



BERNSTEIN

2019

# PHILANTHROPY: ROOTED IN YOUR VALUES





# **TABLE OF CONTENTS**

**4**

## [CREATING A LEGACY OF GIVING](#)

Values-Based Philanthropy

Family Responsibilities and Governance

Investment Strategy

Granting: Your Capacity to Give

**15**

## [IMPLEMENTING STRATEGIES TO SUPPORT YOUR MISSION](#)

Choosing Philanthropic Strategies

Purely Philanthropic Strategies

Partly Philanthropic Strategies

**52**

## [INVESTING FOR IMPACT](#)

An Asset Allocation to Support Your Giving

Assets to Give

**62**

## [CASE STUDY](#)

**66**

## [APPENDIX](#)

Itemized Index

Glossary

Notes on Wealth Forecasting System<sup>SM</sup>

# CREATING A LEGACY OF GIVING





# philanthropy

noun

phi-lan-thro-py | \ fə-'lan(t)-thrə-pē \

## Definition of philanthropy

**Goodwill to fellow members of the human race especially: active effort to promote human welfare**

Many people perceive philanthropy as grandiose gestures or large charitable donations. But it comes in many forms—it's about actions and offerings. Helping your elderly neighbor shop for weekly groceries; buying a homeless individual a sandwich; granting from a family foundation—these are all philanthropic actions that offer goodwill to others.

Not everyone views philanthropy the same way. You may think of it as occurring only within your family; others believe it's about solving the world's issues. Whether it's a small action or a large bequest, most individuals have a philanthropic desire.

Philanthropic giving is inherently personal because it is rooted in your values and in how you choose to fulfill your sense of responsibility to your family, the community, and the world. It inevitably raises questions like:

- What is my charitable goal?
- What do I want my legacy to be?
- Do I want my family to be involved?
- Is my commitment time-bound?
- What responsibilities and commitments am I willing to assume?
- How can I achieve the most impact with the gifts I make?
- How much can I give?

This guide offers advice based on our experiences helping others, like yourself, who have wrestled with these issues. We can provide clear answers to your questions and help you understand your choices. Our process uncovers your unique circumstances, preferences, and goals, then quantifies the likely financial results of the decisions you make, and helps design and manage a strategy that you choose.

**Philanthropy: Rooted in Your Values** is organized around your choices and provides a framework for weighing trade-offs. It offers a roadmap for success for the passage of wealth, knowledge, and values to family, friends, and causes that are most important to you. We embolden you to explore your achievement beyond the numbers, as you build your family and philanthropic legacy, and attain comfort with the decision-making process.

Bernstein doesn't offer legal or accounting advice, so when you consider this material, you should discuss your individual circumstances with professionals in those areas before making any decisions. Indeed, you may already be working with tax and philanthropic advisors to cultivate a giving strategy. We have the tools and expertise to work with your advisors, together empowering you to grow your philanthropic impact.

## VALUES-BASED PHILANTHROPY

In deciding what and how much you want to give to philanthropic causes, it is useful to plot the elements of your philanthropic vision along various dimensions (*Display 1*).

- **Your Passions:** What social, educational, faith-based, or health-related issues or organizations do you care about deeply?
- **Your Target Communities:** Do you want to help your local community, your own or another country, or the world?
- **Your Catalysts:** Do you react generously to other appeals, seek to form a unique relationship with an organization, or prefer to respond to crises?

Designing a philanthropic vision involves personal choices about your values, what you want to achieve, how you want to achieve it, and whether you prefer to give publicly or anonymously. You may find it easier to answer these questions if you reflect on how you have given in the past and how you felt about it.

If you have an established philanthropic plan, take a step back and assess what is working well, what can be improved, and has it had the impact you wanted? If a change needs to be made, what's driving that need for change? For example, consider why you funded the family foundation in the first place (past), where you are today (present) and where you'd like to see the foundation in the years to come (future).

If a philanthropic plan is new for you and your family—perhaps due to a large liquidity event, or a life event that causes a shift in your priorities—it's important to consider the desired strategic direction and focus for your philanthropic capital. To accomplish these, you need to identify your values, and create a vision and mission statement.

### DISPLAY 1: PLOTTING YOUR PHILANTHROPIC VISION

#### PASSIONS



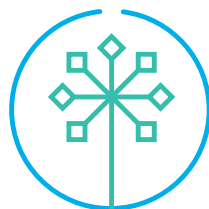
Animals  
Arts  
Education  
Environment  
Faith  
Healthcare  
Human Rights  
Social Justice

#### TARGET COMMUNITIES



City  
Country  
Neighborhood  
State  
World

#### CATALYSTS



Appeals  
Campaigns  
Milestones  
Natural Disasters

## Identifying Values

Values are the principles that guide how most people conduct their daily lives, and are key influencers on everyday decisions for your family, business, and many other aspects of life. Philanthropy is one of those areas shepherded by individual beliefs. Identifying personal tenets is critical, but it's also important to pinpoint the principals of family members and others involved in your philanthropic mission.

At times, defining one's values can seem daunting or "heavy." It may be hard to know where to start, or how to articulate something that is deeply important and an integral part of your being. At Bernstein, we often use exercises that bring to life the values that motivate giving, and facilitate discussions around identifying those that are the most, and least, important (*Display 2*).

### DISPLAY 2: WHAT ARE YOUR VALUES?



Once values are identified, they need to be communicated to family members, to see where there are shared principles, and unique divisions. This will influence the plan for your family. For example, if your family shares justice, freedom, and impact as

core values, you might focus your mission on human rights. For your daughter who values sustainability and resilience, she may establish a donor-advised fund on her own that supports conservation, and your son who values community and compassion may realize his passion lies in homelessness and volunteers his time to local shelters and soup kitchens.

This can enable families to understand and communicate their shared values as well as to appreciate and respect unique differences among members. For senior generations that have an established family philanthropy, there may be concern about what the children will do with the family philanthropy. In our experience, the key is communication and governance.

## Crafting the Vision and Mission Statement

The values you've identified will be the basis for your philanthropic vision and mission statements, which will articulate the architecture of your charitable plan.

A [vision statement](#) focuses on the future that you want to create through your giving. It is often inspirational, and can be ambitious; it might also be challenging. Ultimately, it reflects the core values and principles of your philanthropic program, and should become part of its DNA.

A [mission statement](#) is how that vision will be implemented today. It's a brief description of the purpose of your philanthropy—not just for those family members involved in the philanthropy, but for the outside world as well. The mission should be the center of your philanthropy, supported by family responsibilities and governance, investment strategy, and granting.

## FAMILY RESPONSIBILITIES AND GOVERNANCE

Your children may already be involved with your philanthropy. If not, you may be wondering when and how to prepare them to participate. Some families involve their children in volunteer activities starting at an early age. Others use private foundations, donor-advised funds, or annual charitable giving as ways to get heirs involved in philanthropy and managing wealth now (*Display 3, next page*).

But before assuming your family members will want to be involved in your philanthropic plan, ask them. Think about their talents, too. Do you think they'd be better at grantmaking, research, or investing? Would they be appropriate members of your foundation's board of directors?

As the steward of your philanthropic mission—and perhaps as a legal fiduciary of a trust or foundation—you need to ensure you recruit the right people for the task at hand. You may also need to enlist nonfamily members or hire experts for certain roles.

### Family Engagement

There is no single recipe to follow when engaging through philanthropy. Because each family's circumstances are unique, an engagement plan needs to be exclusively designed. There are several things to keep in mind.

Engagement should be individualized and age appropriate for your heirs—centered primarily around their ability to understand financial and philanthropic concepts, and aligned with their

priorities and interests. Personalizing your plan will allow heirs to understand the goal of the engagement through an appropriate, positive activity (*Display 4, next page*).

### Time Considerations

Think carefully, too, about how much time you and your family are willing to give. Sending money is quick and easy; volunteering to paint a community center is a discrete task. Setting up a trust or a foundation, by contrast, can be time consuming and expensive, and commits you to certain obligations over time.

There are many options that fall between these extremes, such as coupling direct gifts with participation in a nonprofit organization's board or committees. ([See "What to Consider Before Joining a Board." page 10.](#)) How much time you're willing to allot and to whom you give are your decisions to make. Be wary, though, of taking on a commitment that you may not be willing to fulfill in a few years.

---

## DISPLAY 3: FAMILY ENGAGEMENT THROUGH PHILANTHROPY

---



### Revealing Wealth: Decide how much to disclose, when, and to whom

- Share the size of the family philanthropic vehicle and plans for future contributions
- Unveil how much is distributed every year, and how that might change when control is passed to the next generation



### Understanding Values: Communicate the values of the parents and find out what ideals are important to the next generation

- Craft a charitable mission statement that reflects the family's values—include charities that represent the ideals of the parents
- Discuss ways heirs can incorporate their values into the giving plans



### Creating a Lasting Legacy: Uncover the story behind the family's wealth and define a unifying vision for future generations

- Define the family's desired philanthropic legacy
- Identify the areas of impact that are priorities and track giving across impact areas over time
- Encourage both giving and involvement with charitable organizations

Source: Bernstein



## DISPLAY 4: SAMPLE ENGAGEMENT PLAN BY AGE

● Focus ● Goal ● Engage ● Financial Action

### ELEMENTARY SCHOOL



- Creating awareness
- To achieve some understanding of what's happening in the world around them and the needs of others
- Have a conversation in the moment with your child when you see a homeless person on the street
- Ask them why they think the individual was asking for food or money
- Remind them to notice what's around them, and consider ways that they could make an impact in the world
- Adopt the three-jar approach—for money received from allowance, have your child split the money between three jars: "give," "spend," and "save." The conversations you have with your child on the needs of the people surrounding them will inform what organizations they may choose to support

### MIDDLE SCHOOL



- Participation
- To experience having a role in making a difference in the life of someone else or in their community
- Consider a family day of service: they will be able to witness your commitment to giving, and experience it for themselves
- Reflect on the impact they feel they had through service
- Be mindful that if your giving is primarily financial, that may not be visible to your children
- At the next family holiday, have your child pitch what they feel is the best "need" to give to. Have them conduct research into the area and organizations focused on serving this need. Have a nominal budget prepared to award to their pitched need. Through this exercise they can learn to appreciate the importance of due diligence, and of finite financial means

### HIGH SCHOOL



- Leadership
- To take on more philanthropic leadership and lead with passion
- Perhaps your child has expressed a deep interest in animal welfare and volunteers at the local no-kill animal rescue center
- Encourage them to organize a food and toy collection, utilizing their social network to receive donations
- You may consider a match for their leadership—for every person that donates to the cause, you will contribute \$5 to the shelter. Show them how quickly it adds up to be a meaningful benefit, and how small actions of many can surpass expectations

### COLLEGE AND BEYOND



- Financial participation
- To educate the child on the financial philanthropy of the family, and play a role in it
- Encourage their participation in board meetings, or form a junior board/next-gen board where they can become more involved
- Organize a meeting with your financial advisor and have them walk through the investment allocation for the family donor-advised fund (DAF). Explain why it's important to invest in the DAF's assets, and consider allocating a portion of the giving budget to your child

## Preparing the Next Generation

Family engagement should explain the past and encourage participation in the present, but always focus on the future. Your heirs need to understand how the family circumstances and expectations change when generational leadership shifts. Some of that understanding comes in the form of educating the next generation about current charitable giving. But equally important is allowing heirs to express their interests and goals for philanthropy, and how their objectives may impact the current charitable plan. For example, a family foundation that is expected to grow larger upon your or your spouse's death will need to decide whether to increase the size of current grants, or fund new ones with the additional assets.

These discussions will get your heirs involved now—allowing them to work with family advisors, learn about investments, and make investment decisions together while parents supervise—setting up a strong mechanism for future decision-making and solidifying a successful transfer in the future.

Determining when to engage your next generation, and how much you should reveal is not an easy decision. The answers often depend on your family's structure, unique circumstances, and your individual children. Every family is different—and even within a family, each child is unlike the next—and those differences often guide the conversations. But regardless of the timing or amount of information revealed, practical learning is usually more beneficial than just verbal communication.

