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EFFECT OF FINANCIAL LOSSES ON ENDOWMENTS, CHARITABLE GIFTS AND PRIVATE FOUNDATIONS:
What To Do With Underwater CRTs, CGAs And Foundations

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THE SCOPE OF THE PROBLEM

HOW IT IMPACTS DIFFERENT GIFT VEHICLES

CRT
- CRUT - Risk is shared by income beneficiary and charity
- CRAT - Risk is on all charity, until exhaustion

CGA
- Risk is on all the charity, even if gift is exhausted
- May be additional risk if CGAs are restricted as to purpose

Private Foundation
- Won't spend itself down…but it can become inefficient

IS ANYONE AT RISK - AND FOR WHAT?

Investment Performance:
- Just "typical" market loss? Is that going to be a defense?

Other Issues:
- Gift design issues
- Donor education
- Funding asset, initial investment decisions
- Investment monitoring
- Communication to donor regarding trust administration

Who Has Risk:
- Donor's attorney
- Charity's attorney
- Trustee
- Investment advisor
- CPA - trust administrator

WHAT INVESTMENT STANDARDS ARE APPLIED?

CRTs and Private Foundations in Trust Form

- Trustee's Standard of Care in Administering Trust (e.g., Cal. Probate Code section 16040)
- Uniform Prudent Investor Act (e.g., Cal Probate Code section 16045 et seq.)

CGAs

- Investment of Reserves (e.g., Cal. Insurance Code Section 11521.1)

Private Foundations in Corporate Form

- Director Duties and Liabilities (e.g., Cal. Corporations Code Section 5231)
- Standards for Investment or Retention of Assets (e.g., Cal. Corporations Code Section 5240)
- Managing and Investing an Institutional Fund (e.g., Cal. Probate Code Section 18503)

Federal Tax Law (Private Foundations, and generally not CRTs)

- Investments Which Jeopardize Charitable Purpose (IRC Section 4944)

Key Issues

- Process counts
- Reliance on experts
- Monitoring of experts and performance
- Communication of administration to beneficiaries

CAN IT BE SALVAGED?

- Investment strategy
- Ensure efficient management
- Spending strategy
- Donor-beneficiary communication

SOLUTIONS

CRT

- Let the trust run its course
- Give income interest to charity
- Terminate in favor of income and remainder beneficiaries

CGA

- Give annuity interest to charity

Private Foundation

- Terminate into a Donor-Advised Fund

TERMINATING A CRT EARLY

Gift of the Income Interest to the Remainderman

Procedure:

- Income beneficiary "gives" his/her income interest to the charity holding the remainder interest.

Income Tax Deduction Issues:

- IRS has generally held that the value of the income interest (valued at the date of gift) is eligible for an income and gift tax charitable contribution deduction.
- Value of income interest should be calculated at time of gift, using current ages, FMV of trust, Applicable Federal Rate, etc.
- The income interest is a capital asset, deductible subject to the 30% of AGI cap
- Appraisal is required
- Health certificate is recommended
- An unlikely issue: does gift violate the Partial Interest Rule (see Rev. Rul. 86-60)

Gift Tax Deduction Issues:

- Partial interest rule is stricter, and can be a problem in a joint life net income unitrust. See GCM 38380, PLR 9550026.

State Law Issues:

- Terminating the CRT automatically via merger
- Terminating the CRT via written consent of all settlors and beneficiaries (e.g., Cal. Probate Code section 15404)
- Terminating the CRT via Court order

Termination in Favor of Charity and the Donor

- PLR 200127023 and others – all parties agree to terminate a CRT, distribute assets to the income and remainder beneficiaries based upon actuarial values.

- IRS rules, for tax purposes, that income beneficiary's unitrust interest is a long term capital gain asset with a zero basis, and that the beneficiary "sold" it for the value of the assets received.

- IRS also rules that payment to beneficiary is "derived solely" from his right to the unitrust amount, and that the payment is thus not an act of self-dealing.

- Value of income interest should be calculated at time of gift, using current ages, FMV of trust, Applicable Federal Rate, etc.

- Appraisal "required" to ensure proper asset distribution and lack of self-dealing.

- Note: If the CRT is a net-income trust, the IRS may require that income interest be valued using the lower of the stated unitrust percentage or the AFR for the month of gift (see PLRs 200725044, 200733014).

- Note: This technique does *not* work if the remainder beneficiary is the donor's private foundation, as the deemed "sale" of the income interest is an act of self-dealing (PLR 200614032).

- Note: IRS has required the income beneficiary, and sometimes his/her physician, to certify that the income beneficiary has no health issue that would reduce their normal life expectancy.

- State law issues: terminate the CRT via written consent (e.g., Cal. Probate Code section 15404) or Court Order.