Should Your Organization Have A Life Income Program?

PG Calc Webinar

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Introduction

With bequests accounting for 80% to 90% – sometimes even more – of the money raised by most planned giving programs, it is worth asking whether a life income program makes sense for your organization. If you don't offer life income gifts yet, should you start? Perhaps you already have a well-established life income program, but is it still viable? Or, if you have a fledgling life income program, can you give it a boost?

Even though the vast majority of planned gifts are simple charitable bequests, most well-rounded planned giving programs provide donors with the opportunity to consider life income gifts. There are several reasons to offer life income gifts as an option. First of all, life income gifts are, for the most part, irrevocable, and therefore arguably better for the charitable organization because they cannot be changed or revoked like a simple bequest. In addition, the opportunity to discuss these advanced planned giving methods with prospective donors can position the organization to be of service to its donors helping them in creating charitable gift plans that benefit the donor and the organization.

In the following pages we will review some of the factors you should consider when evaluating a life income program for your organization. We will also discuss how and why you might decide to accept some forms of life income gifts but not others, or to issue gift annuities to donors in some states but not others.

Advantages and Disadvantages

Life income gifts offer distinct advantages – and disadvantages – for both the donor and the charitable organization:

- For the donor – the opportunity to receive income, avoid capital gains tax, and shift investment strategies are advantages. However, donors must also consider that these gifts are irrevocable and there is very little flexibility should the donor wish to make changes after the gift is made.
- For the charity – the irrevocability of these gifts is an advantage compared to other planned gifts like charitable bequests and beneficiary designations which can be changed or even revoked, sometimes without the charity being aware of the change. However, the charity must consider that it will be obliged to establish relationships – sometimes lifelong – with the donor(s) and beneficiary(ies) and take responsibility for fiscal and fiduciary matters, which is usually not the case with a simple charitable bequest, where non-financial stewardship is the most important thing.

Why Not Just Stick With Cash?

Let us briefly consider why a charitable organization would even consider anything other than simple cash gifts. As they say, "Cash is King." What organization would not want to have all its contributions in hand now, received in cash, ideally with few or no restrictions, in order to put the money to use immediately for the most pressing needs? But only accepting cash gifts (or even highly liquid gifts like marketable securities) is not a realistic strategy and may not be viable in the long run.

First, from an organizational perspective, relying solely or even primarily on current cash contributions to meet financial needs creates significant stress, particularly as the organization grows and expands its mission. Over-reliance on current cash contributions presumes that existing donors will be retained and will increase their contributions and that new donors can be obtained to help shoulder the increasing financial needs and replace lapsed donors.

Donor retention, increased giving, and recruitment of new donors are hallmarks of a successful fundraising program, but cannot keep up with the budget demands of the organization. A vigorous planned giving program can help provide with current dollars received from a pipeline of maturing bequests and life income gifts or with distributions from an endowment built over many years through planned gifts. A planned giving program provides some financial stability and allows a charitable organization to expand its donor base and gather charitable dollars it would not otherwise receive.

Another shortcoming of a cash-only emphasis is that this strategy restricts the audience of prospective donors and limits the size of contributions donors may make. For most individuals, the largest portion of their wealth is in non-cash assets. A cash contribution comes from disposable income, accessible cash savings, or perhaps selling an asset (which can be disadvantageous from a tax perspective). While many organizations would consider outright gifts of readily marketable non-cash assets like securities to be as good as cash, the donor may not be in a position to give the entire asset, at least not in their lifetime, or unable to give the asset without generating some cash flow in return.

Being open to a broad array of gifts demonstrates an awareness of the donor’s assets, along with a willingness to enable the donor to support the organization in a way that best suits their situation – the charity becomes “donor friendly.” In return, the organization gains added stability in its fundraising and insures it is able to receive what typically are the donors’ largest gifts.

Life Income Gifts

In the simplest terms, a “life income gift” is a plan that allows a donor to make a contribution to charity and receive income in return. Depending upon the plan, the income may be fixed or variable and it can go on for one or more lifetimes, a term of years, or a combination of the two. Later we will explore several specific plans. However, life income gifts have the following features in common:

- are irrevocable once the contribution has been made
- provide a current income tax deduction for the calculated value of the charitable gift
- can be made during lifetime or included in a will or other testamentary instrument

- are subject to both Federal and state laws.