## What to Consider Before Joining a Board

- Does the organization's mission interest me?
- Do I have sufficient time to devote to board service?
- What is the overall time commitment, and what are my responsibilities? How much fundraising will I have to do?
- What expertise will I lend to this board? What is the composition of the existing board? Is there a training program/manual?
- How does the board deal with potential conflicts of interest, and are there conflict-of-interest rules I should know about?
- What is my liability as a board member, and does the organization provide directors' and officers' liability insurance? Any current litigation?
- Is the organization financially stable? Where does revenue come from?
- How does the organization decide what gifts to accept, and how does the organization ensure that donor intent is honored?

## Governance and Family Policies

Once the vision, mission, and family involvement are mapped out, an effective governance system needs to be put in place. That governance system should be centered on ensuring that your vision and mission is well documented and supported to provide the best chance for success.

A governance structure includes crafting a formal giving policy and process, and communicating it to family members. Equally important is defining the rules and expectations for family

participation. Who will participate in decision-making? Does everyone share the same responsibility, or are there individuals that should take on additional responsibility based on skill sets or expertise? Is a "next-generation program" needed as your family expands?

How will conflicts be handled as they arise? For example, if a family member is a board member of a local youth club and requests a grant from the family's foundation to the club, that could cause a conflict of interest. Conflicts can rise to the level of [self-dealing](#), which has legal ramifications. Crafting a [conflict of interest policy](#) can help address these issues head on, and clearly establish protocol for handling potential situations.

## Communication and Education

Communicating expectations, rules, and the mission of the philanthropic plan is vitally important.

A best practice is to establish formal family philanthropy meetings, that are either wholly separate from, or at least a dedicated portion of other family meetings. These should be held at least annually, at a time and location that is attainable for all members.

Agendas should be drafted and distributed ahead of time, if possible, so that members are aware of the topics to be covered, and any required prework. Consider asking for feedback or suggestions from family members, including next generation attendees, prior to the meeting to maximize buy-in.

A third-party facilitator is sometimes involved to run the meetings. This allows for a skilled facilitator to lead the communication and handle conflicts. Family members that may feel they "don't have a voice" might be encouraged to speak up with a neutral party running the meeting.

Education is another key component for new members or rising generations. Knowledge about the philanthropy—both institutional and foundational—needs to be shared with new members.

Create an education program that is customized to your family to equip future leaders with necessary skills. For example, a family might have quarterly next-generation education meetings that start with an introduction to investments and asset allocation paired with a deeper dive into the investment strategy.

## INVESTMENT STRATEGY

The next phase of a philanthropic plan focuses on the assets—what types of investments make sense, how much is being granted, who will help advise or manage them, and how do you measure success?

An investment policy statement (IPS) can help answer these questions. It establishes and documents guidelines for prudent investment of philanthropic assets and ensures that the resources are being used to further your mission. Thus, the IPS should be based on the mission. The goal should be to clearly document and define key components of the investment strategy such that there is a transparent understanding of the strategy. If the IPS is well designed, it should withstand day-to-day market distractions without revision for up to five years—barring significant change to mission, time horizon, or funding. Drafting, monitoring, and adhering to an IPS is an important way to ensure your family is protecting its philanthropic assets. ([See “Crafting Your Investment Policy Statement” on page 14.](#))

### Spending Policy

One component of the IPS is a spending policy. Should it be based on a percentage each year, or a fixed dollar amount? For instance, private nonoperating foundations are required to distribute at least 5% of the portfolio value each year. You may have a private foundation that is spending down its assets over the next 10 years, and thus giving far more than the 5% minimum. This should be clearly documented in the spending policy. In addition, are there annual floors or ceilings that should be considered (i.e., spend 5% with a minimum of \$100,000 spending per year)? Lastly, some policies may include a [smoothing rule](#) which is intended to increase the stability of distributions by applying a multiyear average to giving amounts.

## GRANTING: YOUR CAPACITY TO GIVE

The final phase is granting—determining how much you can give without undermining your long-term spending or wealth transfer needs, and measuring the impact of your giving.

### Our Core/Surplus Framework

To help you understand your capacity to give, we developed a

core/surplus framework for investment planning. First, we seek to ensure that you secure and sustain what we call your “[core capital](#)”: the amount of money you need today to secure your living expenses for the rest of your life.

We use our [Wealth Forecasting System<sup>SM</sup>](#), described on page 13, to conservatively estimate your core capital—we assume that you may live beyond what the mortality tables suggest, that high inflation might drive up your spending needs, and that deep bear markets may depress your portfolio value, at least temporarily. Your assets above your core capital are “[surplus capital](#)” that you could spend on big, optional purchases (such as a country home) or give to friends, family, or charity.

### Less than You Think—or More?

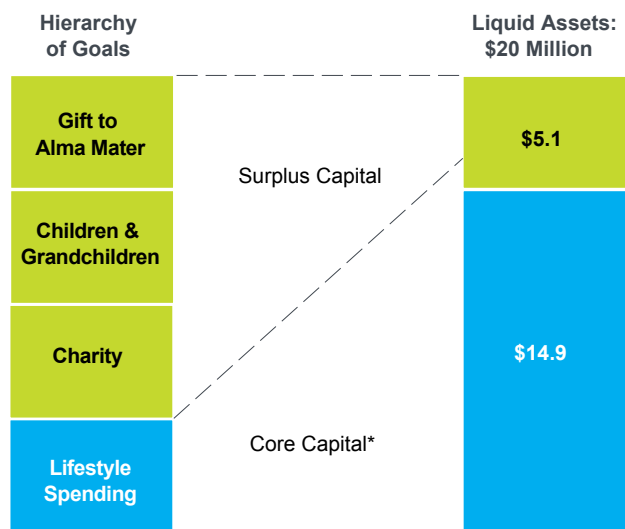
Let’s say you’re 65 years old, you’re recently retired, and you have \$20 million invested in a moderate allocation portfolio. You spend \$500,000 per year, after taxes. You have been considering giving \$1 million to your alma mater, which is building a new campus museum. Our analysis might show that you need \$14.9 million to support your lifetime personal spending, so you have \$5.1 million of surplus capital (**Display 5, next page**). You certainly have the \$1 million you’d like to give to your alma mater.

That’s great. But before you make such a large, irrevocable gift, think through how much you’d like to give to other causes and to your family, and consider other ways to give. You could make smaller (but still substantial) annual gifts, which you could stop if, say, an unexpected medical expense arises, or if you become enamored with another cause.

You could also use one of the philanthropic vehicles discussed in this guide to provide your alma mater with gifts for many years, but leave the remainder to your family—or to provide your children with income for many years, and leave the remainder to the school.

Or, after careful reflection, you could go ahead with your original plan, or give your alma mater even more. Our core/surplus framework is meant to help you feel confident in your ability to give, and to help you understand how much you can give, considering all your other goals. In some cases—like this one—you may be pleasantly surprised to learn you can give more than you thought.

**DISPLAY 5: DETERMINING CORE AND SURPLUS CAPITAL**



*\*Core capital is defined as the amount needed today to support annual spending of \$500,000 after taxes and inflation with a 90% level of confidence for a 65-year-old couple. Portfolio is modeled as 60% global stocks and 40% bonds. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging markets. Bonds are modeled as intermediate-term municipal bonds. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results.*

*See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.*

*Source: Bernstein*

**Tracking and Assessing Your Impact**

Now you need to track your impact. Measuring your giving leads to an understanding of your philanthropic “success.” Not only are you assessing the effectiveness of your plan, but also reviewing your selected charitable organizations and how you structured your gifts.

Selecting nonprofit organizations that run effective programs and don't waste capital on overhead costs is a crucial first step. Fortunately, you can get help in this regard. Several organizations

seek to provide transparency on charities' effectiveness and use of funds. [GuideStar](#), for example, provides online information on millions of public charities.

How you make your gifts can also affect the nature and scope of their impact. A matching grant that prompts other donors to give to the same organization may have greater impact than a direct gift of an equal amount—or more. A pledge of ongoing, annual support may have more impact than a series of one-time gifts, because it relieves nonprofits from having to raise funds each year, and signals a long-term commitment.

Sometimes, establishing a public charity or private foundation with a long-term giving horizon—decades or more—can be transformational. Not only are resources available for the long haul, but the foundation structure can provide additional leverage by giving you a bully pulpit.

The time horizon should not always be perpetuity. For some causes, establishing a foundation, trust, or program that spends down its wealth over 10 or 20 years may have more impact, because each dollar given today will have social and economic benefits that multiply over time. And a shorter time horizon makes more resources available.

Whether your gift is perpetual or time bound, you can assess its potential impact when making choices about its design. By quantifying the trade-offs, Bernstein can help you determine how much to spend, and how much to invest for future giving.

[\(See “Wealth Forecasting” on page 13.\)](#)

Once your philanthropic program is under way, assess its nonfinancial impact periodically. Review an annual accounting of what your gift allowed the nonprofit to accomplish: How many students went to college with the help of your scholarship fund? How many children received TB vaccinations in Peru? How many solar panels were installed in remote villages off the electric grid?

Perhaps the greatest measure of success is to consider the impact on your family. Have your children become engaged in giving through your program? Has it brought your family closer together? Answers to these questions will ensure your plan is the right one for you.

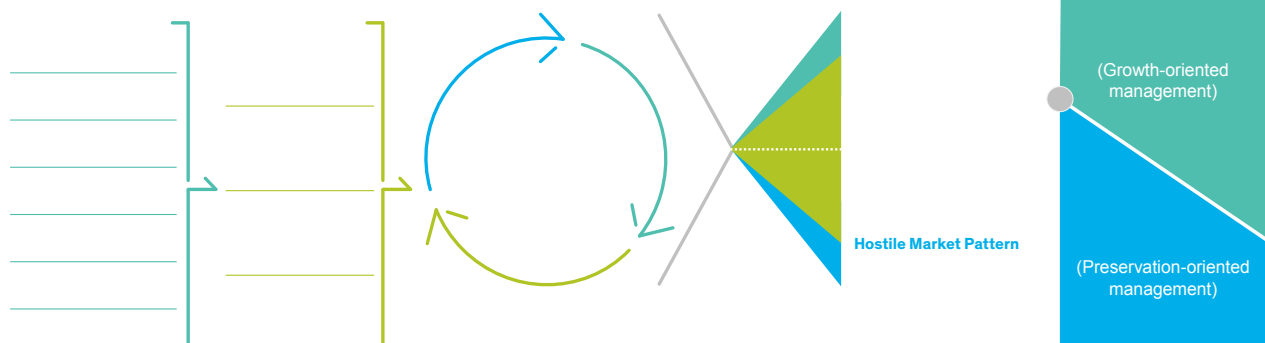
## WEALTH FORECASTING

Investment-planning decisions can have ramifications over decades. Retirement plans, for example, may involve 40 or more years of saving and another 30 to 40 years of spending. Likewise, charitable trusts may make grants over several decades, while foundations are often established with perpetuity in mind.

To make prudent decisions about the distant future, investors need a way to estimate the long-term results of potential strategies. Bernstein uses its Wealth Forecasting System<sup>SM</sup> to make such estimates (**Display 6**).

Our Wealth Forecasting System<sup>SM</sup> considers the historical linkages within and among the capital markets under a broad range of economic environments. Taking into consideration current market conditions, it builds 10,000 plausible future market scenarios to produce a probability distribution of outcomes for a portfolio. The result is a statistically reliable analysis that is able to forecast a range of outcomes under changing, and sometimes extreme, capital market conditions. It enables individuals and fiduciaries to pre-experience portfolio results under poor as well as more attractive market conditions, and to more accurately assess the portfolio's downside risk, so they can make informed decisions with respect to asset allocation and spending.

