TIAA CREF Financial Services

Fiduciary Strategies to Protect and Grow Your Organization.

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Agenda

Welcome. Thank you for joining us.

1. Introduction

   The challenge of funding and maintaining your organization in today's donor and tax environment

2. Fiduciary Considerations

   Creating routines and processes that protect your organization

3. Overview of support options

   Formulating tax efficient programs to support your organization

4. The 2013 Environment

   What impact do the current tax and interest rate environments have on donor behavior?

5. Hot topic techniques

   Giving techniques that may be appealing to today's donors.

Introduction:

Funding and Maintaining the Financial Needs of Your Organization

Two Phases of Financial Support for Your Organization

Phase One: Asset Administration and Fiduciary Management

Managing organization assets prudently

- Investment management practices and policies
  - Uniform Prudent Management of Institutional Funds Act (UPMIFA)
- Fiduciary and legal responsibilities of Directors and Officers
  - Duty of loyalty
  - Duty of care

Two Phases of Financial Support for Your Organization

Phase Two: Asset Acquisition

Fundraising is a constant.

- Developing and cultivating a donor base
- Segmenting donors based on affinity and wealth
- Determining what planned giving fits your organization's needs and resources

People Believe That It Is Important to Give Back

The Center on Philanthropy at Indiana University and the Giving USA Foundation found that charitable giving increased considerably over the past two decades.

- Americans gave $298 billion to charity in 2011 (representing roughly 2.0% of the U.S. gross domestic product over that period).
- 73% of all donations come from individual donors.
- Religious organizations are the highest recipient type – receiving 32% of such donations (or almost $96 billion).
- Education-related organizations are the second highest recipient type – receiving 13% (or almost $39 billion) of such donations.

Based on *Giving USA Foundation's* annual report on philanthropy for the year 2011.

People Believe That It Is Important to Give Back

The Center on Philanthropy at Indiana University and the Giving USA Foundation continued:

- The mix between outright gifts and planned gifts varies widely between organizations, often determined by the organization's focus, donor dynamics and the breadth of the organization's advancement staff.
- Competition for donor-dollars continues to increase – during the first decade of the 21st century, the number of §501(c)(3) organizations grew by 48% (from 865,000 to 1,280,000).
- There are tax considerations associated with charitable gifts. Access to a tax advisor can help donors make tax-sensitive decisions.

Based on *Giving USA Foundation's* annual report on philanthropy for the year 2011.

Managing the Fiduciary Responsibilities of Your Organization

What Does the Duty of Loyalty Require of Directors?

Duty of Loyalty

Directors commit an allegiance to the organization and acknowledge that the best interests of the organization prevail over any personal interest. There are two types of “director actions” that involve the Duty of Loyalty.

- Interested Transactions
  Any proposed transaction that creates a possible conflict between the interest of the organization and the personal interests of the director.

- Corporate Opportunities
  Any venture, activity, property or idea that an organization has or might have a legitimate interest in pursuing consistent with its nonprofit purposes.

What Does the Duty of Loyalty Require of Directors?

A “**written** conflict of interest policy” can provide the framework.

- Disclosure:

  If a director believes that a connection with a firm or individual may be perceived by others as a conflict, the connection must be disclosed to the organization, in a timely fashion.

- Abstention:

  An interested director should not participate in the discussion or voting with respect to the conflicted matter, and the abstention should be well documented.

- Fairness:

  The transaction must be fair and reasonable from the organization’s perspective (e.g., Would the organization enter into the same transaction with a disinterested third party?).

What Does the Duty of Care Require of Directors?

Duty of Care

Directors have an obligation to act with the care that an ordinarily prudent person in a like position would exercise under similar circumstances.

For nonprofit directors, the duty of care means acting in **good faith** *and* with a reasonable belief that you are **informed** and that your decisions advance the mission of the organization.

- It is no defense for a nonprofit director to say that he or she had no knowledge of the subject matter if reasonable inquiry would have provided the information.

The common law "duty of care" is perhaps more accurately described as the "**duty to be informed**."

What Does the Duty of Care Require of Directors?

Establish and follow a decision-making process:

1. Understand how the organization functions;
2. Attend meetings regularly so that you can respond in a timely fashion to organizational issues;
3. Develop a process that allows you to evaluate and analyze the flow of information in an objective and timely fashion;
4. Ask appropriate questions, and request and verify supporting data.

Uniform Prudent Management of Institutional Funds Act

The Uniform Law Commission created the Uniform Prudent Management of Institutional Funds Act ("**UPMIFA**") in 2006, which sets forth the prudent investor rules for managing and investing charitable funds.

Under UPMIFA, directors are expected to discharge their duties as follows:

- In good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances;
- In a manner that incurs only reasonable costs;
- After reasonable efforts to verify relevant facts; and
- Where decisions are based on the totality of the organization's purpose, duration and needs for funds, both operating and for charitable purposes.

