many and gifting securities can result in a much larger gift than would be possible with cash.

- The increasing number of households who own securities has resulted in a *large market for gifts* of these securities.
- Gifts of securities are *easy to administer*.

Caveat for the donor

- Securities fluctuate in value.

Caveat for the recipient

- The value of the gift proceeds may be lower due to the time lag between the gift date and the settlement date (i.e. between the date when the donor transferred the securities and the date when the recipient organisation sells them).

F. Real Property

Description

A gift of real property can be any gift of land, buildings erected on or affixed to land, and rights and easements connected with land. Examples include a principal or vacation home, a farm or ranch, a commercial building, subdivision lots, or any undeveloped parcels of land. The donor may gift all or a fractional percentage of the property to the charity, and the charity may either hold or sell it. The property should be mortgage-free, have a clear title, be marketable, and not be environmentally hazardous. An appraisal by a licensed appraiser is recommended. The property is transferred to the charity by a deed and then is usually sold.

Gifts of real property are often used to fund Charitable Remainder Trusts, or given as a Life Estate (detailed further on).

Tax Scheme

The donor realises a charitable income tax deduction for the full fair market value of the real estate. Long-term capital gain real property is deductible at FMV up to 30% of AGI, or at cost basis up to 50% of AGI. Short-term capital gains are deductible at cost, up to 30% of AGI.

Benefits for the donor

- The donor receives a charitable income tax deduction.
- The donor avoids *capital gains taxes* on any appreciated portion.

- The transfer reduces the value of the donor's taxable estate.
- Appealing to donors who want to avoid maintaining and/or selling property.

Benefits for the recipient

- Charity may either retain property and enjoy use of it, or realise proceeds from sale.

Caveat for the donor

- Donor bears the onus of substantiating the value of real property.

Caveats for the recipient

- Charity should have gift acceptance policy governing such gifts, preventing donations of property with potential liabilities (i.e., environmental concerns).
- Charity should obtain competent legal advice regarding transfer.

G. Tangible Personal Property

Description

Personal property can be either “tangible” or “intangible.” The majority of philanthropic gifts of personal property are tangible, which refers to any property (other than land or buildings) that can be seen or touched. Types of tangible personal property most often donated to charitable organisations are works and collections of art, cars, furniture, jewellery, coins, and wine. (In contrast, intangible property is such property that cannot be seen or touched – including, for instance, securities or bonds.)

Tax scheme²

The tax treatment of tangible personal property depends first on whether the property is classified as ordinary income property (held for a year or less and/or associated with an activity that produces ordinary income) or capital gain property (held for more than one year and not associated with an activity that produces ordinary income).

Secondly, the income tax treatment differs depending on whether the gift is “of related use,” that is, related to the tax-exempt purposes of the recipient charity. It must be reasonable to anticipate that the charity will use the property in a way related to its

² The content of the following paragraphs about the tax treatment of different gifts of property is summarized in a graph at the end of this section.

mission. So, for example, a gift of a painting to an art museum that will be exhibited as part of the organisation's exhibitions passes the test, but, interestingly, a piece of property given to the same organisation for a fundraising auction does not. While raising funds supports the mission of the museum, it is not the mission *per se*.

If the gift passes the related use test (and assuming the item is a long-term capital asset), the donor can claim a charitable income tax deduction equal to the full FMV of the property, up to 30% of his/her AGI. If it does not pass, the donor may claim a deduction at cost basis only. Unused deductions may be carried forward for up to five tax years.

The burden of substantiating non-cash gifts is on the donor. Most gifts (and all donated art) appraised at \$5,000 or more require a signature from a qualified appraiser. If the total value of gifts is between \$5,000 and \$20,000, a summary of the appraisal is also required. If the total value of gifts is above \$20,000, a copy of the signed appraisal is required. If a single art work is valued above \$20,000, more details may be required. The donor can itemise and deduct the cost of the appraisal.

It is worth noting that the legislation governing the deductibility of gifts of tangible property is currently under scrutiny in the U.S. Reacting to well-publicised cases where the value of gifts was overstated and donors claimed exaggerated deductions, the U.S. Senate is considering making recipient organisations responsible for appraisals of non-cash gifts.

Benefits for the donor

- The donor receives an income tax deduction in the year in which the gift was made.
- This vehicle provides a way to convert unwanted items into income tax deductions.
- If the gift is made as a bequest, the estate will receive an estate tax deduction.

Benefits for the recipient

- Related-use gifts, such as collections or pieces of art to an art museum, can substantially improve museum collections and, indeed, are an increasingly important way that leading museums acquire major works.
- This vehicle allows a charity to tap into a donor constituency who may be property rich yet cash poor.