### DISPLAY 6: THE CORE OF YOUR RELATIONSHIP—TAILORED WEALTH PLANNING



*The Bernstein Wealth Forecasting System<sup>SM</sup> is based upon our proprietary analysis of historical capital-market data over many decades. We look at variables such as past returns, volatility, valuations, and correlations to forecast a vast range of possible outcomes relating to market asset classes, not Bernstein portfolios. While there is no assurance that any specific outcome suggested by the model will actually come to pass, by quantifying the possibilities of achieving financial goals under changing, and sometimes extreme, capital-market conditions, the tool should help our clients make better choices. See Notes on the Bernstein Wealth Forecasting System<sup>SM</sup> at the end of this report for further details.*

Source: AB

## CRAFTING YOUR INVESTMENT POLICY STATEMENT

Whether you have your own private foundation, or volunteer on the board or investment committee of a nonprofit, writing an investment policy statement (IPS) is an important way to ensure you, and the rest of the board or committee, are meeting your fiduciary duty to protect the foundation's assets. The IPS should be adhered to, and updated as needed. Here are some elements to include:

- Anticipated Fund Duration: How long should the funds last? The anticipated time horizon is crucial to determining proper fund investments and risk budget.
- Investment Goals: What purpose will these funds serve for the foundation? If the goal is to preserve a perpetual foundation and generate a reasonable cash flow, the IPS should state that, so the responsible parties can manage the assets to meet that goal. If the goal is to support construction of a new campus, the IPS should say so clearly, so the board will adopt the (quite different) investments appropriate to that short-term goal.
- Roles and Responsibilities for Officers, Directors, and Committees: The IPS can be useful in defining roles and responsibilities in managing the foundation's assets. If oversight of finances is delegated to an investment committee or finance committee of the board of directors, say so in the IPS. If the foundation engages a professional investment manager, delineate the manager's authority.
- Target Asset Allocation: Define how the assets will be allocated among asset classes. Assign ranges around asset classes to provide flexibility.
- Constraints: List any restrictions on investments, spending, and liquidity.
- Performance and Risk Guidelines: Specify benchmarks for assessing performance and risk. Define risk budget and specific parameters.

A well-written IPS should tie back to the ultimate goal: The vision and mission of the foundation or charitable organization to which you dedicate your time.

# **IMPLEMENTING STRATEGIES TO SUPPORT YOUR MISSION**



## CHOOSING PHILANTHROPIC STRATEGIES

Now that you've done all the hard work, determined that your core capital is secure, and you can afford to make substantial gifts, you need to uncover which philanthropic strategy will best fulfill your mission (*Display 7*).

We urge you to work with your legal and tax advisors on estate planning. In addition, in seeking your philanthropic objectives, you have a choice between purely philanthropic gifts and gifts

that provide some financial benefit to you or your family. Both purely philanthropic and partly philanthropic strategies give you the flexibility to make immediate, staged, or deferred gifts. The pages that follow provide more detail to help you identify strategies that could meet your goals. Please note, in the strategy examples on the subsequent pages, we assumed that the donor is able to [itemize](#) his or her tax return and receives a [charitable income-tax deduction](#) for a charitable gift made.

### DISPLAY 7: NARROWING DOWN YOUR CHOICES







# DIRECT GIFTS

<b>Best for:</b>	Donors seeking a simple and flexible way to make a gift of cash or securities directly to charity
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	Receive charitable income-tax deduction in year of gift, subject to AGI limitations
<b>Distributions to Donor:</b>	No
<b>Limitations/Drawbacks:</b>	Gifts of cash can be less efficient than other strategies, from an income-tax perspective

The simplest way to give to a [qualified charity](#) is to make a direct gift of cash. Writing a check or using your credit card is easy, scalable, and flexible: You can give more or less from one year to the next, or stop giving altogether, if your situation changes financially or a new cause grabs your heart. You will receive a personal income tax deduction for however much you give. But too often, even financially sophisticated people miss another simple way to boost the tax benefit of their charitable donations: giving appreciated securities, rather than cash.

paying the 23.8% tax on the stock’s \$100,000 gain, as the right-hand bar shows. The extra tax savings would cut the effective cost of his \$100,000 gift to \$39,200.

To receive a deduction for its fair market value, a capital asset must be held for more than one year, among other requirements. The Internal Revenue Code permits charitable deductions of up

## How It Works

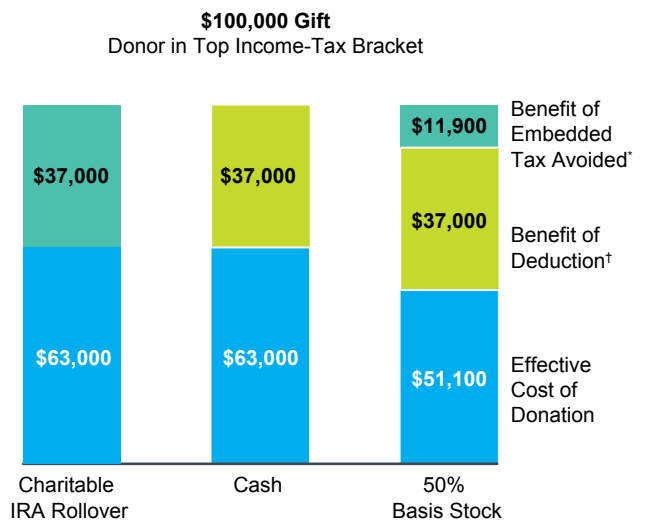
For someone in the top (37%) tax bracket, deducting the value of a \$100,000 cash gift to a qualified charity reduces the federal income tax owed by \$37,000 and thereby cuts the effective cost of the gift (the value of the gift minus the tax benefit) to \$63,000, as the left-hand bar in **Display 8** shows. For clients who pay state and local income-tax, the effective cost may be even lower.

By contrast, gifts of appreciated publicly traded stock or other assets can also reduce or eliminate tax on capital gains, as well as reduce tax on ordinary income.

If the same taxpayer donated \$100,000 in publicly traded stock bought for \$50,000, he could also avoid paying the 23.8% tax on the stock’s \$50,000 gain. The extra tax savings would cut the effective cost of the donation to \$51,100, as the middle bar shows.

If he donated \$100,000 in publicly traded stock that he received at no cost—perhaps when he founded his firm—he could avoid

**DISPLAY 8: NOT ALL CHARITABLE GIFTS OFFER THE SAME TAX SAVINGS**



\* Applicable rate for stock gain is assumed to be 23.8%.

† Deduction limited to 60% of AGI in year of gift for cash or 30% of AGI in year of gift of appreciated publicly traded stock. Benefit of deduction assumes full use of deduction against income otherwise taxed at 37.0% tax rate. Gift is to a public charity.

Source: Bernstein

to 60% of [adjusted gross income \(AGI\)](#) in the year of the cash gift, and up to 30% in the year of the gift of appreciated publicly traded stock.<sup>1</sup> However, the deduction can be carried forward for five years.

Deferring a deduction is valuable if a taxpayer wants to give more than can be deducted in one year\*—perhaps to help a charity get

a matching grant. The limitations on the charitable income-tax deduction vary with the donor's income, the type of property being donated, and the nature of the recipient charity (for example, a public charity versus a private foundation). [See “Assets to Give” on page 60](#), and consult your tax advisor.

### IF YOU CAN'T PART WITH A FAVORITE STOCK

One couple we worked with asked if there was a better way to help their local hospital than writing a large check, as they had done in years past. Their advisor suggested giving low-basis stock. They had a large position in a pharmaceutical stock that had appreciated since they bought it six years earlier for \$15,000: It was now worth \$100,000.

The couple really liked the stock, and struggled with the idea of giving away anything that had performed so well, and which they felt complemented the rest of their holdings. Fortunately, the advisor was able to suggest an alternative that would give them the best of both worlds.

The couple's large portfolio included over \$100,000 in cash that they had accumulated in anticipation of the gift to the hospital. If they gave the cash to the hospital and retained

the pharmaceutical stock, they would fulfill their charitable goal, receive a \$100,000 charitable income-tax deduction, and hold the stock with its \$15,000 tax basis.

But if they gave the stock to the hospital, they could use the cash they'd accumulated to buy a new position in the same stock. They would still fulfill their charitable goal and receive a \$100,000 charitable income-tax deduction—and they would reset the cost basis of their position in the stock to \$100,000.

That's what they ultimately decided to do. If at some point in the future they decide to sell the stock, they would avoid \$85,000 in embedded capital gains—and \$26,000 in capital-gains taxes.<sup>2</sup>

\* Assumes donor is able to take a charitable income-tax deduction.

<sup>1</sup> These are the deduction limitations for gifts to public charities, including donor-advised funds.

<sup>2</sup> Assumes the gain would otherwise be taxed at a blended long-term capital-gains rate of 30.2%, based on a federal rate of 20% with 3.8% Medicare surtax, including a combined state and local tax rate for New York City of 12.7%.



# CHARITABLE IRA ROLLOVERS

<b>Best for:</b>	IRA owners at least 70½ years of age who have exceeded the annual limit of charitable deductions; donors who cannot itemize deductions
<b>When Charity Receives Gift:</b>	<p>Now                      Staged Over Time                      Later</p>
<b>Tax Impact:</b>	Counts toward RMD but excluded from AGI, so no charitable income-tax deduction; avoids tax on income from IRA distribution
<b>Distributions to Donor:</b>	Up to \$100,000 from IRA can be granted to public charity; donor can withdraw from IRA and receive any remainder of RMD
<b>Limitations/Drawbacks:</b>	Same effective tax impact as giving cash, if itemizing deductions; rules are complex

If you are more than 70½ years old, don't need the [required minimum distribution \(RMD\)](#) from your individual retirement account (IRA) to fund your living expenses, and want to avoid paying income tax on the RMD, a charitable IRA rollover, technically called the qualified charitable distribution, may be a valuable strategy to consider. Donors who have exceeded the annual income limitations on charitable income-tax deductions or who do not itemize deductions generally benefit most.

## How It Works

Giving opportunities are limited with regard to IRA accounts ([see "Assets to Give" on page 60](#)), but there's an exception for people who must take required distributions. The Protecting Americans

from Tax Hikes (PATH) Act of 2015 allows IRA owners who are at least 70½ years old to donate up to \$100,000 each year directly from their IRA to a qualified public charity, but not to donor-advised funds, supporting organizations, or private foundations.<sup>3</sup>

For donors who may not be able to fully use their charitable income-tax deductions, a charitable IRA rollover can be an efficient way to give.

However, for donors who can use their charitable income-tax deductions, the effective tax impact is the same as for giving cash. Charitable IRA rollovers may require extensive documentation.

## SHOULD A DONOR CHOOSE A CHARITABLE IRA ROLLOVER OR A DIRECT GIFT?

Charitable IRA rollover may make sense when:	Giving appreciated securities may make sense when:
• Donor cannot itemize deductions	• Donor can itemize deductions
• Majority of assets are held in an IRA	• Donor owns highly appreciated assets in taxable accounts
• RMD will push donor into higher tax bracket	• RMD will not push donor into higher tax bracket

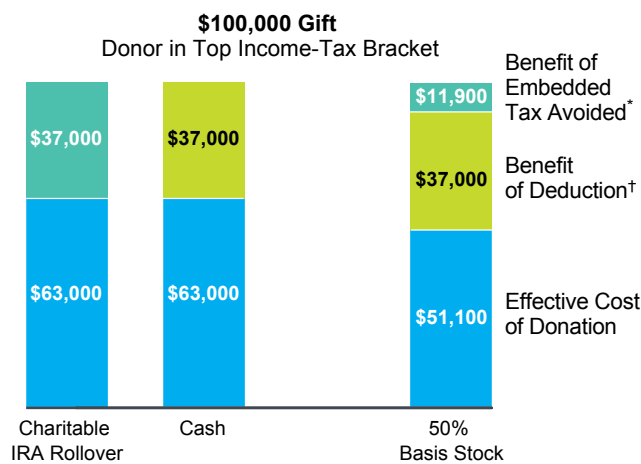
<sup>3</sup> As of publication of this guide, qualified charitable distributions may only be made to public charities. Legislation has been proposed to include donor-advised funds, but it has not been adopted.

## Assessing the Opportunity

For a donor in the top federal income-tax bracket, a \$100,000 gift from an IRA to a charity will avoid \$37,000 in embedded federal income tax (**Display 9**). That is, it would reduce the effective cost of the gift to just \$63,000. Note that a cash gift would result in the same economic benefit—if the donor itemizes his or her tax return and could take full advantage of the charitable income-tax deduction in

the current year. For donors who face deduction limits, or take the standard deduction, the qualified charitable distribution may be a better strategy. However, if the donor gives highly appreciated stock, the combined benefit of avoiding the capital-gains tax and creating a charitable income-tax deduction may be greater than a charitable IRA rollover.

**DISPLAY 9: IRA AND CASH GIFTS CAN HAVE SAME TAX IMPACT; APPRECIATED STOCK STILL ATTRACTIVE**



\* Applicable rate for IRA distribution is assumed to be 37.0% (no after-tax IRA contributions, and Medicare surtax does not apply). Applicable rate for stock gain is assumed to be 23.8%.