How Do Nonprofit Directors Protect Themselves?

1. The director’s decisions must be reasonable and defensible based upon the organization’s mission.
2. There must be an element of oversight.
3. Directors are not expected, nor legally required, to be experts in the stock market or other investment vehicles.

How Do Nonprofit Directors Protect Themselves?

Example:

- The members of the board of Canine Companions for Independence are seeking assistance with the investment of their operating funds.
- Claire, a director, interviews a number of financial advisors and prepares a summary on each company’s investment philosophy, fees and experience.
- Claire chooses a financial advisor with the approval of the Board.
- Claire meets with the financial advisor quarterly to remain informed of the investments and strategy, and Claire regularly reports to the Board.
- The financial advisor employs a sound investment policy, which ultimately results in a loss to the portfolio.

Query: Does this result create fiduciary concerns for Claire or other board members?

How Do Nonprofit Directors Protect Themselves?

It is common for a nonprofit entity to delegate the investment authority to a third party financial provider.

For example, by partnering with TIAA-CREF Trust Company, FSB, the board can delegate the execution of the organization’s investment strategy to qualified portfolio managers who can create customized portfolios for the organization and who can also monitor the investments to ensure compliance with the IPS.

TIAA-CREF offers this service to nonprofit organizations.

Operational Checklist

Every organization should have the following:

- A written conflict of interest policy
- A written policy for document retention/destruction
- A “whistleblower” protection policy
- Procedures for reporting wrongdoing within the organization
- Written policies for financial controls and safeguards
- A written investment policy statement

There should also be processes in place to assure periodic reviews and discussions of each of the above by the Board to assure its oversight of these critical governance features.

Tips for Directors and Officers

- Prepare a written statement of the organization’s mission and purpose
- Understand and follow requirements and procedures in governing documents (articles of incorporation and bylaws)
- Select a qualified person as CEO
- Attend board meetings regularly
- Review meeting minutes, committee reports and other materials prepared for board meetings in advance; prepare questions and discussion points
- Review financial statements, Form 990, audit reports. Review material prepared by the organization’s auditors
- Request that experts be retained when making decisions on matters that exceed the collective expertise of the directors and chief executive
- Promptly disclose conflicts of interest
- Understand and adhere to policies and procedures of the organization
- Keep sight of the governance role of the board
- Establish committees to carry out the board’s activities and fulfill its oversight role

Funding Your Organization’s Mission:
An Overview of Support Options

Funding Your Organization’s Mission

A Successful Program:

- An advancement program your organization can afford and the organization has the ability to properly support.

  AND

- An advancement program that meets the interest and needs of your donor pool.

Funding Your Organization's Mission

Factors that impact Donor Support:

- Tax implications
- Interest rate and economic environment
- Type of asset
- Type of gift – immediate or planned gift

Charitable Giving Tax Implications Can Impact Donor Behavior:

- What are the deduction limitations for the charitable gift?
    - Could the changing tax laws impact or limit the amount of the income tax deduction?
- Does the type of donee organization impact or limit the amount of the income tax deduction?

Funding Your Organization's Mission

Gift	Public Charity or Operating Private Foundation	Non-Operating Private Foundation
Cash	FMV up to 50% of AGI	FMV up to 30% of AGI
Marketable Securities Short-Term (< 1 year) Marketable Securities Long-Term (> 1 year)	Cost basis up to 50% of AGI FMV up to 30% of AGI	Cost basis up to 30% of AGI FMV up to 20% of AGI
TPP – Gift is related to charity's exempt purpose TPP - Gift is not related to the charity's exempt purpose	FMV up to 30% of AGI Cost basis up to 50% of AGI	FMV up to 20% of AGI Cost basis up to 30% of AGI
Real Estate (< 1 year) Real Estate (> 1 year)	Cost basis up to 50% of AGI FMV up to 30% of AGI	Cost basis up to 30% of AGI FMV up to 20% of AGI
Conservation Easements	FMV up to 30% of AGI with a 5 yr carry forward	N/A
Retirement Plan Assets	Up to $100,000 from IRA if age 70½ or older	Available from IRA if age 70½ or older
Existing Life Insurance Policy	Policy's FMV or net policy premiums paid, whichever less, up to 50% of AGI	Policy's FMV or net policy premiums paid, whichever less, up to 30% of AGI

Note that the above limitations are subject to any "phase-out" of itemized deductions per the 2012 American Taxpayer Relief Act.