Types of Life Income Gifts

Charitable Gift Annuity

- Money, property, or other assets are irrevocably given now to a charitable organization in exchange for a contractual promise to pay a fixed amount – an annuity – each year to one or two annuitants.
- The dollar amount of annuity payment is set at the time the gift is made and cannot be changed.
- One or two annuitants are named at the time the gift is made and cannot be changed.
- The annuity payments usually begin right away but may be delayed (a deferred payment gift annuity).
- The obligation to make annuity payments is backed by the financial resources of the charitable organization that issues the gift annuity.

Charitable Remainder Trust

- Money, property, or other assets are irrevocably transferred to a trustee with instructions to pay income to one or more income beneficiaries for a period of time and then to transfer the funds remaining in the trust to charity.
- Two types:
  - Annuity trust – pays a fixed dollar amount to the income beneficiaries; the amount received by the income beneficiaries does not change regardless of investment return
  - Unitrust – pays a fixed percentage of the value of the trust, as re-determined annually, to the income beneficiaries; the amount received by the income beneficiaries changes from year to year depending upon investment return.
- A charitable remainder trust cannot be perpetual. It must have a specific end point. The trust can run for one or more lifetimes, a term of years (not to exceed 20), or a combination of lifetimes and years.
- The payout method (annuity or percent of trust value), the payout amount or percentage, the income beneficiary(ies), and other terms of trust are set at the time the gift is made and cannot be changed.
- The trustee may be the charitable organization, a trust company, an individual, or others authorized by state law.

Pooled Income Fund

- A number of donors irrevocably contribute money, property, or other assets to a pooled investment fund operated by a charitable organization.
- Under the terms of a gift agreement, income beneficiaries are paid a share of the fund's net income proportionate to the relative value of the contribution to the fund.
- When the income beneficiaries die, their share of the fund is withdrawn for use by the charity.
- Note that pooled income funds have become less popular because the beneficiary payment is limited to the net income (generally dividends and interest) of the fund. However, pooled income funds remain a good option for donors who are willing to accept a more modest income in order to provide the potential for a larger remainder for the charitable organization.

Organizational Readiness – Key Questions to Ask

Whether launching a new life income program or revitalizing an existing program, an organizational self-assessment should consider several key questions:

1) How successful is your annual giving program?
2) How is your charitable bequest effort going?
3) Does your organizational culture support this new type of philanthropy?

How Successful is Your Annual Giving Program?

The best prospects for a planned gift – whether a charitable bequest or a life income gift – are those who are already regular annual givers. Intuitively, this makes sense. Those who are passionate enough about the mission to give regular annual gifts are most likely to be willing to consider the ultimate gift of their lifetime accumulation of wealth. In addition, the roster of current donors is a remarkably rich prospect group. Research indicates that between 5% and 8% of donors have also made a planned gift – either charitable bequest or life income gift. But more than one-third of donors indicate they would be willing to consider a planned gift!

Beyond providing a good source of prospects, a successful annual giving program requires the organization to build other strengths that are key for an expanded planned giving program including life income gifts.

First, a well-integrated annual giving effort includes stewardship efforts and, more importantly, an organization ethos of accountability to donors for the proper and respectful use of their charitable contributions. One of the intangible effects of a successful individual fundraising program is a perception among prospective donors that the charitable organization is trustworthy and respectable, providing confidence to donors that the organization will do right with their contribution.

In addition, a solid annual giving program usually requires the organization to make the investments necessary to maintain a complex database including relationship management capabilities and the capacity to efficiently accept and accurately process and account for charitable contributions. These elements will be crucial when accepting and managing life income gifts.

Finally, annual giving programs that have major gifts components to them have the ability to discern wealth and specific interests of their donor pool. This information, coupled with good database use, can help identify sources of volunteers and staff who can best approach donors for gifts that will last beyond their lives.

How Is Your Charitable Bequest Effort Going?

A robust program promoting, soliciting, recording, and stewarding charitable bequests of all sorts and sizes provides an excellent foundation for a successful life income program. As mentioned in the introduction, even planned giving programs with highly successful life income gift components still receive 80% to 90%, perhaps more, of funds from charitable bequests. This holds regardless of the longevity or sophistication of the program. Clearly, a strong charitable bequest program is a key component for any organization and provides a firm footing for a life income gift effort.

Everyone throughout the organization should appreciate that the term “charitable bequest” is not limited to a provision in a donor’s will or living trust, but also encompasses a range of end-of-life gifts made by naming the charitable organization as a beneficiary of an IRA or other retirement plan, a life insurance policy, checking or savings accounts, investment or brokerage accounts, and even in some cases real estate (via a “transfer on death” deed).