† Deduction limited to 60% of AGI in year of gift for cash or 30% of AGI in year of gift of appreciated publicly traded stock. Benefit of deduction assumes full use of deduction against income otherwise taxed at 37.0% tax rate. Gift is to a public charity.

Source: Bernstein

## TOTAL PHILANTHROPIC VALUE: A MEASURE OF FINANCIAL IMPACT

Measuring the financial impact of direct gifts to charities can be complex, especially if some of those gifts will be made over time or at a future date. Bernstein created its [total philanthropic value](#) (TPV) metric to help you assess the projected financial impact of various giving strategies or spending policies. TPV is the sum of distributions over time and any remaining assets that will support future giving, in current dollar terms.

If you write checks directly to nonprofit organizations, your TPV is the total you plan to give over time in today's dollars. The more you give and the earlier you give it, the greater the TPV.

If you give now to a donor-advised fund (DAF), private foundation, or trust that will distribute money over time, your TPV is the sum of the expected annual grants and the expected amount remaining after, say, 20 years. The size of the annual grants, the time horizon for making the grants, the asset allocation of the charitable entity's investments, and the expected capital-market returns determine the TPV.

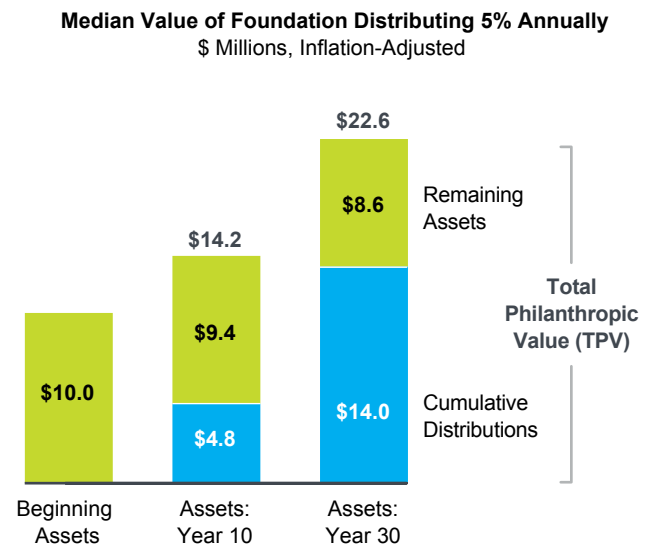
For example, if you establish a \$10 million foundation, adopt a growth-oriented asset allocation, and distribute 5% of assets annually, we estimate that the TPV will grow to \$14.2 million in 10 years and \$22.6 million in 30 years, in the median case (**Display 10**). While in 30 years, the real value of the foundation's remaining assets would decline to \$8.6 million, the cumulative distributions would boost the TPV to more than double the initial gift.

TPV can also dimension the percentage you've already distributed versus the philanthropic reserve remaining, which can help you decide the size of future grants.

But nonfinancial considerations should also play a role. If your philanthropic mission is focused on a near-term goal, such as halting an epidemic disease, you might decide to spend down your philanthropic assets. If your philanthropic mission has a longer horizon, such as sustaining an arts institution, you may want to keep a greater share of your philanthropic assets in reserve.

No matter what your mission, TPV can help you quantify the financial impact to charitable organizations.

### DISPLAY 10: TPV = TOTAL GIFTS + REMAINDER



*TPV is the sum of cumulative distributions and the portfolio remainder value after inflation. Allocation is 80% stocks and 20% bonds. Global stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as 50% intermediate-term taxable bonds and 50% global intermediate-term taxable bonds, hedged. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.*

Source: Bernstein

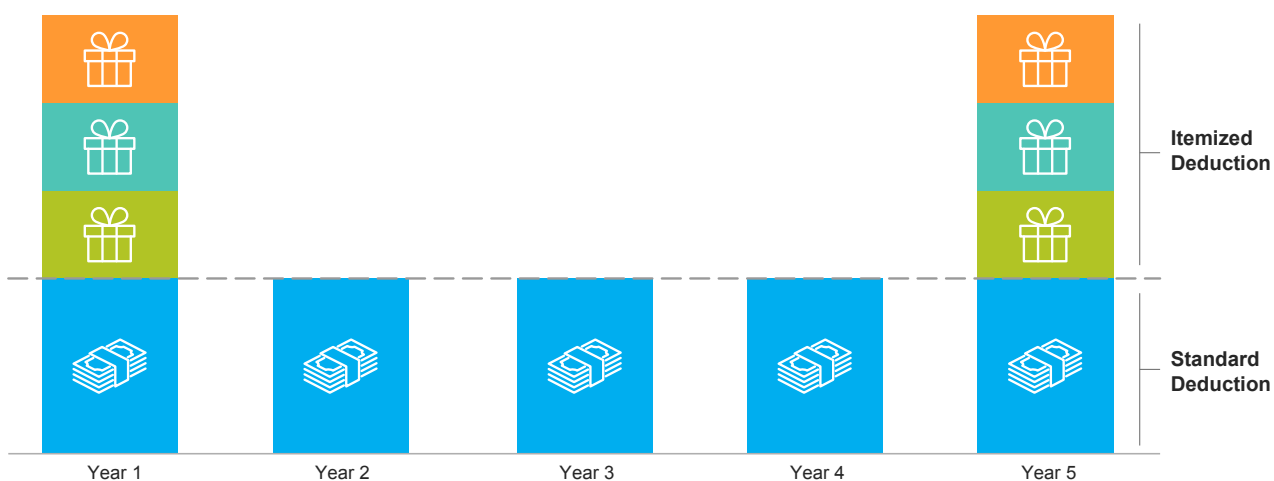
## MAXIMIZING CHARITABLE INCOME-TAX DEDUCTIONS

Did you experience an unusually high-income year, perhaps due to a large year-end bonus, or from the recent sale of your business? If so, you will likely be faced with a high tax bill. Fortunately, you may be able to marry certain charitable giving strategies to help offset taxes. A bunching strategy and combining gifts are examples.

**Bunching**—accelerating charitable gifts into a high-income-tax year instead of spreading these gifts over several years—works like this: A donor groups charitable donations into a single year. In off-years (or “skip-years”), a donor does not make charitable gifts (and either has lower itemizations or takes the standard deduction\*). By utilizing this strategy, multiple years’ worth of charitable gifts are made in a single year to receive a greater deduction. If the donor is concerned with making “lumpy” gifts, a donor-advised fund (DAF) may be utilized to maintain a steady stream of giving in a tax-efficient way to support favorite charities on a regular basis (**Display 11**).

Combining cash and long-term appreciated securities, for example, is another strategy that may offer a larger deduction than contributing securities alone. Cash donations can be deducted up to 60% of [adjusted gross income](#) in the current year. Donations of securities—publicly traded stocks, bonds, or mutual funds that were held for more than a year—are generally deductible at fair market value, and current year deductions can be in amounts up to 30% of your adjusted gross income. If both types of contributions are made, the IRS has an ordering mechanism in place to determine which deductions are taken first and to what extent. It’s also possible to carry forward any unused deductions for up to five years.

### DISPLAY 11: ACCELERATING GIFTS IN A HIGH INCOME YEAR



\* Under the tax reform bill of 2017, the standard deduction is \$12,000 for individuals and \$24,000 for married couples. The deduction for state income and property taxes (SALT) is capped at \$10,000 and many other deductions were repealed or reduced. Bernstein does not provide legal or tax advice. Please consult with these professionals before making any decisions.

Source: Bernstein



# DONOR-ADVISED FUNDS

<b>Best for:</b>	Donors seeking a low-cost and flexible philanthropic vehicle to contribute to and make grants from; potential family legacy
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	Receive charitable income-tax deduction in year of gift, up to limits; future growth avoids income taxes
<b>Distributions to Donor:</b>	No
<b>Limitations/Drawbacks:</b>	Irrevocable gift; subject to AGI limitations on charitable contributions; donor advises on, but doesn't control grantmaking

Low cost and highly flexible, donor-advised funds (DAFs) have become philanthropy's fastest-growing vehicle in recent years.

Here's why: Low operating costs reduce the minimum endowment generally required; you can contribute to a DAF as frequently as you like; there's no minimum annual grant; you don't have to administer the fund; and you can preserve your anonymity. The principal drawback is that you don't have complete control over grantmaking and investments.

## How a DAF Works

A DAF is an account or fund that you create at a sponsoring organization that is itself a [qualified public charity](#)—perhaps a community foundation, faith-based organization, or specialized provider. You make irrevocable gifts of cash or other assets to the fund, and you receive an immediate charitable income-tax deduction. The DAF is not part of your estate for gift and estate tax purposes.

The DAF can sell the assets you contribute, including highly appreciated stock, without triggering capital-gains tax. It can then reinvest the untaxed proceeds in a diversified portfolio, and benefit from its tax-free growth and income.

Most DAFs are not subject to annual giving requirements: You can grant as little as 0% or as much as 100% of the assets in any year.

As the name implies, in a DAF you play an advisory role with respect to investments and grants. The sponsoring entity (or administrator) handles checkwriting, recordkeeping, and other administrative tasks, and it disburses grants.

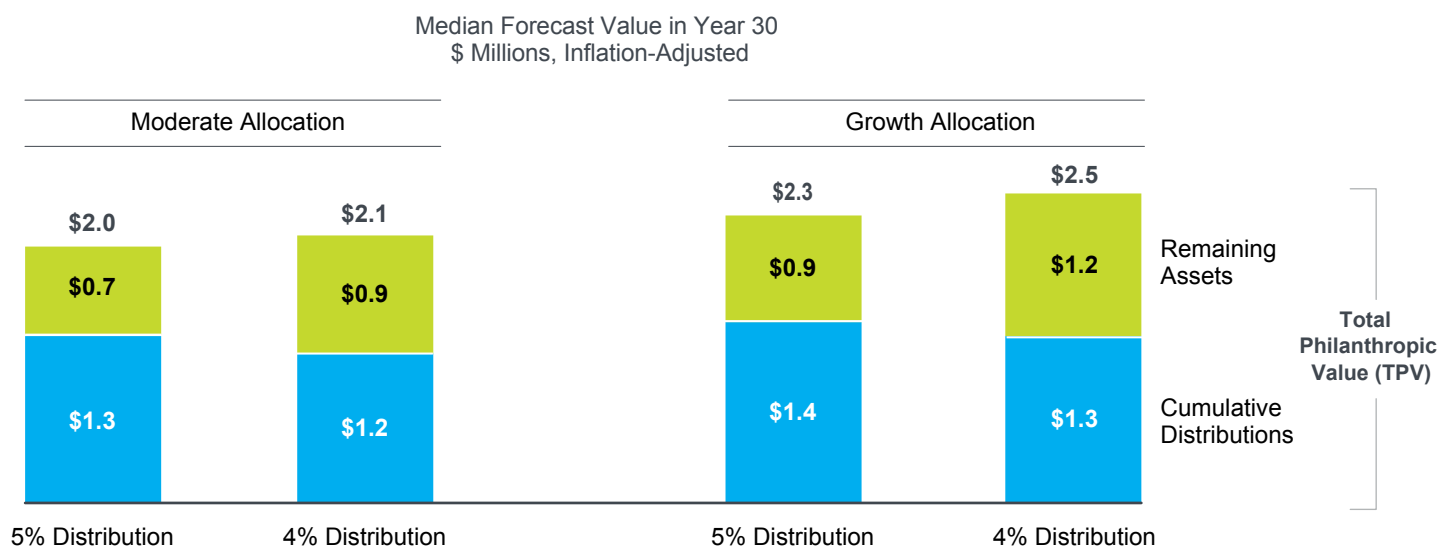
## Setting the Payout Rate and Asset Allocation

The flexibility of DAFs has a downside: Donors often have difficulty deciding how much to recommend that the fund distribute annually and what its asset allocation should be. To help frame the trade-offs, we use our total philanthropic value (TPV) metric to quantify the likely financial impact of a DAF's giving and investment choices. TPV measures the inflation-adjusted sum of total distributions and remaining assets after a stated period of time. ([See "Total Philanthropic Value: A Measure of Financial Impact" on page 21.](#))

For example, you want to make a \$1 million contribution to a DAF to fund your charitable giving over 30 years. While you think giving 4% to 5% a year seems reasonable, you want to know whether the higher giving rate or a growth allocation would increase its financial impact over time.