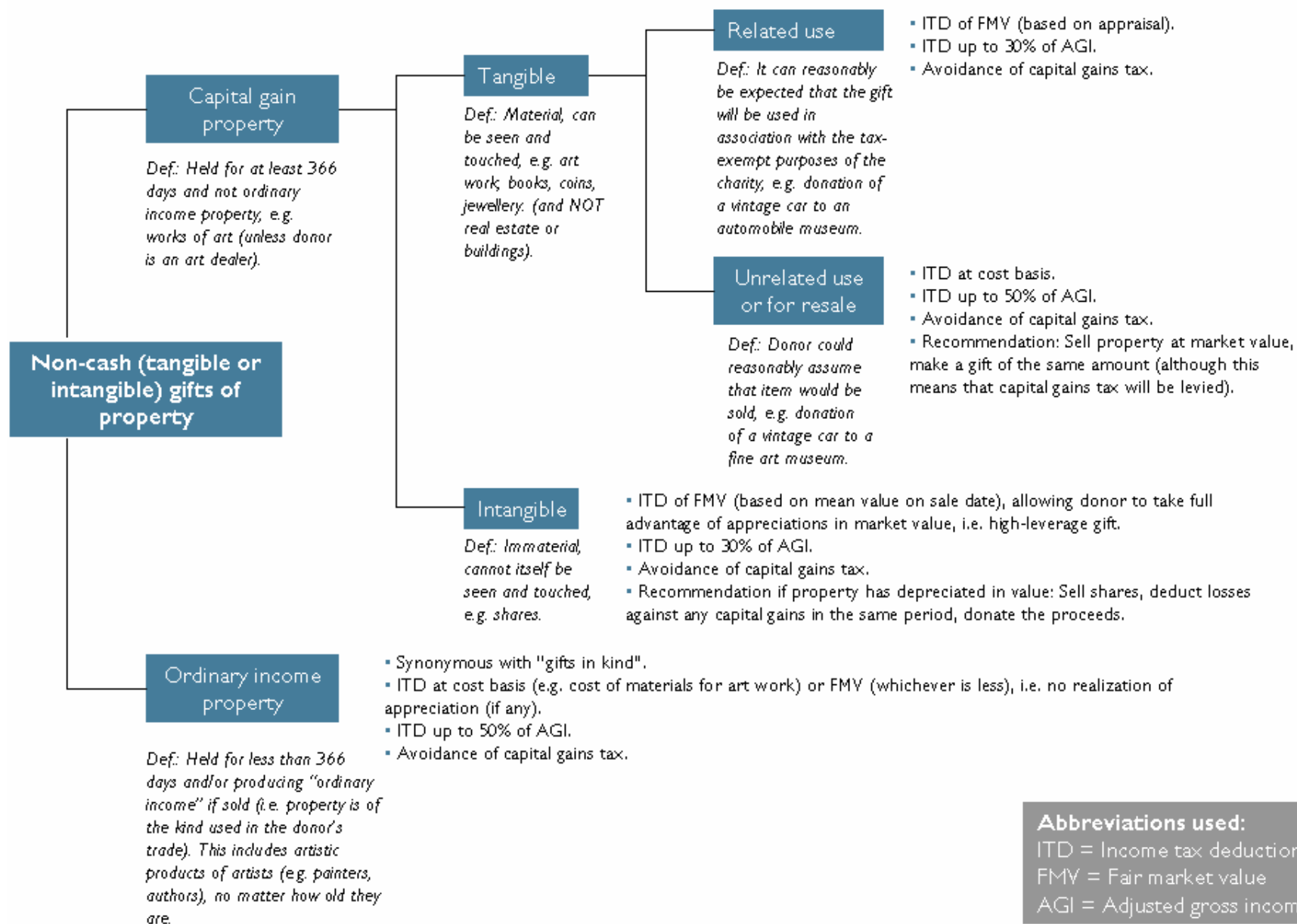
Caveats for the donor

- The transfer of some items, e.g., automobiles, requires formal legal steps.
- The onus for establishing FMV of the gift/s is on the donor.

Caveats for the recipient

- Charity should have gift acceptance policy governing such gifts.