The 2013 Tax Considerations – The Donor's Perspective

2013: New tax changes may impact donor behavior:

- Affordable Care Act (2010) creates new taxes on passive income:
- American Taxpayer Relief Act (2013) increases income and capital gain taxes on upper income donors

The Affordable Care Act

<u>2010 Healthcare Law imposes new taxes on “wealthy”</u>:

A “Wealthy” taxpayer:

- Single taxpayer with annual income of $200,000
- Married taxpayer with annual income of $250,000

Tax increase on two forms of income:

- Earned income
- Investment income

The Affordable Care Act

Tax law in 2013 for "earned income":

"Wealthy" taxpayers pay an additional 0.9% Medicare tax on income exceeding $200,000 for individuals and $250,000 for married couples.

Tax on "investment income":

3.8% tax on the lesser of:

- Taxpayer's net investment income for the tax year, or
- Modified adjusted gross income (MAGI) in excess of $200,000 if single, $250,000 if married, $125,000 if married filing separate

Example:

Harry, single, has earned income of $175,000 and investment income of $50,000. Harry is subject to a 3.8% tax on $25,000 (MAGI in excess of $200,000). If Harry has earned income of $200,000 he would be subject to a 3.8% tax on $50,000 (net investment income).

Net investment income includes interest, long-term capital gains, dividends, after tax annuities, royalties, and rents other than from trade or business. It does not include distributions from a qualified plan or IRA.

American Taxpayer Relief Act of 2012

Tax Law Change Increases Capital Gains Tax:

- Long-term capital gain and qualified dividend tax rates continue at 15% for taxpayers *below* $400,000 (single) or $450,000 (married) of income.
- Above that level, the rate now increases to 20%.
- Short-term capital gains are taxed at ordinary income tax rates.
- Municipal bond income continues to receive favorable income tax treatment.
- These rates are in addition to the 3.8% net investment income tax imposed under the Affordable Care Act.

LT Capital Gains and Dividend Tax Rates	
Income Tax Bracket	LT Capital Gains Dividend Tax Rates
10%	0 %
15%	
25%	15%
28%	
33%	
35%	
39.6%	**20%**

2013 Tax and Interest Rate Considerations

As the tax on capital gains increases this year by almost 60% for donors in the top tax bracket, gifts to your organization of highly appreciated assets becomes significantly more appealing

- Russell and Pam, who are in the top income tax bracket, own securities they originally bought for $25,000, which are now worth $100,000. They would like to contribute $50,000 worth of these securities to their favorite charity.

… but will other changes in the tax laws impact the tax incentives of their gift?

Phase outs, capital gains and dividends

The Phase Out rules again apply to itemized deductions and personal exemptions for years beginning in 2013.

- Itemized deductions and personal exemptions phase out in 2013 if income exceeds $250,000 for singles and $300,000 for married couples filing jointly.
- Itemized deductions are phased out by the *lesser* of:
  a) 3% of the amount taxable income exceeds this threshold, or
  b) 80% of total itemized deductions.
- Personal exemptions are completely phased-out at $375,000 (single) and $425,000 (married).

Income Tax in 2013

Single Taxpayer	Married Taxpayer	Social Security Tax	Medicare Tax	Net Investment Income Tax	Itemized Deductions	Personal Exemptions	Income Tax	Capital Gains Tax
$0 to $8,925	$0 to $17,850	**6.2% on first $113,700 of income (up from 4.2% in 2012 due to expiration of "payroll tax holiday")**	1.45% on all income				10%	0% no change
$8,925 to $36,250	$17,850 to $72,500						15%	
$36, 250 to $87,850	$72,500 to $146,400						25%	15% no change
$87,850 to $183,250	$146,400 to $223,050						28%	
$183,250 to $200,000	$223,050 to $250,000						33%	
$200,000 to $250,000	$250,000 to $300,000		**2.35% (an additional 0.9% tax on income exceeding threshold)**	**3.8% net investment income tax on lesser of net investment income or MAGI exceeding threshold**				
$250,000 to $398,350	$300,000 to $398,350				**Itemized deductions phased out by 3% of income exceeding threshold up to 80% of deductions**	**Personal Exemptions phased-out by 2% for every $2,500 exceeding threshold**		
$398,350 to $400,000	$398,350 to $450,000						35%	
$400,000+	$450,000 +						39.6% **up from 35% in 2012**	20% **increased from 15% in 2012**

Phase-Out of Itemized Deductions

Donors may pause to reconsider charitable gifts if:

- Income tax charitable deduction is phased-out
- They are concerned Congress may further limit how much of their gift is deductible (e.g., limiting deductions to 28%)

Help donors appreciate how the phase-out rules impact them.

- Donors in higher tax states may be less impacted then those in low or no-tax states

Example – High State Income Taxes

Russell and Pam have an AGI of $670,000 and their itemized deductions total of $110,000 and are as follows:

Mortgage interest deduction:	$10,000
Property tax deduction:	5,000
State income tax deduction:	45,000
Charitable deduction:	50,000

The itemized deductions will be reduced by the lesser of:

a) 3% x $370,000 ($670,000 – $300,000) would reduce the couple's itemized deductions by *$11,100*.

b) 80% x $110,000 would reduce the couple's itemized deductions by *$88,000*.