**Display 11, next page,** shows that with either asset allocation, the TPV would be higher over 30 years with a lower giving rate of 4%, in the median case. That's because the lower distribution rate would leave more assets in the fund to benefit from the compounding of investment returns. Of course, distributions of 4% would initially be smaller than distributions of 5% off the same asset base. But because the asset base grows more in the fund with a 4% distribution, the dollar value of its distributions would grow more, narrowing the gap.

## DISPLAY 12: HOW YOUR CHOICES AFFECT THE TPV OF A \$1 MILLION GIFT



Numbers may not sum due to rounding. TPV is the sum of real cumulative distributions and the real portfolio remainder value in a given year. Moderate allocation is 60% global stocks and 40% bonds. Growth allocation is 80% global stocks and 20% bonds. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as 50% intermediate-term taxable bonds and 50% global intermediate-term taxable bonds, hedged. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.

Source: Bernstein

The TPV would also be higher with a growth allocation than with a moderate allocation. In the median case, there would be more assets remaining after 30 years and more cumulative distributions.

However, the growth allocation would also likely have more-volatile investment returns, which could lead to more variability in distributions, if the donor remained wedded to the 4% giving rate.

Because there are no annual distribution requirements, DAFs have the flexibility to hold grants steady during bull markets so that the fund value can grow, and increase grants in challenging times. Some DAFs adopt a [smoothing rule](#) that applies the distribution rate to the average asset base for the last three or five years, in order to smooth out annual distributions. Some simply say that annual distributions will never decline more than, say, 5% from the previous year. This flexibility can be helpful to donors and to nonprofits, which often receive fewer donations during market and economic downturns, when the need for their programs may rise.

### Key Considerations

The various advantages and disadvantages of DAFs are laid out in the table on [page 36](#). Here, we explore a few key issues in greater depth.

**Control.** When you donate assets to a DAF, you relinquish legal control. You don't make grants yourself; you submit recommendations for grants to a DAF administrator, which conducts due diligence to ensure the nonprofit you recommended is a qualified public charity that meets the sponsoring charitable organization's own guidelines and mission. Most of the time, the administrator will follow your recommendations, but there's no guarantee.

DAF sponsors/administrators have the legal right to introduce restrictions on investments or grantees at any time, and can refuse a particular grant request, perhaps because the philanthropic cause, the geographic region, or the grantee lies outside the administrator's area of interest. For example, some DAF administrators will not make grants to non-US charities.



You can create an advisory board to help you with your grant suggestions, conduct official meetings, and make formal decisions on recommended grants and investments that you convey to the fund administrator. You cannot compensate the advisory board from the DAF's assets.

**Time Horizon.** Many DAFs are established for a defined term, such as two or three decades. Whether succeeding generations can participate in a DAF program depends on the sponsoring organization's rules. If you want your children or more distant descendants to continue your philanthropic mission, you should find a DAF that permits successor advisors, or consider creating a private foundation instead.

Rules also differ regarding any assets remaining in the account when the DAF ends. In most cases, the donor can designate one or more charities or purposes for the remainder, but some programs require that remainders flow into the sponsoring charity's unrestricted fund. It's important to inquire about this in advance.

**Anonymity.** Most DAF programs will make grants in a way that does not disclose your identity, if you wish. If you want complete anonymity, you can give your DAF a name unrelated to your own. But DAFs can also make your gift public, if you want to attract attention to a cause, or be associated with the gift and the cause.

**Taxes.** The charitable deductions available for contributions to DAFs are generally based on the assets' fair market value, no matter if you give cash, marketable securities, business interests, real estate, or other privately owned assets.\* ([See "Assets to Give" on page 60 for some exceptions.](#)) If you give cash, the maximum deduction you can use in any year is equal to 60% of your [adjusted gross income \(AGI\)](#). If you donate assets, the maximum deduction you can use in any year is equal to 30% of your AGI. Charitable income-tax deductions can be carried forward for as many as five tax years. The DAF administrator has to file taxes annually for its entire portfolio of funds; that has no impact on the individual donor.

**Private Benefit.** A DAF cannot make grants for which the donor would receive a tangible benefit. For example, it cannot buy a table at a charity event that would provide you and your friends or family with a nice meal and entertainment, as well as a tax deduction. However, recent IRS guidance stipulates that satisfying charitable pledges from DAF grants does not provide the donor with an impermissible benefit. ([See "Charitable Pledges" on page 37.](#))

**Funding.** While some DAF administrators won't accept gifts other than cash and readily marketable securities, others are open to receiving complex assets, such as private or closely held C- and S-Corporation stock, restricted stock, limited partnership interests, real estate, and other illiquid assets. Often, this can provide a tax-efficient way to support your charitable causes. But before accepting any complex asset, the DAF administrator will perform a comprehensive review of all circumstances related to the legal transfer of these assets. ([See "Assets to Give" on page 60.](#)) There are many points of due diligence, including evaluating carrying costs, marketability, and liabilities. Additionally, as a donor, you will be required to obtain a qualified appraisal of the fair market value to substantiate a charitable income-tax deduction.<sup>4</sup>

**Investing.** DAFs are eligible to invest in alternative investment strategies that are only open to qualified investors with at least \$25 million, because these funds are a part of a larger sponsoring organization. Key determinants for selecting the right alternatives allocation are spending and time horizon. Most alternative assets are illiquid, which means they cannot be readily sold for cash. Because of this characteristic, you should select an alternatives allocation that does not put your granting at risk. Likewise, DAFs need to have significant investable assets to ensure enough liquidity to avoid a shortfall. ([See "Going Beyond Stocks and Bonds" on page 54.](#))

\* Assumes you are able to take a charitable income-tax deduction.

<sup>4</sup> Bernstein doesn't offer legal or tax advice. Please consult with a professional.

Similarly, this illiquidity means that if your time horizon is short—less than five years, for example—an allocation to illiquid alternatives may not make sense. But longer horizons can withstand having assets locked up for a significant period, so alternatives can be part of your fund. Of course, your circumstances are unique, so an allocation should reflect your giving goals.

**Legislative Risks.** Certain lawmakers have attempted to reduce the value of the charitable income-tax deduction and require that assets contributed to DAFs be distributed within five years of making the contribution. Many DAF administrators have adopted policies that require the donor to make grants after a specified period of inactivity, whether to a fund at the DAF sponsor, or to charities that the donor recommends.

## KEY QUESTIONS WHEN ESTABLISHING A DONOR-ADVISED FUND (DAF)

To help you decide if a DAF is a giving vehicle that aligns with your philanthropic goals, here are some key questions to ask a DAF sponsoring organization:

- Can the DAF continue in perpetuity or is it limited to the life of the donor?
- Can I choose a successor advisor to my DAF?
- Am I able to decide where any remaining assets are distributed when the DAF is terminated? Are they automatically granted to the DAF sponsor, or can I choose the charities?
- What are the administrative fees?
- What are my investment options?
- In addition to cash and securities, what other types of complex assets can the DAF sponsor accept?
- Are there any limitations (i.e., geographic, religious) with the grants I recommend?
- What is the timeline of when I can expect the grant to reach the charity?
- What are the rules regarding inactivity before a grant is forced out?
- Are there any other philanthropic services that I receive as a donor?

## LENDING A SUPPORTING HAND

A supporting organization is a public charity that fulfills its charitable purpose by supporting another public charity.

There are three types of supporting organizations<sup>5</sup>

**Type I:** An organization controlled by the organization(s) it supports, typically by giving the supported organization(s) the power to appoint or elect a majority of the directors or trustees of the supporting organization. The relationship between the supported organization(s) and the supporting organization is similar to a parent-subsidiary relationship.

**Type II:** An organization under common control with its supported organization(s), usually by having a majority of the directors or trustees of the supported organization(s) serve as a majority of the trustees or directors of the supporting organization. The relationship between the supported organization(s) and the supporting organization is similar to a brother-sister relationship.

**Type III:** An organization operated in connection with one or more publicly supported organizations.

Supporting organizations are considered public charities even though they can be funded by a single donor or family. Accordingly, gifts to a supporting organization are eligible for more favorable charitable income-tax deductions than gifts to private foundations. In addition, most supporting organizations are not subject to the 5% payout requirement or [excess business holdings](#) limitations applicable to private foundations. Thus, supporting organizations can be an attractive option for a family who wishes to give closely held business interests to charity so that the charity can benefit from the business's earnings. Except as discussed below, the gift will not be subject to the excess business holdings limitations that would otherwise require selling the business interests within five years.

On the other hand, a donor who establishes a supporting organization will have less control than if the donor creates a private foundation. Furthermore, certain Type III supporting organizations will be subject to the 5% payout requirement and excess business holdings limitations. Supporting organizations can be complex to establish and maintain. A donor who is interested in establishing a supporting organization should consult with tax and legal counsel familiar with the complexities surrounding supporting organizations.

<sup>5</sup> IRC Section 509(a)(3).



# PRIVATE NONOPERATING FOUNDATIONS

<b>Best for:</b>	Donors who want to devote time and money to establish a long-term philanthropic program; provides control and potential family legacy
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	Receive charitable income-tax deduction in year of gift up to limits; future growth avoids income taxes
<b>Distributions to Donor:</b>	No
<b>Limitations/ Drawbacks:</b>	Irrevocable gift; potentially costly; subject to AGI limitations on charitable contributions; 5% minimum required distribution

Private nonoperating foundations provide flexibility and control to donors willing to devote substantial time and money to establishing a long-term philanthropic program. These vehicles are often intended to be perpetual (to last well beyond your lifetime), and thus can allow you to establish a legacy, engage your family in your giving program, and pass on your philanthropic values to your next generation.

They also offer some tax advantages that are particularly valuable if you want to reduce a larger-than-usual tax bill in a given year.

You or your designated representative is responsible for writing checks, corresponding with grantees, keeping records, applying to the IRS for tax-exempt status, and complying with regulations.

## How a Private Foundation Works

Legally, a private nonoperating foundation is a freestanding entity that you and perhaps a few other donors (often family members or business partners) establish and control in order to make philanthropic grants. The limited number of donors makes it private. Private operating foundations, by contrast, run programs, such as a school or museum. ([See page 33.](#))

The donor makes an irrevocable gift to the foundation and receives a charitable income-tax deduction in the year he or she makes the gift, although the donor may grant the money to charity over time. The foundation's assets grow tax-free.

To preserve the foundation's tax-exempt status, the foundation must distribute at least 5% of its assets towards [qualifying charities](#) each year. [Program-related investments](#) count toward the 5%, as do grants made from a private foundation to individuals for educational purposes.<sup>6</sup>

The foundation may make grants to any qualified nonprofit organization in the US whose goals are consistent with the foundation's mission or purpose. Grants to charities outside the US are also acceptable, but extensive due diligence to ensure eligibility is necessary.

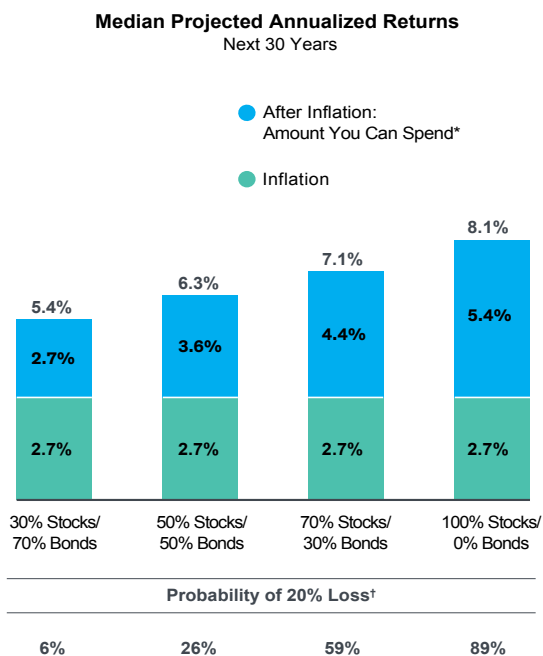
Within limits, a private foundation may also make [mission-related investments](#). For example, a private foundation seeking to combat climate change might invest in an early-stage technology company that is developing advanced batteries for storing solar power. Since the mission-related investment is likely to be illiquid and difficult to value, it could complicate the process of determining the required 5% spending rate each year thereafter.