Tax benefits for donations of tangible/intangible property

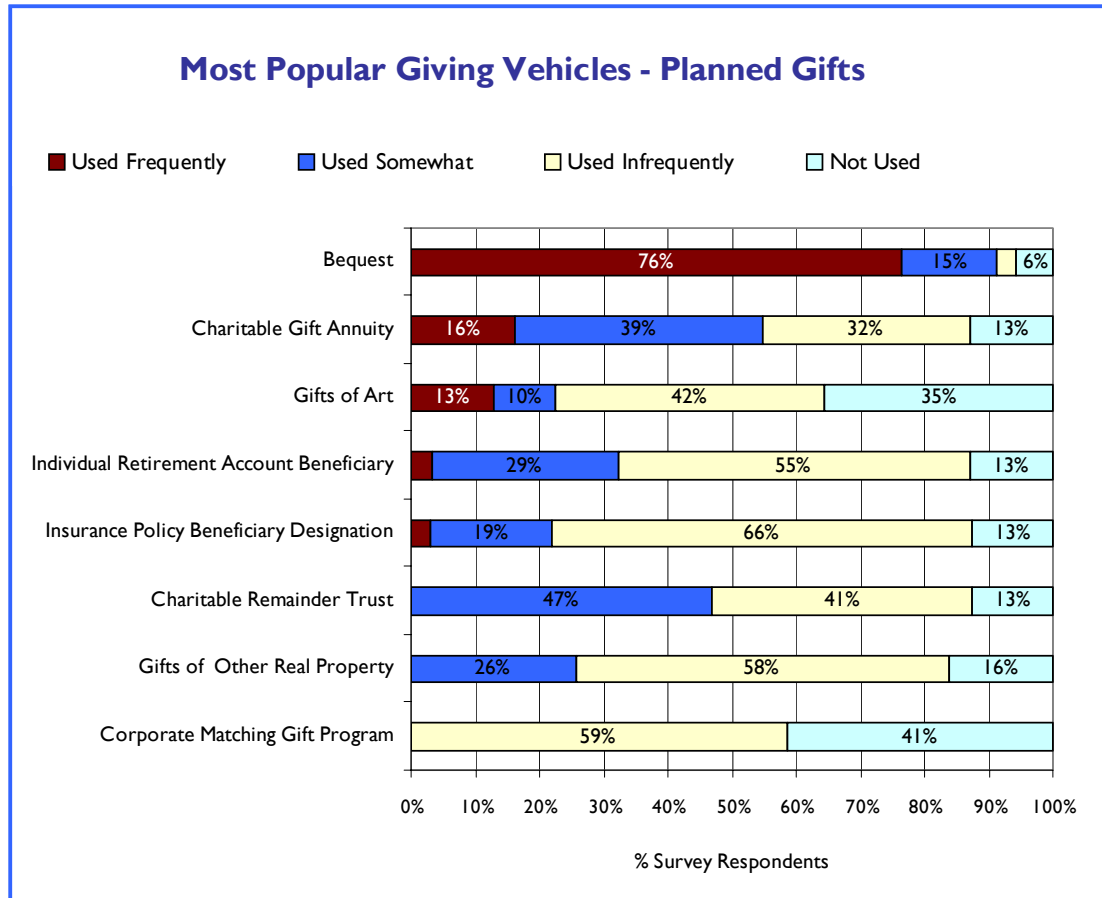


3. Deferred Gifts

Deferred gifts are gifts that are distributed, or have ownership finally resolved, only after a specified event or period of time has passed, at least one year. They differ from outright gifts in that the charity does not realise the asset immediately upon gifting by the donor, and the donor retains an interest in deferred gifts.

Deferred gifts generally take one of two forms: an estate gift, provided for in a donor's will and that typically comes out of their estate; or a life income gift, made during the donor's lifetime and that provides an income stream to the donor for the rest of his or her life. (In some cases, however, life income gifts are created in a donor's will. Under this scenario, a Charitable Remainder Trust, for example, is established upon the death of a donor, and someone other than the donor is the income beneficiary.)

Worldwide, the most popular form of a deferred gift is a bequest, and, in the U.S., charitable gift annuities are the second most popular. Below is a chart showing the most popular form of deferred gift received by their organisation, according to the AEA survey. It is noteworthy that, while the most popular deferred/planned giving vehicle among survey respondents' organisations – not all of whom represented collecting art museums – was the bequest, fully 23% of respondents cited gifts of art as either “used frequently” or “used somewhat.”



❖ Life Income Gifts

A life income gift is an irrevocable donation of cash or securities to a charitable organisation for which the donor (or other beneficiaries) receives, in return, income payments for a certain term or for life. A life income gift can be funded with cash, securities, real property or, in very rare circumstances, with tangible personal property such as furniture, books, automobiles, jewellery, paintings, and antiques. In the U.S., by far the most common assets used to fund life income gifts are cash and securities, followed by real property.

Following are several types of Life Income Gifts.

H. Charitable Gift Annuity

Description

A charitable gift annuity (“CGA”) is a contractual arrangement between a donor and a charitable institution whereby a donor makes a gift to a charitable organisation and

receives income for life at regular intervals (usually monthly or quarterly) by the charity. Upon the death of the donor, the remainder of the original gift goes to the charity.

The amount of the income to the donor is determined at the time the annuity is set up. The gift may also provide income to a second beneficiary. The annuity can be *immediate*, with annuity payments starting when the gift is made, or *deferred*, with payments beginning at a certain time in the future.