Since the 3% limitation of $11,100 is the lesser of the two limitations, the couple's itemized deductions would *only* be reduced by 10%. Their total itemized deductions of $110,000 will be reduced to just under $100,000 ($110,000-$11,100).

Example – Low State Income Taxes; No Mortgage

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Russell and Pam have an AGI of $670,000 and their itemized deductions total of $55,000 and are as follows:

Mortgage interest deduction:	$ - 0 -
Property tax deduction:	5,000
State income tax deduction:	- 0 -
Charitable deduction:	50,000

The itemized deductions will be reduced by the lesser of:

a) 3% x $370,000 ($670,000 – $300,000) would reduce the couple's itemized deductions by *$11,100*.

b) 80% x $55,000 would reduce the couple's itemized deductions by *$44,000*.

Again, the 3% limitation of $11,100 applies, and the couple's itemized deductions are now reduced by 20%. Without other itemized deductions to absorb all of this reduction, their charitable deduction is now reduced, as their total itemized deductions of $55,000 will be reduced to $43,900 ($55,000-$11,100).

Planning Opportunities Attractive to Donors in Today's Unique Environment

Tax Efficient Use of Retirement Assets

Estate = $100,000 of Traditional IRA assets, and $100,000 of securities

Gift in Will or Trust Agreement = 1/2 to Charity and 1/2 to Individual

Without Any Designation

Charity Receives:

$ 50,000	Securities
50,000	IRA
$100,000	

Individual Receives:

$ 50,000	Securities
50,000	IRA
(20,000)	Income Tax*
$ 80,000	

With Specific Designation

Charity Receives:

$100,000 IRA

Individual Receives:

$100,000 Securities

Tax Savings = $20,000

* Assumes a combined federal and state income tax rate of 40%.

IRA to Charity rules

The qualified charitable rollover provision was extended to December 31, 2013.

- Individuals over age 70½
- Direct from an IRA to a public charity (cannot be a donor advised fund, non-operating private foundation, or Charitable Remainder Trust).
- Satisfies RMD but not included in income and no charitable deduction for contribution.
- Contribution of up to $100,000 per individual.

Falling Interest Rates Impact Gift Valuation

- The interest rate the IRS uses to determine the actuarial value of a split-interest gift is referred to as the Applicable Federal Rate (the "AFR").
- AFRs have fallen considerably over the past decade:
  - AFR for March 2000 = 8.2%
  - AFR for February 2013 = 1.2%
- The lower the AFR, the lower the value of a remainder interest in a split-interest gift (e.g., Charitable Remainder Trusts and Charitable Lead Trusts).

April Section 7520 Rates

April Section 7520 Rates

	Apr.
2001	**6.0%**
2002	**5.6%**
2003	**3.6%**
2004	**3.8%**
2005	**5.0%**
2006	**5.6%**
2007	**5.6%**
2008	**3.4%**
2009	**2.6%**
2010	**3.2%**
2011	**3.0%**
2012	**1.4%**
2013	**1.4%**

Charitable Lead Trust

Charitable Lead Trust: Irrevocable trust benefitting charity with a stream of payments for fixed term and/or life, with the remainder paid to noncharitable beneficiaries.

- Variations on a theme:

  Charitable Lead Annuity Trust (CLAT)

  Charitable Lead Uni-Trust (CLUT)

- Income tax deductibility dependent on “grantor” or “non-grantor” status.
  - Grantor Trust: Charitable deduction, recognize income during the term of the trust
  - Non-grantor Trust: No current charitable deduction, no recognition of income.

Charitable Lead Trust

Example:

Donors: Harry (age 65) and Ginny (age 65)

Amount: $500,000 of appreciated stock

Annuity Payment to Charity: 6% of trust assets determined at funding of trust

AFR rate for February 2013: 1.2%

The annuity is determined in the first distribution year. The charity will receive $30,000 annually. Upon the death of surviving spouse, remaining trust assets pass to the Grantor's children in equal shares.

Charitable Lead Trust

NPV of payments to charity: $466,300
Future value to children: $105,300
Federal Exemption used: $105,300

If the trust return is greater than the AFR, then the excess growth is transferred to remainderman gift and estate tax free

AFR	Annuity Amount	Value to Charity
1.2%	$466,300	$394,600
8.2%	$293,100	$293,100

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Questions

Thank you for joining us.

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For further information relative to this topic, or for more specific application of your organization's state statutes to your organization's circumstances, or for a complimentary overview of TIAA-CREF's breadth of services in the nonprofit and endowment space, please contact your TIAA-CREF advisor, or email us at EJohnson@tiaa-cref.org.

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