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Planned Giving News—Second Quarter 2004

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## Proposed Legislation

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By Ken Dike

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### Proposed Federal Legislation: Tax-Free IRA Rollovers to Charitable Remainder Trusts

On April 9, 2003, the Senate passed S.476, *The Charity Aid, Recovery and Empowerment ("CARE") Act of 2003* by a vote of 95 to 5. On May 7, 2003 the House introduced companion legislation H.R.7, *The Charitable Giving Act of 2003*. It now appears as if Congress will not attempt to reconcile the differences between the Senate and House versions leaving both bills to die.

Among other objectives, the purpose of these 2003 bills was to provide additional tax incentives for charitable contributions by individuals and businesses and change the way certain nonprofit entities are regulated. Both bills would have allowed tax-free rollovers from an individual's IRA to a charitable remainder trust.

In an attempt to resurrect the tax-free IRA rollover, a new bill has been introduced in the Senate. The *Public Good IRA Rollover Act* (S.283) introduced on February 4, 2004 by Sen. Byron L. Dorgan and co-sponsored by Sen. Olympia Snowe and Sen. John Kerry would allow tax-free IRA rollovers for both outright gifts and charitable remainder trusts. A companion House bill is expected to be introduced in the near future.

### Proposed California Legislation: Increase to maximum amount of gift annuity reserves invested in common stocks

A charitable gift annuity is an arrangement whereby assets are given to a charity in return for the charity's promise to make payments of a fixed amount to a beneficiary designated by the donor. These annuity payments are a general obligation of the charity and often continue for the beneficiary's life. California is one of several states that regulate the investment of the donated assets until all required beneficiary payments have been made.

California requires the periodic calculation of a *required reserve* for each gift annuity. The amount of the reserve is based on the amount and expected duration of the annuity payments and anticipated earnings on the invested assets. The required reserve is intended to represent the amount that must be invested on a particular date to make all future annuity payments as required by the charitable gift annuity contract.

California currently limits the investment in common stocks to 10% of the required reserve. A bill has been introduced in the California Senate (SB 1088 on 1/6/2004) that would increase the common stock maximum to 50% of the required reserve. Approved by the Senate and Assembly

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Insurance Committee, the next step is a vote by the full assembly.

Increasing the amount of the required reserves that may be invested in common stocks from the current 10% would permit charities to more fully diversify their charitable gift annuity investment portfolio. Such increased diversification would serve to reduce the total portfolio risk especially in situations where the portfolio is invested predominately in bonds during times of historically low interest rates. If interest rates were to rise, the market value of the bonds held in the portfolio would decline while the required annuity payments would remain unchanged.

Increasing the allowable equity exposure to 50% of the investment portfolio is also more in line with the total return concept of investing that recognizes all forms of investment returns including interest, dividends, and realized and unrealized gains and losses. This approach attempts to maximize a portfolio's total return which includes the common stock potential for capital appreciation that is far more significant, over the long term, than expected common stock dividends and bond interest. As indicated by the accompanying table, a balanced portfolio of 50% stocks and 50% bonds has historically produced average annual returns, over ten-year rolling pe-

riods, that are 39% greater than those produced by a portfolio invested 10% in stocks and 90% in bonds.

Most charities base the amount of the annuity payment on rates established by the American Council on Gift Annuities (ACGA). The ACGA charitable gift annuity rates assume a total return on all gift annuity investments of 6%, fees and expenses of 1%, and a target remainder (funds existing when the annuity payments terminate) of 50% of the initial gift. US government bonds, which currently comprise about 90% of the gift annuity reserve investment portfolio under existing California regulations, offer less than a 5.5% interest return and very little potential for appreciation given the historically low interest rates. Although this is somewhat mitigated by the excess funds (gifted assets in excess of the required reserve) that may be invested entirely in common stocks, California charities can expect to ultimately receive less than the assumed 50% of the initial gift.

Increasing the allowable equity exposure of charitable gift annuity required reserve investments would allow for a more diversified portfolio and a corresponding reduction in total portfolio risk as well as increasing the potential long-term total return.



<b>10 Year Rolling Returns 1935-2003</b>			
<b>Portfolio Balance</b>	<b>10% Stocks/ 90% Bonds</b>	<b>50% Stocks/ 50% Bonds</b>	<b>Percentage Difference</b>
Avg. Annual Return	5.99	8.32	<b>39%</b>
Highest Annual Return	13.57	15.36	<b>13%</b>
Lowest Annual Return	2.56	1.92	<b>-25%</b>

Returns based on S&P 500 & Intermediate Government Bonds

Past performance is no guarantee of future results.

Data source: Ibbotson

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