Income is determined on the basis of payout rates, which in turn are determined with reference to charitable gift annuity rates. The American Council on Gift Annuities offers suggested rates that are followed by many charities. Rates established for charitable gift annuities take the following factors into account:

- Mortality
- A residuum of at least 50% of the initial gift amount
- Interest
- Expenses
- Payout to the beneficiary/beneficiaries.

The annuity is backed only by the assets of the charitable organisation. Some charities buy re-insurance in order to cover the payments due on their gift annuities, which otherwise are an unsecured obligation. Some consider re-insurance advantageous for both parties.

Tax Scheme

The donor receives a charitable income tax deduction equal to the net present value (NPV) of the remainder interest to the charity. This amount is equal to the excess of the net FMV of the property transferred over the present value of the annuity. If the gift is made in cash, the charitable income tax deduction may be used to offset up to 50% of the donor's AGI. If funded with appreciated property, it may be used to offset up to 30% of the donor's AGI. The income tax deduction can be carried forward up to five years.

A portion of the income payments received by the donor may also be tax free. The donor defers paying capital gains on any appreciated assets used to fund the CGA, and the asset is removed from their estate.

Benefits for the donor

- Immediate *income tax deduction* for the value of the gift.
- Augments income with *fixed payments for life*, a portion of which may be tax free.
- Way to convert low-yielding securities into a higher-yield annuity.
- *Estate tax* reduction

Benefits for the recipient

- Charitable gift annuity is *irrevocable*.
- The charity may receive a larger gift than may otherwise be possible.
- There is a *large market for CGA's*, as they can be funded with as little as \$5,000.

Caveat for the donor

- The gift is *irrevocable*.
- The *income level is fixed* and thus will not increase with inflation.

Caveats for the recipient

- It is unknown when the gift will be received.
- Charity must *guarantee income* to the donor.
- Requires a *professional administrator*, either in-house or outside.
- Payout rates for older donors are high.
- Uncertain length of obligation.

I. Pooled Income Fund

Description

A *pooled income fund* (“PIF”) works like a mutual fund. Gifts to a PIF are invested together with similar gifts from other donors, and invested to the benefit of the donors or designees. The donors to the fund receive a variable income for life, the level of which depends on market performance and is net of administrative expenses, which are shared among the participants. Each donor’s proportional share of all PIF assets passes to the charity at the death of the donor or beneficiary.

Gifts to a pooled income fund can be made typically with as little as \$5,000 - \$10,000, and are usually made in the form of cash or readily marketable securities. Closely held securities or real estate are usually not accepted.

It is important to note that a PIF is market-sensitive, rather than age-sensitive like the CGA.

Tax Scheme

The donor receives a charitable income tax deduction in the year the gift is made. The amount of the deduction is based on the present value of the expected remainder interest of the gift. The latter is calculated on the basis of the life expectancy of the beneficiary, IRS actuarial tables and the highest return earned by the fund in the three preceding years.

Income from the PIF is treated as ordinary income and taxed to the beneficiary accordingly. If there is a survivor beneficiary, the value of any interest is included in the donor's taxable estate at its value at the time.

Donors also avoid capital gains taxes on the appreciated portion of any long-term securities transferred to the fund, and the gift reduces the donor's estate.

Benefits for the donor

- *Income tax* deduction
- Capital gains tax reduction
- *Income for life* is provided for beneficiary or beneficiaries.
- Estate tax reduction.

Benefits for the recipient

- A PIF may yield a *larger gift* than may otherwise have been possible.
- The gift is *irrevocable*.

Caveat for the donor

- The gift is *irrevocable*.
- Income is generally taxed as ordinary income.

- Income payments are variable and market-based, as opposed to fixed and age-based.
- Caveats for the recipient
- The administration and maintenance of a Pooled Income Fund *require professional expertise*.
- A PIF is a more sophisticated mechanism which appeals to a smaller market.

J. Charitable Remainder Trust

Definition

A charitable remainder trust (“CRT”) is established by transferring assets to a trust (see “Glossary of Terms”) and the donor or other beneficiary receives income from the trust for life or for a term of up to 20 years. At the death of the donor or last income beneficiary, the corpus of the trust is distributed to the charity.

There are two types of CRTs: a *charitable remainder annuity trust*, which provided fixed income payments, or a *charitable remainder unitrust*, which provides variable income based on the value of the trust.

For unitrusts, the income payments are variable, based on a fixed percentage of at least 5% to no more than 50% of the net FMV of the trust assets, which are valued annually. For annuity trusts, the income distribution is a specified dollar amount.

The term during which the trustee is obliged to make payments can be specified as life (most common) or for a maximum of 20 years. A donor can reserve the right to terminate a beneficiary’s interest prior to the term stated in the trust.

