
CLIFFORD ASSOCIATES

INVESTMENT COUNSELORS SINCE 1915

Planned Giving News—Spring 1999

Don't Slip If You Flip

If you are considering an application to convert older NIMCRUTS to standard unitrusts by the June 8th deadline, you have no doubt reviewed the benefits with your beneficiaries and can easily speak to the issue of why the conversion should be allowed from their perspective. But don't slip up by overlooking many other complicated and often conflicting issues before making any final determination. Some of these include:

- The level of the percentage distribution
- The expected duration of the trust
- The donor's original and/or present intent
- Current income needs of the donor
- Multiple beneficiary interests if any
- The cost of conversion versus size of the trust
- Establishment of an appropriate "triggering" event
- Establishment of an appropriate investment strategy
- Risk tolerance of the donor
- Overall donor relations
- Tax considerations - especially if the investment mix is altered

CONSIDER BOTH INTERESTS

Most institutions we consult with favor income beneficiaries when possible.

This policy is good public relations and may result in referrals or additional gifts. Nevertheless, the court system may disregard this benevolent attitude and ask for evidence that **both** beneficiary interests are enhanced. Because the institution as trustee should remain unbiased, the trustee's interests as remainder beneficiary must be protected. The courts may be more critical than expected and rule the split-interest character of these trusts cannot be ignored.

EXPECTED RESULTS

To demonstrate the effect of both trust duration and percentage distribution, we have developed exhibits that illustrate the impact on the remainder interest when a high-income investment policy is changed to a total return approach. Yes, increased capital appreciation emphasis may improve the overall return expectation, but it's subject to a reasonable life expectancy horizon.

We also caution the potential for greater return may not always be realized after a flip. The eventual remainder interest is very sensitive to the level of percentage distribution. Our analysis suggests income distributions greater than 8 percent often severely

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penalize the remainder interest. In addition, it may be useful to point out any makeup obligation will also be forfeited by the income beneficiary.

DONOR'S INTENTIONS

Also to be considered is the donor's intent in establishing a NIMCRUT as well as their current need for increased distributions. Occasionally, net income arrangements are established by donors with the express intent of receiving less current income in exchange for portfolio growth. Examples would be younger donors looking for near-term portfolio growth leading to greater income in the future. Also, certain donors intentionally constrain their personal benefit as a method of increasing the trust's eventual charitable distribution. Such portfolios are often constructed specifically with low-income, higher-growth assets. A flip to a standard unitrust may frustrate the long-term purpose of the trust from the donor's perspective.

COST

Another careful consideration is the cost of conversion. One typical approach is for trusts to absorb normal on-going administrative fees. They are often split

between principal and income. But because conversion charges occur only one time, a 50/50 split may disproportionately penalize the income interest, particularly in a smaller trust where the cost may be a much larger percentage of 1999 income.

Another approach is for the non-profit trustee/remainderman to pay all fees directly outside of the trust. This may be particularly distasteful to the court as it appears somewhat as a conflict of interest where the remainderman stands to gain substantially from a flip to a total-return managed portfolio.

FLIPPING AHEAD

After thoroughly analyzing all relevant issues and determining a conversion makes sense, Clifford Associates suggests our clients approach donors and seek their approval to **apply**. An effort to convert is really all that can be promised prior to court approval. Our investment simulation—coupled with our expert witness letter—may be helpful to your counsel. Please call us if we can be of help to you or your counsel as you prepare flip applications.

Terry Price

Donor Trusteed Gifts

A continuing concern for charities is the possible erosion of gift (remainder) value of a poorly-managed, self-trusteed charitable remainder trust. Clifford Associates is prepared to act as investment advisor and administrator of these trusts subject to a minimum charge. We will work directly with the donor in developing an investment policy that balances the interests of the charity and the income beneficiary. Please contact us if your donor will consider professional assistance.

Jim Fox

200 South Los Robles Avenue, Suite 320
Pasadena, California
(626) 792-2228

1050 Seventeenth Street, Suite 1690
Denver, Colorado 80202
(303) 623-2228