<sup>6</sup> The grant must qualify as 1) a scholarship under section 117 of the Internal Revenue Code; 2) a prize excludable from income under section 74(b) of the Code or 3) having the purpose of achieving a specific objective, providing a report, or improving a literary, artistic, musical, scientific, teaching, or other skill or trade of the grantee. This does not apply to donor-advised funds.

## The Opportunity Today

Expected returns for stocks and bonds are lower related to history. This can pose significant challenges for foundations that aim for perpetuity. Foundations must distribute 5% a year to maintain their tax-exempt status, which increases their return hurdle. If perpetuity is a goal, they must earn at least a 5% return to avoid spending down their capital—and even more, to maintain their distributions on an inflation-adjusted basis. Based on our forecasts, only the most aggressive asset allocations may achieve 5% returns, after inflation. **Display 13** shows our median projected returns for various mixes of global stocks and taxable bonds for the next 30 years.

### DISPLAY 13: REAL RETURNS OF 5% ARE HARD TO ACHIEVE



\* Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international and 7.3% emerging market. Bonds are modeled as 50% intermediate-term taxable bonds and 50% global intermediate-term taxable bonds, hedged.

† Data indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of 20% over the next 30 years. Because the Wealth Forecasting System<sup>SM</sup> uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.

Source: Bernstein

The conservative portfolio, with a 30% allocation to global stocks, would return 5.4% a year on average, in our median forecast. That's enough to cover the 5% required distribution, but it would only support sustainable spending of 2.7%, assuming future inflation averages 2.7%. To maintain its spending power, the foundation would have to spend from principal.

The more growth-oriented asset allocations would likely have higher returns, but based on our forecasts, only the all-stock portfolio would be able to spend 5%, on an inflation-adjusted basis.

While growth-oriented allocations generate higher returns, they also create more investment risk, defined as short-term drops in portfolio value. We estimate that there's an 89% chance that the all-stock portfolio would lose 20% from peak to trough at some point in the next 30 years, but only a 6% chance that the conservative portfolio would lose that much.

There are several ways to address the challenge of perpetuity:

- The foundation can take more investment risk, perhaps shifting from a moderate to a growth allocation, with a higher weight in stocks, if its board is comfortable with the investment risk this creates.
- The donor or other parties can make additional contributions to offset any decline in assets due to lower investment returns.
- The foundation can accept a decline in the purchasing power of its distributions.
- The foundation can decide that perpetuity is no longer paramount, and that spending down the foundation to maximize its impact over a decade or more is a more relevant strategy for it today. (See "[Perpetuity or Spend-Down?](#)" on [page 34.](#))

### Key Considerations

The various advantages and disadvantages of private foundations are laid out in the table on [page 36](#). Here, we explore a few key issues.

**Time Horizon.** Private foundations are often described as perpetual philanthropic vehicles—ones that last forever. As directors or trustees retire or pass away, successor trustees—often family members—take their place. A foundation could go on

for hundreds of years, giving the family ongoing control over its assets and philanthropic program.

If you intend to pass on your private foundation to your children and grandchildren, it's critical to engage them in your giving program early—and to assess periodically whether they want to take on the responsibility when you're gone. If children are not interested in running their parents' or grandparents' foundation, then the private foundation should shift into spend-down mode or be converted to a donor-advised fund (DAF) that can spend down its assets within 20 years or so. ([See "Perpetuity or Spend-Down?" on page 34.](#)) If considering unwinding the foundation, consult with a tax advisor as these terminations require careful analysis of federal and state requirements.

**Operating Costs.** Private foundations are generally more expensive to establish and run than other philanthropic vehicles, such as DAFs. Applying for tax-exempt status for a private foundation entails legal fees, and you will probably need accounting and bookkeeping services to prepare the foundation's annual tax returns.

**Taxes.** The tax advantage of a private foundation comes from decoupling the timing of asset donations and grantmaking. For example, you can donate highly appreciated assets when you and your advisors deem appropriate, often because you face a particularly large tax bill. The foundation can sell these assets without incurring taxable gains, reinvest the proceeds, and make grants over the following years.

If you fund a private foundation with cash, the maximum amount of the deduction you can use in any year is equal to 30% of your [adjusted gross income \(AGI\)](#); if you donate securities, the maximum deduction in one year is 20% of AGI. The deduction for gifts of private or illiquid assets may be limited to their cost basis, which in some cases could be zero. Charitable income-tax deductions above the stated limits can be carried forward for as many as five additional tax years.

Private foundations are subject to an [excise tax](#) on the income and realized capital gains they generate each year. The excise tax will be 1.39% of income. Private foundations also face burdensome annual tax-filing requirements: [Form 990-PF](#) can be a long document, and its details are public, available for anyone to review.

**Investment Policy.** A long-term investment policy is critical to a foundation's success. To keep pace with inflation after spending 5%, a foundation typically invests the majority of its portfolio in return-seeking assets, such as stocks, with the balance in risk-mitigating assets, such as high-quality bonds and cash. In certain situations, an allocation to diversifying assets may be appropriate. ([See "Going Beyond Stocks and Bonds" on page 54.](#)) Understanding the risk and return trade-offs in your foundation's asset allocation is especially important if you want your foundation to be able to step up grantmaking when the economy is weak. A sound investment policy statement will give succeeding generations a road map for managing your foundation's assets. It also informs your board and investment manager on roles and responsibilities. ([See "Crafting Your Investment Policy Statement" on page 14.](#))

**Funding.** Private foundations can be funded with a wide range of assets. If you are on the verge of selling a small family business, you may want to give an interest in the business to your foundation. If your company is closely held, the deduction will be limited to your cost basis. If you donate more than a minimal share to a private foundation, the IRS will consider it an ["excess business holding"](#) that you will have to remove from the foundation's balance sheet within five years. If the prospective sale of the business falls through and the holding is not removed, a stiff penalty is assessed.

**Compensation of Board Members.** Some private foundations provide "reasonable" salaries and benefits to board members, as defined by state law, and reimburse board members for expenses related to foundation work. Your children or other family members can be officers or directors, but paying yourself or family members requires strict adherence to detailed IRS rules (and, in some cases, state rules) to avoid legal complications and penalties for [self-dealing](#).

**Legislative Risks.** Some lawmakers have attempted to reduce the value of the charitable income-tax deduction, reduce the tax advantage for growth in the foundation's portfolio, and increase the required minimum spending rate. While no significant legislation has passed since the rules for private foundations were revised in the Tax Reform Act of 1969, legislative action remains a risk.

## CHECKLIST FOR ESTABLISHING A PRIVATE FOUNDATION

- Create entity documents, such as articles of incorporation
- Establish a board of directors
- Determine the foundation's charitable objectives and develop a mission statement
- Prepare and adopt bylaws and board policies, such as an investment policy statement, a spending policy, and a conflict of interest policy
- Obtain an employer identification number
- Establish a bank account
- Apply for federal tax exemption and state tax exemption, if applicable
- Register foundation with state agencies, if applicable
- Secure insurance
- Find suitable office space, if applicable
- Hire staff and develop employee manuals, if applicable
- Develop a fundraising plan, if applicable



## PRIVATE OPERATING FOUNDATIONS

Private operating foundations are sometimes referred to as “hybrids” of private nonoperating foundations and public charities. They are often established by a single family that operates charitable programs. A private operating foundation, like a private nonoperating foundation, is typically managed by a board of directors comprising the donor and members of the donor’s family.

Private operating foundations use the majority of their income to operate charitable programs. They are not subject to the 5% payout requirement imposed upon private nonoperating foundations. However, the prohibitions against “[self-dealing](#)” and the [Form 990-PF](#) IRS reporting requirements applicable to private nonoperating foundations are also applicable to private operating foundations.

Gifts to private operating foundations enjoy more favorable charitable income-tax deductions than gifts to private

nonoperating foundations. Charitable income-tax deductions for gifts to a private operating foundation of real estate or art not created by the donor are based on their fair market value. On the other hand, charitable income-tax deductions for gifts to a private nonoperating foundation of real estate or art not created by the donor are limited to the donor’s cost basis.

At times, a family with a private nonoperating foundation may decide that the goals for the foundation would be better accomplished with a private operating foundation. In that event, the family may be able to make the transition to a private operating foundation. However, the IRS requires that the foundation meet certain tests, and submit its governing documents for review. The rules surrounding a transition can be complex; please consult your tax and legal advisors.

## PERPETUITY OR SPEND-DOWN?

A private foundation or donor-advised fund (DAF) is a way to establish your philanthropic intent today that allows for staged giving over time. But what does “over time” mean to you? You can spend down the assets over a given period, say, 20 years, or you can create a fund that will distribute grants in perpetuity.

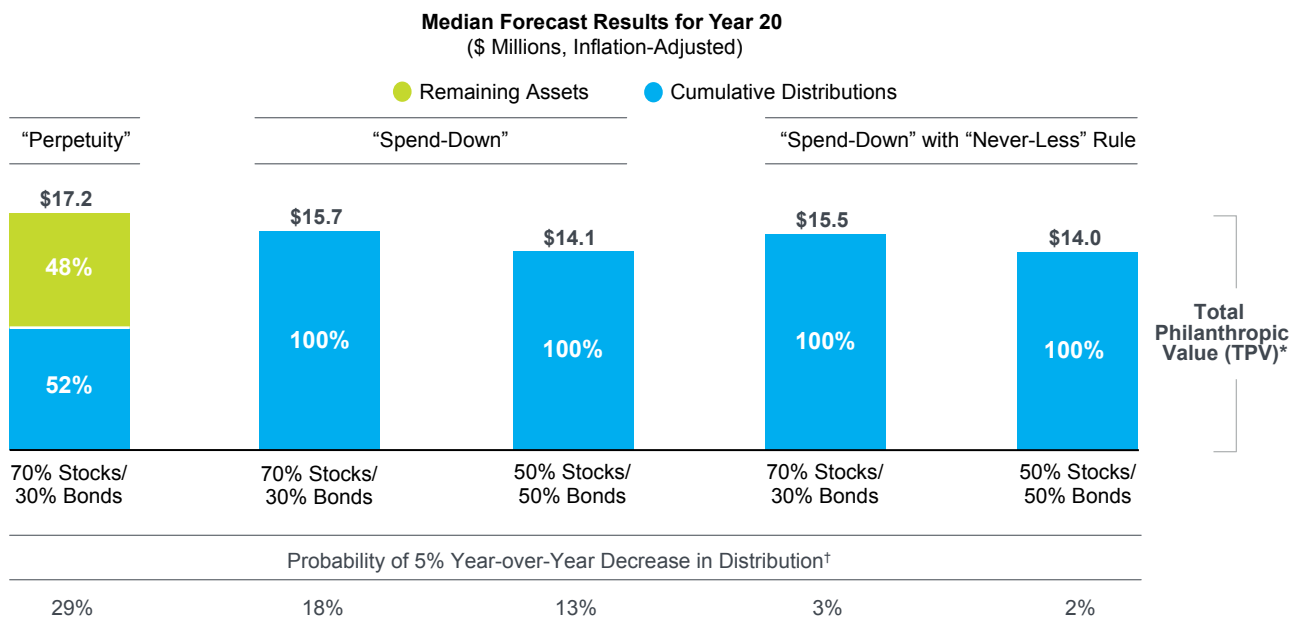
The spending policy should align with your philanthropic mission. To achieve some goals—such as earthquake reconstruction—you may want to spend down your foundation’s or DAF’s assets rapidly. For other goals, you might prefer to maximize how long the distributions last—or maximize the stability of distributions. Unfortunately, the investment

policies that lead to longevity and stability tend to be at odds. Typically, you have to trade off between these goals.

Foundations aiming for perpetuity require a high allocation to return-seeking assets such as stocks (typically 70% or more) to generate the growth needed to sustain 5% annual distributions and stay ahead of inflation. This will likely result in greater volatility in both annual returns and distributions.

But foundations and DAFs that plan to spend down their assets have flexibility about their investment policies and can take steps to stabilize distributions, if that would serve their charitable goals.

### DISPLAY 14: SPEND-DOWN POLICIES REDUCE TPV AND VOLATILITY OF DISTRIBUTIONS



\* TPV is the sum of real cumulative distributions and the real portfolio remainder value in a given year.

† Data represent the likelihood of experiencing such a decline over the course of any one year. Distribution is defined as charitable distribution only, excluding expenses.