CRT’s are most often funded with cash, securities and real property.

Tax Scheme

Donors who establish CRT’s receive a charitable income tax deduction for the year in which the assets are transferred. Calculating the deductible portion can be complex; it is determined on the basis of unisex Treasury tables that discount the net FMV of the transfer by the present value of income that will be distributed to beneficiaries over the trust’s term. A probability test is made to prevent tax deductions for trusts that have a high chance of being exhausted before remainder interest is transferred to a charity.

The donor is also able to defer capital gains taxes and their estate is reduced by the

property transferred to the trust. However, the beneficiary is taxed for distributions from a CRT.

Benefits for the donor

- *Income tax deduction* for year in which assets are transferred.
- *Capital gains tax* deferred for appreciated security or property.
- *No limit* to the amount of the contribution.
- *Estate tax* reduction.
- Income payments for life.
- The donor can change the remainder beneficiaries, if the document establishes that right.

Benefits for the recipient

- CRT's often result in *large gifts*.

Caveats for the donor

- CRT's are *somewhat complicated* to set up and require an attorney.

Caveats for the recipient

- The administration is somewhat complex.
- Beneficiaries of CRT's *can be changed by the donor*, if the document has established that right.
- Marketing CRT's *requires sophisticated knowledge*, and thus requires either an in-house planned giving specialist with appropriate tax and legal background, or an outside advisor.

K. Charitable Lead Trust

Description

A Charitable Lead Trust ("CLT") involves an irrevocable transfer of assets to a trust that pays income annually to a *charity* during the life of the trust, usually 10 to 25 years. When the trust terminates, the principal plus any appreciation reverts to the donor or, in most cases, to the donor's beneficiary/ies. Thus, the CLT functions in a manner

opposite to the CRT in terms of whether the charity receives the income payments or the corpus remainder. Technically, CLT's are not "life income" gifts, but could constitute a category of their own. They are included in this section, however, as income-producing vehicles.

Income-producing assets, such as cash, stocks, or real estate, are the most common asset forms used to create a CLT.

Like CRT's, CLT's can be either annuities, which provide fixed payments, or unitrusts, providing variable payments according to a fixed percentage.

Tax Scheme

Donors who establish CLT's receive a charitable income tax deduction in the year in which the assets are transferred for the present value of the total income the charity will receive. As the CLT itself is technically the taxpaying entity, it is responsible for any capital gains taxes. In most cases, the donor's estate size is reduced by the transfer of assets to a CLT. However, the beneficiary is taxed on distributions from a CRT.

Benefits to the donor

- *Income tax* deduction
- *Gift tax* deduction.
- *Estate tax* reduction
- *Flexibility*, in terms of the term of years, and whether the income will be a fixed or variable payout, the appointment of trustee.

Benefits for the recipient

- Immediate and long-term income stream.
- The vehicle helps the charity build affinity with the donor.
-

Caveats for the donor

- A CLT is somewhat complex to establish.
- There are annual administrative costs and fees.

Caveat for the recipient

- A CLT is somewhat complex to administer.

❖ **Estate Gifts**

Typically, estate gifts are a type of deferred gift distinct from “life income gifts.” Estate gifts are normally made through the donor’s will, are revocable until the donor’s death, and realised by the charity after the donor’s death. As stated previously, life income gifts can be created in a donor’s will, but his practice is somewhat rare.

The most popular estate gifts include bequests, gifts of real property with life estate, gifts of life insurance policies and retirement accounts.

L. **Charitable bequest**

Description

A bequest is a provision in a will that provides for a gift of assets to a charity that becomes effective after the donor’s death. Bequests can be:

- *general*, usually a gift of a stated sum of money to a specified beneficiary;
- *specific*, meaning a specified item to a specified beneficiary;
- *contingent*, made on condition that a certain event occur before distribution to the beneficiary; or
- *residuary*, whereby a gift of all the “rest, residue and remainder” of an estate after all other bequests, debts and taxes have been paid.

Bequests can be either a fixed dollar amount, or a percentage of an entire estate. Percentage-based bequests are more common, as the exact value of the donor’s estate is normally not known when the will is made.

Bequests are revocable during the lifetime of the (future) donor. However, if there is “consideration,” that is, if the charity has acted upon the donor’s promise of a gift, the pledge agreement may become legally binding. (Pledge agreements may say that a pledge agreement is binding even without consideration.)

Bequests are the most popular form of planned gift in the United States, where they account for approximately 80% of all money raised through planned giving.

Tax Scheme

Bequests provide no tax benefits to the donor during his or her lifetime; however, they are fully deductible from the donor's estate for federal estate tax purposes, and there is no limit to the amount of the deduction. Some states have additional laws that may affect the tax consequences of bequests, however.