Obviously, even very young donors can include a charitable bequest in their wills, but the primary focus of marketing and cultivation for most charitable bequest programs is on prospective donors in their 50s and up. From an actuarial perspective, this age demographic makes sense for life income gifts too. In addition, there is a demographic wave of individuals in this age group, providing an encouraging outlook for bequest programs in the coming years.

There is good reason to expand the promotion of simple charitable bequests to younger audiences. A study commissioned by the Giving USA Foundation in 2019 surveyed donors who had already made planned gifts and disclosed their gifts to the organization. The report challenges several persistent myths about planned giving, namely that charitable bequests are only for older donors who make up their mind late in life and then amend or revoke their gifts.

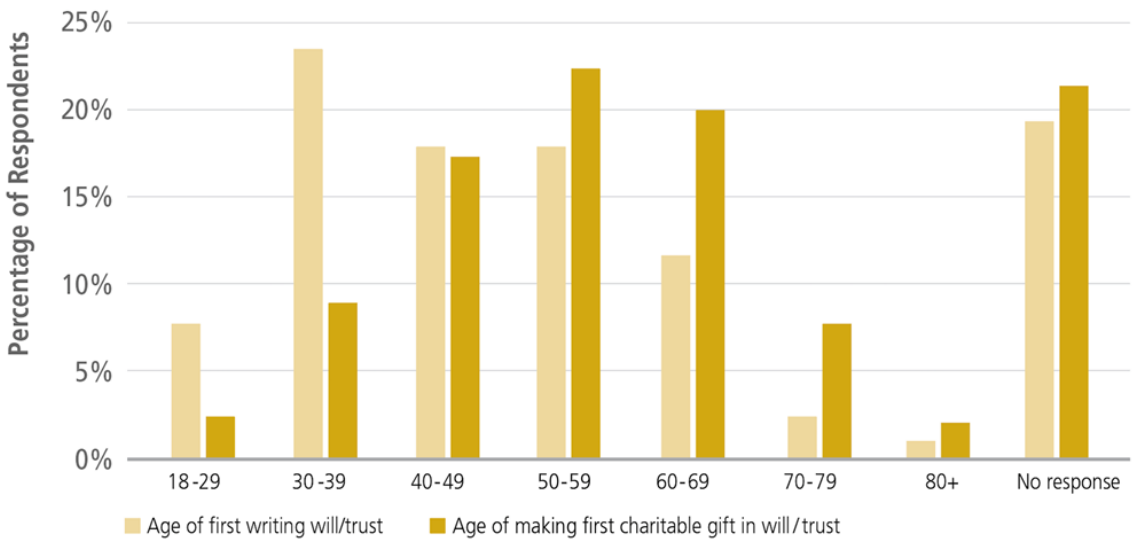
A common misconception is that planned gifts should be marketed to older individuals because wills are written later in life, perhaps when people are more concerned about their own mortality.

However, donors often write their first will when they are in their 30s and by age 60 the majority of donors who are going to write a will have already done so.

Furthermore, often it is assumed that donors make the decision to include a charitable bequest in their wills only later in life. However, the study finds that donors are likely to have included a charitable bequest in their very first will. As shown in the graph below, most donors (53%) included a charitable bequest in their first will and, by age 60, most who will make a charitable bequest have already done so.

Figure 7

Age of adding a charitable gift in will/trust vs. first writing will/trust



A key takeaway from these two findings is that, rather than waiting until later in the donor's lifetime, charitable bequests should be promoted even to younger donors. This may be counterintuitive because, on average, the organization will wait many decades before receiving a charitable bequest from a young donor, and donors can change their minds at any point. While we will not speculate about ways to shorten the actuarial reality, there is a persistent myth that, somehow, donors will reduce or even eliminate their other giving to the organization once they've made a charitable bequest. Research indicates otherwise: not only do bequest donors maintain their regular giving, they increase it over time.

Table 4

Charitable legacy giving as a factor of age

Changes in gift planning	Percentage
The number of gifts has not changed	50.4%
I have increased the number of gifts	44.2%
I have decreased the number of gifts	5.4%

The Giving USA study suggests that, as a matter of fact, charitable bequest donors do not reduce or eliminate their charitable bequest, indeed most donors maintain or even increase their gifts over the years and, for most bequest donors, their charitable bequest is the largest gift of their lifetime.