Initial assets of \$10 million. "Perpetuity" refers to a 5% annual distribution for 20 years, and "Spend-Down" refers to linear spending from the foundation over 20 years. "Never Less" refers to the annual distributions never being less than the prior year's distribution. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as 50% intermediate-term taxable bonds and 50% global intermediate-term taxable bonds, hedged. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.

Source: Bernstein

**Display 14**, [on page 34](#) shows that we estimate a \$10 million perpetual foundation with a 5% spending policy and a 70% stock allocation would have significantly more [total philanthropic value \(TPV\)](#) after 20 years than a foundation with the same asset allocation that is spending down its assets. However, the foundation spending down its assets faces less risk of distributions falling 5% from one year to the next.

The foundation spending down its assets could stabilize distributions even further, if it's willing to give up some TPV. Reducing the stock allocation to 50% would lower the odds of a 5% year-over-year drop in distributions from 18% to 13%, but also reduce TPV from \$15.7 million to

\$14.1 million. That option generally isn't available to a perpetual foundation, which needs the growth that a higher stock allocation can generate over time.

The foundation spending down its assets could also adopt a rule that it will never spend less from one year to the next, with minimal impact on its TPV, whether it allocated 70% or 50% of its assets to stocks. (The slight odds of a 5% decline in annual distributions shown capture the final year, when only a little capital may be left.)

The choice is yours. If you think a drop in annual funding would be highly disruptive to the programs you support, you can reduce that risk—but it may mean granting less money over time.

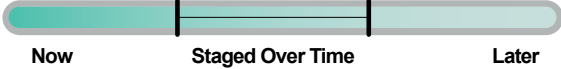
**DISPLAY 15: COMPARING VEHICLES FOR PURELY PHILANTHROPIC GIVING**

	Donor-Advised Fund (Public Charities)	Private Foundation (Nonoperating)
<b>Overview</b>	Good fit for donors who desire flexibility with grantmaking; very little administrative burden on donor; generally cost-effective for small gifts; Bernstein provides advisory and management services and partners with sponsors	Good fit for donors who desire maximum control over gifts and assets and may wish to involve family deeply; donors must deal with administrative complexity and legal/regulatory scrutiny; Bernstein provides advisory and management services
<b>When Charity Receives Gift</b>	Beginning now, over time	Beginning now, over time
<b>Income-Tax-Free Environment</b>	Yes, assuming no <a href="#">unrelated business taxable income (UBTI)</a>	Yes,* assuming no unrelated business taxable income (UBTI)
<b>Operating Costs</b>	Generally low, but varies among administrators	High, but declines (on percentage basis) as assets rise; includes legal fees, start-up costs; ongoing costs vary but can be significant
<b>Income-Tax Deductions for Contributions</b>	Generally based on fair market value of gift; can be carried over five years	Generally based on fair market value of gift; can be carried over five years
Cash	Deductions limited to: 60% of <a href="#">adjusted gross income (AGI)</a>	Deductions limited to: 30% of adjusted gross income (AGI)
Marketable Securities	30% of AGI	20% of AGI
Private Securities	Fair market value, at 30% of AGI	Cost basis, at 20% of AGI
<b>Excise Tax</b>	None	1.39% of income
<b>Control</b>	Contingent on sponsor	Significant, subject to constraints of federal and applicable state laws
<b>Funding</b>	Fewer legal restrictions on types of noncash gifts they can receive; <a href="#">excess business holdings</a> can be a challenge	Excess business holdings can be a challenge
<b>Annual Grants</b>	Flexible—no minimum or maximum	Required 5% distribution
<b>Anonymity</b>	Achievable if desired	No
<b>Perpetuity</b>	Contingent on sponsor	Yes
<b>Compensation of Board Members</b>	No	Yes, subject to state requirements
<b>Administrative/ Compliance Burden</b>	Minor; handled by sponsor	Can be significant; subject to strict rules
<b>Legislative Risks</b>	Yes	Yes
<b>Other Tax Issues</b>	Can be subject to UBTI at corporate rate of 21% depending on some types of investments	Can be subject to UBTI at corporate rate of 21% depending on some types of investments
<b>Beneficiary of IRA</b>	Yes	Yes
<b>Lead Beneficiary of CLAT</b>	Yes	Yes, but requires careful documentation
<b>Remainder Beneficiary of CRT</b>	Yes	Yes

\*There is an excise tax of 1%–2% on net investment income.  
Source: IRS and Bernstein



# CHARITABLE PLEDGES

<b>Best for:</b>	Wealthy donors seeking recognition today for sizable gifts over set period of time
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	Contributions made during tax year are income-tax deductible
<b>Distributions to Donor:</b>	No
<b>Limitations/Drawbacks:</b>	Potential legal consequences if pledge is not honored; failure to donate all money pledged deprives charity of relied-upon funding

Structuring a charitable gift as a pledge is a way to make a significant gift to your favorite nonprofit organization in installments. Charities accept pledges because they realize that some donors are more comfortable making sizable gifts over time.

A pledge is an agreement between you and a charity that you will make a gift to the charity over a set period of time. Only contributions made during the tax year are deductible. Thus, if you pledged this year to donate \$100,000 to your favorite charity but paid the charity only \$25,000 by December 31, you can deduct only \$25,000 this year.

Before you commit to a charitable pledge, be sure you are comfortable with locking in your obligation. If you know that you want to make a sizable charitable gift but are not comfortable picking just one charity, a gift to a donor-advised fund (DAF) or a series of gifts may make more sense for you.

Can a charitable pledge be satisfied from your DAF? Recent IRS guidance<sup>7</sup> indicates that it can as long as 1) the pledge is not referenced in the grant distribution, 2) the donor does not receive any benefit in connection with the grant, and 3) the donor does not claim an additional income-tax charitable deduction for the DAF's satisfaction of the pledge.

Failure to donate all the money pledged may deprive the charity of funds upon which it relied for programs or capital expenditures. If the pledge is structured as a legally enforceable contract, under certain circumstances the charity can sue you or your estate to recover the unpaid portion of the pledge.

While charitable pledges can provide valuable benefits to you and your favorite charity, they can be complex. Consult with competent tax and legal counsel before you promise to pay a charitable pledge to make sure your interests are protected.

## GIFT AGREEMENTS— FORMALIZING YOUR GIFT

Sophisticated charitable gifts, such as a long-term pledge, should be documented by a gift agreement. A gift agreement sets forth a donor's intent and a charity's obligation concerning the donation. One important aspect of the document is

to set a process for how changes to the use of the gift will be determined—if the purpose for which the contribution was made has been fulfilled, or if the program the donation was designed to support no longer exists. Gift agreements are binding legal documents; a donor should consult with competent tax and legal counsel before executing one.

<sup>7</sup> IRS Notice 2017-73.

## COMPELLING COMBINATIONS: DONOR-ADVISED FUNDS AND PRIVATE FOUNDATIONS

Some donors think they have to choose between creating a private foundation and a donor-advised fund (DAF). But to achieve some goals, it may make sense to create both.

For example, let's say your required distribution from your private nonoperating foundation is higher this year due to strong market performance. You don't have an additional grant lined up, and you need a little more time to decide where to send the money. Creating a "sister" DAF can make this possible.

If the foundation has \$10 million in assets and a minimum required distribution of \$500,000, you could grant \$400,000 to the qualified nonprofit organizations that you've already identified and \$100,000 to your sister DAF. Then you could take your time in deciding how to advise the DAF administrator to distribute the \$100,000.

While the private foundation and DAF are legally separate entities, you might view your combined balance sheets as a single pool of philanthropic capital that you can manage

with this kind of transfer. Keep in mind, though, that grants between private foundations and DAFs are a one-way street running from foundations to DAFs, not vice versa.

The combination of a private foundation and a DAF would also allow you to make an anonymous grant from time to time. While the foundation itself cannot conceal its identity, you can grant part of the foundation's 5% annual distribution to your sister DAF, which can make an anonymous grant. Creating a sister DAF is also useful when you want to engage your kids in the family philanthropy—allowing them to gain experience through a passion. ([See "Preparing the Next Generation" on page 9.](#))

You can make additional contributions to either entity over time. If you have both, you can generate higher charitable income-tax deductions by donating certain assets, such as real estate and privately held securities, to the DAF. Only the cost basis of these assets can be deducted if you donate them to a private foundation, but their fair market value can be deducted if you donate them to a DAF.



## BEQUESTS

<b>Best for:</b>	Donors seeking to contribute a gift to charity upon death; avoids giving money needed during life
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	No charitable income-tax deduction; estate tax charitable deduction if donor has a taxable estate
<b>Distributions to Donor:</b>	No
<b>Limitations/Drawbacks:</b>	Charity does not receive benefit of gift until donor's death; inflation could erode its value

When you make your charitable gift is often as important as how much you give. It may make sense to hold off giving a large chunk of assets now to your favorite cause and instead write it into your estate plan, to ensure you can cover your expenses for as long as you live. But, from the nonprofit's perspective, a gift in hand is worth two in the bush. Many promised gifts never arrive, and inflation often reduces the spending power of gifts that arrive after many years of waiting.

It's important to analyze your estate's charitable giving capacity, just as it's important to analyze your capacity to make lifetime gifts. We can help you determine how much of your estate to earmark for philanthropy, given your other goals, such as providing for your family.

Here are three key ways to provide for charity in your estate plan:

**Wills/Living Trusts.** If you make a not-for-profit organization a beneficiary of your will or revocable trust, the gift passing to charity at your death qualifies for the unlimited estate tax charitable deduction.<sup>8</sup> Thus, the gift can reduce, and in some cases eliminate, tax on your estate. The gift can be general or directed to a specific program or cause. You can also establish a charitable remainder trust (CRT) or charitable lead

trust (CLT) as part of your estate plan. Note, however, that the success of both strategies is uncertain, because it will be driven by the prevailing interest rate when the trusts are funded from your estate. (See [“Charitable Lead Annuity Trusts,” page 40](#), and [“Charitable Remainder Trusts,” page 44](#), for more details.)

**Individual Retirement Accounts (IRAs).** If you wish to leave some assets in your estate plan to family and some to a nonprofit, it often makes sense to make the nonprofit the IRA beneficiary, since it will not have to pay income tax on the IRA distributions. By contrast, IRA distributions to you during your lifetime and to your taxable beneficiaries after your death are taxable at ordinary income-tax rates. (You can also give to charity from your IRA late in life; [see page 19](#).) It's less desirable to donate a Roth IRA to charity; because you contributed to the Roth IRA on an after-tax basis, the distributions are tax-free.

**Insurance Proceeds.** Naming your favorite charity as a beneficiary of your life insurance can provide the charity with liquid funds fairly soon after your death. This makes sense if your family does not need the proceeds to pay estate taxes or other expenses.

<sup>8</sup> Code Section 2055(a)(2).



# CHARITABLE LEAD ANNUITY TRUSTS

<b>Best for:</b>	Wealthy donors seeking to pre-fund annual charitable gifts and transfer wealth to noncharitable beneficiaries
<b>When Charity Receives Gift:</b>	
<b>Tax Impact:</b>	Varies depending on type of trust (grantor or non-grantor)
<b>Distributions to Donor:</b>	No
<b>Limitations/Drawbacks:</b>	Highly complex and costly

A charitable lead annuity trust (CLAT) allows you to pre-fund annual gifts to charitable organizations and may also transfer wealth to your children or other noncharitable beneficiaries, free of transfer tax. Some structures can also reduce income taxes. Setting up a CLAT can be costly, and as a result, CLATs are typically most economical for sizable contributions.