Benefits for the donor

- Easy and inexpensive to establish.
- Unlimited estate tax deduction.
- The *bequest is revocable* before the donor's death

Benefits for the recipient

- Bequests are relatively *easy to explain and market* to potential donors.
- There is a *large market* – anyone can make a bequest, even younger donors.
- *Easy to process*; usually no need for outside administrator.

Caveats for the donor

- There is *no income tax benefit* to the donor.
- *A bequest may become a liability* to the estate if, for example, the value of the estate is unknown prior to the donor's death, or if most of the estate's assets are not cash, which can force the liquidation of assets in order to fulfil the charitable obligations of the estate.

Caveats for the recipient

- Bequests are revocable.
- The value of the donor's estate may change between the time when the provision was made and the donor's death (inflation may lower the value of the bequest considerably).
- Bequests are not legally binding to the donor unless there is consideration or there is a specific clause in the bequest agreement making them binding.
- Conditions may be attached to a donation from a bequest that may make the administration of a gift difficult, such as a no-sell clause to real estate.

M. Real Property Gift with Life Estate

Description

A donor may make a gift of real property, such as a personal residence or farm, to a charity, and reserve what is called a "life estate" for the donor and/or any others the donor wishes to include as "life tenants." This means that the donor or his/her designees continues to possess and retain use of the property, with all rights and responsibilities of ownership, for the rest of their lives. At the death of the last surviving life tenant, the property passes to the charity.

Tax Scheme

The donor receives a charitable income tax deduction equal to the present value of the charitable remainder interest of the property. In addition, the donor avoids capital gain taxes on any appreciation, and the gift reduces the value of the donor's estate.

Benefits to the donor

- Immediate *income tax deduction* equal to the present value of the charitable remainder interest.
- Avoidance of *capital gains* tax on any property appreciation.
- Estate tax reduction
- The donor enjoys *continued use* of the property.

Benefits to the recipient

- The charity will benefit from the ultimate use or sale of the property.

Caveats to the donor

- To receive tax benefits, deed cannot be placed in trust, nor can donor require the charity to sell the property.
- Onus for appraisal is on the donor.

Caveats to the recipient

- Charity should have *gift acceptance policy* governing all deferred gifts.
- Potentially *complex* gift terms; professional counsel needed.

N. Life Insurance

Description

A donor may make a gift of life insurance by designating a charity as both owner and beneficiary of the policy, which may be either fully or partially paid-up. Upon the death of the donor, the charity receives payment for the full value of the policy. If the policy is not paid up, the donor makes annual contributions equal to the premium amount and is credited with deductible gifts of cash to the charity, which then pays the premium.

Tax scheme

For a paid-up policy, the donor receives a charitable income tax deduction for the replacement value, that is, the cost of purchasing an identical policy. If the replacement value exceeds the donors' cost basis, the deduction is limited to the cost basis. Donors can deduct up to 50% of their AGI in the year when the gift is made; unused amounts can be carried forward for up to five additional years.

For a partially paid-up policy, calculating the tax deductible amount is more complicated. It is generally equal to the lesser of the donor's cost basis and the *interpolated terminal reserve* of the policy. The interpolated terminal reserve equals an amount slightly larger than the cash surrender value of the policy plus a portion of the last premium paid before the gift is made. If the donor continues to pay the premiums after donating the policy to charity, those payments also qualify for an income tax deduction.

Donors can deduct up to 30% of their AGI in the year when the gift is made; unused amounts can be carried forward for up to five additional years.

Benefits for the donor

- Income tax deduction.
- Estate tax reduction.
- May be revocable or irrevocable.

Benefits for the recipient

- May be irrevocable
- *Large market* of "over-insured" people capable of this form of gift.

Caveats for the recipient

- The charity may be liable for paying premiums if donor defaults.
- Administration can be complex; professional advice is recommended.

O. Individual Retirement Account Beneficiary Designation

Description

A donor may make a charitable gift by naming a nonprofit as the beneficiary of a remainder interest in a retirement plan. In the U.S., retirement vehicles that can be gifted include employee benefit plans, individual retirement accounts (IRA's), corporate savings plans, 401(k) pension and profit-sharing plans, and 403(b) annuities.

Tax scheme

The donor's estate is reduced. Transfers to a charity at death enable an income tax deduction.

Benefits for Donor

- Income tax deduction
- Estate tax deduction
- Easy to transfer

Caveats for Donor

- None.

Benefits for Recipient

- Fairly large market
- May yield large gifts

Caveats for Recipient

- May require outside administrator.

Appendix A: Glossary of Selected Terms

Following are terms frequently used in the context of charitable and planned giving in the U.S.³:

ADJUSTED GROSS INCOME ("AGI") A federal tax term for gross income minus business, investment, and certain other deductions but before exemptions and itemised deductions (including the charitable deduction) are subtracted to determine taxable income.