Clearly, a vigorous charitable bequest program is an essential element of a well-rounded fundraising effort. Charitable bequests contribute to regular giving and prepare prospective donors to think about life income gifts. A solid charitable bequest program is the basis for a successful life income gift effort.

Does Your Organizational Culture Support This New Type of Philanthropy?

Over the years, much has been written about the key role of a "culture of philanthropy" in fundraising success. There is little doubt that organizations with a healthy culture of philanthropy are more successful in their individual fundraising. An emphasis on accountability to donors and a clear acceptance of the donor as a partner and not just a revenue source builds lifelong donor loyalty. A culture of philanthropy also speaks volumes to prospective donors who want to be confident that their life income gift will be well managed and, more importantly, ultimately honored by the charitable organization.

Launching or revitalizing a life income program will push the organizational culture of philanthropy to new levels and in new directions. Whenever a life income gift is accepted, the charitable organization engages in a much higher level of donor relationship. These life income gift relationships often involve fiduciary and legal obligations and are likely to endure for one or more lifetimes.

A successful life income gift program requires more than generous donors and staff skilled in the techniques of charitable gift planning. It also requires a significant and long-term commitment on the part of the charitable organization. Life income gifts obligate the charitable organization to provide services to donors and beneficiaries. In some cases, the organization will incur fiduciary obligations and enter into relationships that last for one or more lifetimes. Following we review some organization considerations including engagement by the governing board, creation of policies and procedures, and administrative and compliance concerns.

Life income gifts stand apart from other simpler forms of charitable giving. Life income gifts are far more technical and complex, require specialized knowledge, involve long-term cultivation of donors, and rely heavily on outside professional advice. Close ties are often formed with donors and members of their families, and these relationships can endure for lifetimes.

Many planned gifts, by design, involve splitting interests between the charitable organization and the donor. The successful completion of a planned gift often requires negotiation and compromise between the donor and the organization. These “split interest” transactions require that the interests of the parties be carefully balanced. Throughout the course of gift negotiations, the organization may be required to make important decisions which will have an impact on the gift and the organization’s obligations. In addition, the split interest environment abounds with potential conflicts of interest for the development officer and his or her organization.

Administrative and Legal Concerns

Life income gifts require administrative support and supervision for legal and fiduciary obligations that may last one or more lifetimes. Federal and state laws and regulations govern the promotion and solicitation of life income gifts, particularly the issuance of gift annuities must be considered.

The Philanthropy Protection Act (1995) exempts most life income gifts from securities registration requirements provided that (among other things) full and complete disclosure is made to prospective donors prior to completion of the gift. PG Calc’s PGM Anywhere software provides disclosure statements designed to meet these requirements.

Charitable gift annuities are subject to regulation under state law. Many states exempt charitable gift annuities from regulation, while others require registration of the charitable organization before it issues a gift annuity. Some states require annual reporting by the organization and others require registration of each gift annuity contract. Some states regulate only the charities located within the state, other states take the position that out-of-state charities must comply with state regulations whenever a state resident makes a gift in exchange for a gift annuity. Some states take the position that even making a gift annuity payment to a state resident requires registration.

Even worse than the overlapping and sometimes contradictory state requirements, state laws and regulations are ever changing. The American Council on Gift Annuities is a good resource for current state regulations.

A crucial part of the deliberations regarding a life income gift program is whether or not the charitable organization will issue charitable gift annuities and, if so, how it will comply with the wide range of state requirements. Some organizations have taken the position that they will comply with the laws of their home state, others have endeavored to register and comply with the requirements of all 50 states. Some organizations have chosen to register in some states – perhaps waiting until there are donors from a state – and not others.

How the charitable organization will accommodate state regulation is a business and legal decision that should be made in consultation legal advisors. However, this is an issue that should be addressed long before promoting and issuing charitable gift annuities, especially if donors reside out of state.

Policies and Procedures

A set of thoughtful and well-developed institutional policies and procedures will be strong enough to protect the interests of the organization while still providing flexibility and guidance to encourage the negotiation and acceptance of high-quality charitable gifts that benefit both the organization and help the donor fulfill his or her charitable objectives.

The activity of creating and adopting policies and procedures is as important as the final product. During a thorough policy development process, the organization will engage in a healthy internal dialog regarding alternatives and issues that will inevitably arise as you pursue more complex charitable gift situations. Rather than wrestling with such issues under time pressure and with a contribution hanging in the balance, a workable set of policies and procedures will provide a basis for thoughtful deliberation and good decision making that will serve both the organization and the donor.