ADMINISTRATOR A legally competent individual, bank, or trust company appointed by a probate court to administer the estate of an intestate. Persons entitled to be administrators are specified in priority order by state laws.

ANNUAL EXCLUSION An amount (presently \$11,000) which every individual can exclude from federal gift tax for every gift of a present interest which that individual gives to another individual.

ANNUITY An amount to be paid periodically. Usually (1) the amount is a fixed sum not dependent upon income; (2) the period is the life of an annuitant; and (3) the frequency of payment of the fixed sum is at least annual.

APPRECIATION The excess, if any, of the value of an asset above its basis.

BASIS The purchase price of an item of property, minus depreciation allowed or allowable as a tax deduction, plus improvements

BENEFICIARY An individual or entity named to receive some assets.

CAPITAL GAIN The appreciation in a capital asset.

CAPITAL GAINS TAX The tax due as a consequence of selling an asset which has capital gain. The term capital gains tax almost always is used to refer to the tax on long-term capital gain.

CARRYOVER The five years following the tax year in which a gift to a nonprofit is made and during which the donor must claim any balance of the value of the donation which he or she could not claim as a charitable contribution tax deduction because of the applicable percentage limitation.

CHARITABLE LEAD ANNUITY TRUST A charitable lead trust which pays a fixed amount

³ Sources: American Council on Planned Giving, National Council on Planned Giving, Nonprofit Resource Center, Planned Giving Resource Center.

annually (an annuity) for its duration to a nonprofit or a private foundation. Compare with charitable remainder annuity trust.

CHARITABLE LEAD TRUST A charitable lead annuity trust or charitable lead unitrust. Compare with charitable remainder trust.

CHARITABLE LEAD UNITRUST A charitable lead trust which pays a fixed percentage of its annual value to a nonprofit or a private foundation. An alternative form can pay the greater of a fixed percentage of the trust's annual value or its net income. Compare with charitable remainder unitrust.

CHARITABLE REMAINDER ANNUITY TRUST Even though recipients of charitable remainder annuity trusts receive annuities, they are referred to in the Regulations and generally in this book as recipients, not annuitants. Compare with charitable remainder unitrust.

CHARITABLE REMAINDER TRUST A trust described in Internal Revenue Code Section 664, more specifically, a charitable remainder annuity trust or charitable remainder unitrust.

CHARITABLE REMAINDER UNITRUST Compare with charitable remainder annuity trust.

CHARITABLE TRUST A trust in which all interests (or rights), income interests as well as remainder interests, are devoted to nonprofits. Such trusts are often perpetual and, generally, are private foundations under U.S. tax law.

CORPUS The assets of a trust or its principal.

DEFERRED CHARITABLE GIFT ANNUITY A charitable gift annuity which is to make its first payment more than twelve months after the gift is set up.

DEFERRED GIVING Methods of giving which require the nonprofits to wait a year or more before being able to use the gift assets. Deferred giving is only one part of planned giving.

DEPRECIATION A deduction allowable to taxpayers on depreciable assets used in a trade or business and which is intended to reflect the fact that such assets wear out.

DIVIDENDS Payments which corporations make to their stockholders based on the amount of stock they hold.

ESTATE All the assets and liabilities of individuals or entities, such as corporations, trusts, or partnerships. The most common sorts of estates thought of in planned giving are the estates of

living individuals and decedents.

ESTATE TAX A tax imposed on decedents' estates.

FAIR MARKET VALUE I.R.S. Regulation Section 170A-1(c)(2) says, regarding charitable deductions: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts."

FAMILY TRUST Same as revocable trust.

FUTURE INTEREST A gift tax term describing interests which individuals give to donees but which the donees will not possess for a year or more.

GIFT ACCEPTANCE GUIDELINES Guidelines, policies, or procedures to help charities avoid accepting planned gifts which might result in undue expense.

GIFT TAX A tax imposed on gifts made during life.

GRANTOR Someone who makes a gift; often used interchangeably with "trustor."

GRANTOR TRUST A trust where all or part of the trustees earnings are taxable to the trustor or some other person who does not necessarily actually receive the income under Internal Revenue Code Sections 671 - 679.

INCOME BENEFICIARY An individual or entity who owns an income interest.

INHERITANCE TAX A tax which some states impose on beneficiaries of decedents' estates rather than on the estates themselves. Inheritance taxes are usually based on how much is received from decedents and by whom, rather than on the size of the estates.

IRREVOCABLE Something that cannot be revoked or changed.

LIFE ESTATE GIFT A life estate includes such things as life tenancies and life income interests in trusts. "Life estate gift" is sometimes used to refer to remainder deed gifts.