The policy development process should not be shortchanged. As tempting as it may be to simply adapt a template or perhaps adopt the policies of another organization, the result will be unsatisfactory. The process should be a collaborative effort including the development office, the business office, legal counsel, leadership and, as noted above, with crucial involvement of the governing board. While it will probably fall to the development office to lead the way, the creation of policies and procedures should never be a solitary effort.

You may consider forming a task force or advisory committee. Members should have an understanding of your organization and its processes and expertise or interest in subject areas to be covered by your new policies and procedures such as internal processes, legal affairs, financial records, and marketing. Staff support may be required for research, distribution of material to committee members, planning agendas, making assignments and managing the process.

You may wish to review the policies of other organizations as a starting point. However, you should not haphazardly adopt the work of others. Carefully studying your own circumstances and engaging both internal and external stakeholders will help ensure that you settle on a set of policies and procedures that best serve needs of your organization and your donors.

Some issues, specifically related to life income gifts, you may wish to consider depending upon your organization's circumstances include:

- Care and caution in working with donors who are ill, near death, or incompetent

- Working with the heirs of donors
- Organization position regarding “finder’s fees”
- Clarification of duties, responsibilities, and relationships among the development office, business office, and executive leadership
- The organization’s position regarding trusteeship of charitable remainder trusts (organization, bank or trust company, individual, co-trusteeship)
- Position regarding trustee fees and expenses and accountability for these costs
- Method and approach for counting and crediting planned gifts for donor records, campaign goals, endowment goals, present value, matured value and projecting expectancies

Informed Acceptance of Risk

Active and informed engagement by the governing board is imperative before launching a life income gifts program. Often, the process of reviewing amending and expanding – or perhaps creating – governing policies is the way to ensure engagement by the governing board. As a component of its policy making, the governing board should carefully consider and agree to accept the risks to the organization that accompany life income gifts. The following table summarizes and compares some of these risks for gift annuities and charitable remainder trusts compared to simple charitable bequests.

	Charitable Bequest	Charitable Gift Annuity	Charitable Remainder Trust	
			Charity serves as Trustee	Outside Trustee
Financial Risk for the Organization	• Minimal risk to the organization	• Organization assumes a primary financial obligation to ensure annuity payments are made on a timely basis	• Maximum financial risk to the organization is limited to diminished value lost value of the trust fund – though reputational risk may be a concern in such a case	
Administrative Considerations	• Maintain liaison and monitor estate executor during estate settlement process	• Ensure annuity payments are made accurately and on time • Annually issue 1099-R • Track annuitants for life	• Fiduciary responsibility for investments and trust management • Complex trust accounting • Tax preparation and reporting (Federal, state, and beneficiary)	• Outside trustee manages the trust • Organization may be obliged to monitor the trustee
Regulation	• Minimal	• Subject to state regulation	• State law may not permit organization to serve as trustee	• None
Minimum gift size	• Any size	• Depends upon organization’s policy; typically, tens of thousands	• As a practical matter, typically hundreds of thousands of dollars	
Other considerations	• Gifts are revocable, though they rarely are	• Lower gift minimum can appeal to broad range of donors	• Careful planning for the administrative burden is essential	• Charity as co-trustee with corporate fiduciary is an option

Four Scenarios

If your organization …	Consider these strategies:
… is small or new, perhaps growing, but still struggling to make ends meet	Focus on building a charitable bequest program; entertain life income gifts on an *ad hoc* basis if opportunities arise
… lacks capacity in some of the essential elements: annual giving, bequest giving, and organizational culture	Invest time and resources bolstering fundraising efforts, build capacity over time toward life income gifts
… mission requires significant cash now and future gifts are not particularly helpful	Consider that life income gifts and perhaps even charitable bequests are just not mission critical
is affiliated with a national organization that offers life income gifts	Explore options to partner with national organization to offer life income gifts

In Summary

A well prepared and carefully managed life income gift program can significantly expand the reach and productivity of your fundraising efforts. Life income gifts create life-long relationships that include financial, fiduciary, and legal obligations. Also, life income gifts can change the donor-charity relationship in subtle ways – donors become beneficiaries and clients of the organization. For charities that have a robust annual giving and bequest program, as well as a long-term commitment to building and sustaining donor relationships, a life income program can make a valuable contribution to their fundraising. Without all these ingredients, however, a life income program can be a burden rather than a boon.