LIFE TENANCY Most commonly, a life estate in an asset not in trust. Sometimes also referred to as a "legal life estate."

LONG-TERM CAPITAL GAIN Capital gain in an asset held for investment or use in a trade or

business and obtained from a decedent or held for more than one year.

NICRUT Acronym for "net income charitable remainder unitrust." Example: A charitable remainder unitrust which calls for payment to the recipients of 5% of the annual value of the trust's assets but not more than the actual net income of the trust.

NONPROFIT Nonprofits referred are those which have their tax-exempt status under Internal Revenue Code Section 501(c)(3).

PERSONAL PROPERTY Property other than real estate. Examples: Cash, stock, jewelry, copyrights, furnishings. Compare with real estate and tangible personal property.

PLANNED GIVING A form of fund raising which includes deferred giving.

POOLED INCOME FUND A trust described in paragraph (5) of Internal Revenue Code Subsection 642(c).

PRESENT VALUE The value today of an amount to be paid at a future time, assuming certain interest rates.

REAL ESTATE Land and things permanently affixed to land.

RELATED USE A use related to the purpose for which a nonprofit received its tax-exempt status. Donors who give long-term capital gain tangible personal property to nonprofits for a "related use" can deduct the full fair market value of those gifts.

REMAINDER The rights to an asset that remain after intervening estates have expired.

REMAINDER BENEFICIARY A beneficiary who owns a remainder.

RESTRICTIONS Donors' specifications on how nonprofits should use their gifts.

REVOCABLE TRUST A trust that can be revoked by its creator.

S CORPORATION A corporation which is not taxable. S corporations' income is taxed to their shareholders, similar to partnerships.

SECTION 501(c)(3) The paragraph of Internal Revenue Code Subsection 501(c) which describes organizations that can be tax-exempt, and gifts to which can be tax deductible under other Internal Revenue Code Sections (170, 642, 2055, and 2522).

SHORT-TERM CAPITAL GAIN Capital gain which is not long-term capital gain, meaning the asset was held for 365 days or less.

SPLIT-INTEREST GIFT A gift which is not a gift of an entire interest but satisfies the interest limitation requirements so that the rights given to nonprofits are tax deductible as a charitable contribution.

TANGIBLE PERSONAL PROPERTY Personal property which can be touched and moved, but not including things which are only symbols of intangible personal property, such as stock certificates, certificates of limited partnership, savings account passbooks, etc. Examples: Art, jewellery, furnishings, collections, automobiles.

TAX DEDUCTIBLE Can be claimed as a deduction against taxpayers' incomes, estates, or gifts, depending on what the deductible item is and what tax is in question.

TAX EXEMPT Not required to pay income taxes on income received.

TAX REFORM ACT OF 1969 The tax act which completely revamped federal income tax deductions for gifts to nonprofits and private foundations as well as tax exemptions for those organizations, created the new planned giving devices of charitable remainder trusts, charitable lead trusts, and pooled income funds, and changed the tax treatment of others. Congress has made modifications since that time, but the basic structure is unchanged.

TRUST "Trust" is a generic term for an asset management vehicle. Trusts were created as a concept centuries ago to keep owners' assets from reverting to the king. The creator of the trust is called the "trustor," "grantor," or "settler." (For the purposes of this paper, we shall refer to the creator of the trust as the "donor.") The person or institution administering the trust and to whom the assets are transferred is called the "trustee." The person or institution receiving income from the trust is called the "beneficiary." Beneficiaries can be "current" (receiving income or principal from the trust) or "remainder" (receiving principal or corpus upon termination of the trust).

Charitable Remainder Trusts are tax-free vehicles; Charitable Lead Trusts are not. Taxes are levied only on the recipients of distributions from the trust's income and/or assets. The most common forms of trusts used in charitable planned giving are Charitable Remainder Trusts, where the charity is a remaining beneficiary and Charitable Lead Trusts, where the charity is a current beneficiary.

TRUSTEE One or more legally competent individuals, banks, or trust companies who own the

assets of a trust. Trustees are subject to a very high standard in carrying out their duties under their trust agreements. Although they have legal ownership of trust assets, they must manage and distribute those assets as prescribed in the agreements. See the example under trust.

TRUSTOR One who creates a trust. Usually the trustor is the individual or entity who executes the trust agreement with the trustee and places the assets in the trust. Trustors of split-interest trusts are often called donors.

VALUATION DATE Dates prescribed in charitable remainder unitrust and pooled income fund documents. In unitrusts they are used to determine the date (or dates-there can be more than one) when the trust assets are to be valued to determine the payout for that year. In both unitrusts and pooled income funds they are also used to value assets added to the trusts.

WILL A written document executed in accordance with formalities required by state law to carry out decedents' wishes at death, including disposing of their assets; naming executors, trustees, guardians; and setting up trusts.