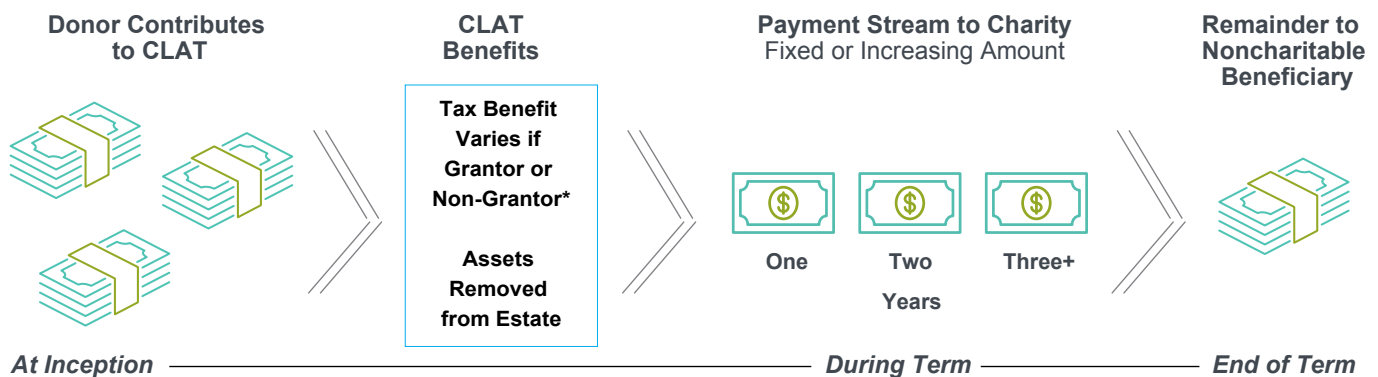
## How the Strategy Works

You establish a CLAT by making a large gift to a trust, which will typically distribute all of its principal plus interest over time to one

or more [qualified charities](#) of your choice (**Display 16**). The gift is usually irrevocable. In some CLATs, the remainder reverts to the grantor at the end of the trust term. The benefit of making an irrevocable gift is that the assets are permanently removed from your estate for estate tax purposes.

A CLAT is designed to make charitable distributions for many years, so in effect it's a way to pre-fund charitable donations. For example, someone who typically gives \$50,000 a year to charity can pre-fund a 20-year CLAT today with \$833,573.<sup>9</sup> That's less than \$1 million (20 annual gifts of \$50,000) because the IRS assumes a modest investment return.

## DISPLAY 16: HOW A CHARITABLE LEAD ANNUITY TRUST WORKS



\* A non-grantor CLAT is not exempt from income taxes but is entitled to an annual charitable deduction equal to the lesser of the annuity distribution to charity or the trust's income. There is no charitable income-tax deduction for the donor. A grantor CLAT is a grantor trust, and the grantor is responsible for any income tax generated by the assets in the trust. In the year he or she makes a contribution to the CLAT, the grantor receives a charitable income-tax deduction based on the size of the contribution; the deduction can be carried forward for five years.

Source: IRS and Bernstein

<sup>9</sup> Assumes a zeroed-out CLAT, with level annuity payments and a 1.8% 7520 rate.



When the trust expires, any remaining assets pass to taxable beneficiaries, typically children or a trust for their benefit, free of gift and estate tax.

Today's low interest rates reduce the annual charitable donations required and increase the odds of transferring assets to your children tax-free with a CLAT. Any remaining assets after making all annuity payments pass to the noncharitable beneficiaries.

The [Section 7520 rate](#) is the "hurdle rate" that applies to newly established CLATs and is applied to annuity payments paid each year to charity. This rate was just 1.8% in October 2019, compared to its 5.2% average since the IRS established it in 1989.

### Key Decisions

CLATs are complex, vary widely in structure, and are relatively expensive to set up and maintain. **Display 18, on page 43**, lists key decisions to consider, and the impact of these decisions on the charity and donor or taxable trust beneficiary. Here, we provide a bit more detail on a few strategies.

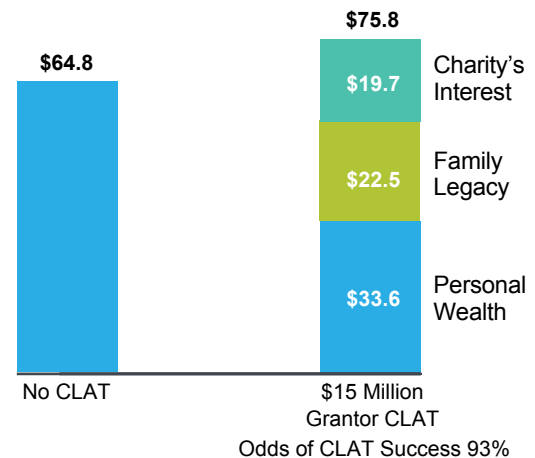
A **non-grantor** CLAT is a separate tax-paying entity subject to the income-tax rules associated with trusts. As the donor, you do not get a personal income-tax deduction after the initial donation, but the trust itself can deduct its annual payments to the charity against its income or gains, usually eliminating any tax due.

Most commonly, non-grantor CLATs are created upon the donor's death as part of an estate plan. The CLAT may be "zeroed-out" so that the value of the assets contributed to the trust is exactly equal to the present value of annuity payments made to the charity, which eliminates potential estate tax.

A **grantor** CLAT passes all trust income and expenses through to you for income tax purposes. Hence, when you establish the CLAT, you can take an immediate income-tax deduction for the present value of the payments to be made by the trust to the charity. Minimizing income taxes (in addition to future transfer taxes) is especially valuable if you create the trust in a year when your tax bill would otherwise be unusually high, perhaps as a result of selling your business. Grantor CLATs may also be "zeroed-out" for transfer-tax purposes.

## DISPLAY 17: GRANTOR CLAT SUPPORTS CHARITY AND FAMILY LEGACY GOALS

**After-Tax Sale Proceeds of \$31.8 Million**  
Median Wealth Value in Year 20  
\$ Millions, Nominal



*Reflects Bernstein's estimates and the capital-market conditions as of January 31, 2019. Assumes a \$15 million grantor CLAT with annuity payments increasing by 20% each year for 20 years. Grantors are responsible for paying the income taxes on any trust earnings during the 20-year CLAT term; assumes grantors survive the term. CLAT is zeroed-out, assuming a 1.8% Section 7520 rate.*

*"Odds of CLAT Success" is defined as remainder interest >\$1. CLAT is allocated 60% to global stocks and 40% to bonds. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as 100% intermediate-term municipal bonds. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.*

*Source: Internal Revenue Code and Bernstein*

Note: If you receive the immediate income-tax deduction, you will not receive an annual charitable income-tax deduction when the trust makes payments to the charity. Furthermore, if you do not survive the trust term, the IRS may recapture part of the upfront income-tax deduction, and the CLAT will be taxed as a non-grantor trust.

**Display 17** illustrates how a grantor CLAT may be especially valuable for those who experience a high-income year. In this example, a couple, residing in California, received approximately \$31.8 million, net of fees and taxes, from the sale of their business. They determined that they would need \$12.6 million to comfortably support their annual spending of \$400,000 with a very high level of confidence,<sup>10</sup> leaving \$19.2 million of [surplus capital](#) to give to

<sup>10</sup> Core capital is the amount needed to support lifetime, inflation-adjusted spending needs, calculated to the 90% confidence level.

charity or family if desired. They wanted to lessen the bite from income taxes due from the sale, while supporting philanthropic causes and leaving a legacy for their children.

The couple funded a \$15 million, 20-year grantor CLAT with 20% increasing payments, and received a charitable income-tax deduction that would reduce the income tax owed on the sale by \$5 million.<sup>11</sup> They invested 60% of the trust's assets in global stocks and 40% in municipal bonds. Over the span of 20 years, the charity would receive \$19.7 million in distributions from the CLAT, leaving \$22.5 million for the children, outside of the estate. This strategy would generate roughly \$10 million more in combined charitable benefit and family wealth over 20 years than if the couple had not acted. Due to today's low interest rates, the CLAT payment stream is smaller which contributes to the CLAT's high success rate. And if the charitable distributions went into a donor-advised fund or private foundation, the charitable benefit could grow even larger, with further deferral of the final charitable distribution.<sup>12</sup>

The grantor CLAT accomplishes the couple's goals while enabling them to minimize income taxes owed from the business sale. If they did not have such high income, a non-grantor CLAT may be a better strategy in that scenario.

### **Backloading**

Unlike other partly philanthropic trusts, CLATs are not subject to minimum or maximum payout requirements. The annuity payment to the charity can be "backloaded," starting low and increasing by a stated amount. Backloading the payments leaves more investment assets in the trust to grow in the early years, therefore, the trust is likely to have more funds for the noncharitable beneficiary

at termination (because of the lower initial charity distribution requirements), even though the charity gets the same amount on a present-value basis. Backloading can provide tremendous wealth transfer, particularly for longer-term CLATs (i.e., longer than 10 years). There are trade-offs to assess: if the donor's goal is to make stable distributions to charity, backloading may not be the best payout structure. If the donor wants to maximize the wealth generated for noncharitable beneficiaries, backloading could be successful. Analysis is required to see if backloading aligns with your charitable goals or is likely to have a negative tax impact, or both.

### **Asset Allocation**

The asset allocation challenge with CLATs is to balance the promise of the payments to the charity with the desire to generate additional growth that can be passed on to your family. If the CLAT takes too much risk and the market falls, the trust may "fail." That is, it may not deliver the intended amount to the charity, and the beneficiaries will get nothing. If it takes too little risk, the charity may have a better chance of receiving the payment intended, but the beneficiaries are more unlikely to get anything.

If the CLAT has 10 or more years remaining, a growth-oriented allocation with a sizable allocation to global stocks is generally appropriate. Diversifying investments, such as hedge funds, may enhance the overall risk/return trade-off of the portfolio.

The trustee may make allocation changes during the trust term to help secure a "win" for the noncharitable beneficiaries and ensure that the charity receives its payments. Careful analysis is needed.

<sup>11</sup> The CLAT is "zeroed-out" so that the value of assets contributed to the trust equals the present value of the annuity stream to charity. This structure maximizes the charitable income-tax deduction. We further assume the annuity payments increase by 20% each year, which increases the likelihood of the trust having a remainder value for noncharitable beneficiaries.

<sup>12</sup> If the lead beneficiary is a private foundation of which the donor serves as director, then the gift may not be complete. See PLR 199908002, PLR 199903045, PLR 201323007.

## DISPLAY 18: THE IMPACT OF KEY CHARITABLE LEAD ANNUITY TRUST (CLAT) DECISIONS

	Impact to Donor/Beneficiary	Impact to Charity
<b>TYPE OF CLAT</b>		
<b>Non-Grantor</b>	No charitable income-tax deduction for donor; the trust gets a deduction each year	Potential for tax inefficiency and less wealth transferred
<b>Grantor</b>	Charitable income-tax deduction in year of contribution; grantor pays annual income taxes	Because the grantor pays income taxes, the odds are greater that the charity will receive all the payments promised
<b>TRUST TIMING</b>		
<b>Funded at Death</b>	Significant estate-tax savings	Non-grantor CLAT; potential for tax inefficiency/less wealth to charity
<b>Funded During Life</b>	Donor can observe the impact of charitable gifts; possible income-tax deduction	Charity receives benefit sooner
<b>TRUST TERM</b>		
<b>Shorter</b>	More immediate benefit to beneficiary, but wealth transfer may be smaller	Charity receives value of gift sooner
<b>Longer</b>	Delayed benefit to beneficiary, but potential for more wealth	Greater probability of receiving full benefit of gift
<b>PAYOUT STRUCTURE</b>		
<b>Fixed Annuity</b>	Lower wealth transfer to beneficiaries	Charity receives benefit sooner
<b>Backloaded Payments</b>	Allows assets to work longer, allowing for possible increase in wealth transfer	Charity receives majority of benefit later
<b>ASSET ALLOCATION</b>		
<b>Best Type of Assets</b>	High-basis assets	High-basis assets

Source: Bernstein



# CHARITABLE REMAINDER TRUSTS

<b>Best for:</b>	Wealthy donors with large holdings of low-basis assets seeking to pre-fund a charitable gift while retaining income stream
<b>When Charity Receives Gift:</b>	 Now                      Staged Over Time                      Later
<b>Tax Impact:</b>	Income-tax deferral and avoidance; deduction subject to AGI limitations on charitable contributions
<b>Distributions to Donor:</b>	Yes, distributes a fixed (dollar or %) amount each year; size of lifetime payouts selected by donors within limits
<b>Limitations/Drawbacks:</b>	Irrevocable gift; highly complex and costly

Charitable remainder trusts (CRTs) can be viewed as a way to pre-fund a charitable gift while retaining income for yourself or another beneficiary for life or a term of up to 20 years. They are also an effective way to sell an appreciated asset while deferring and potentially reducing taxation on any resulting capital gains. For many donors, CRTs offer the opportunity to make a sizable contribution to charity at little, if any, cost to personal wealth.

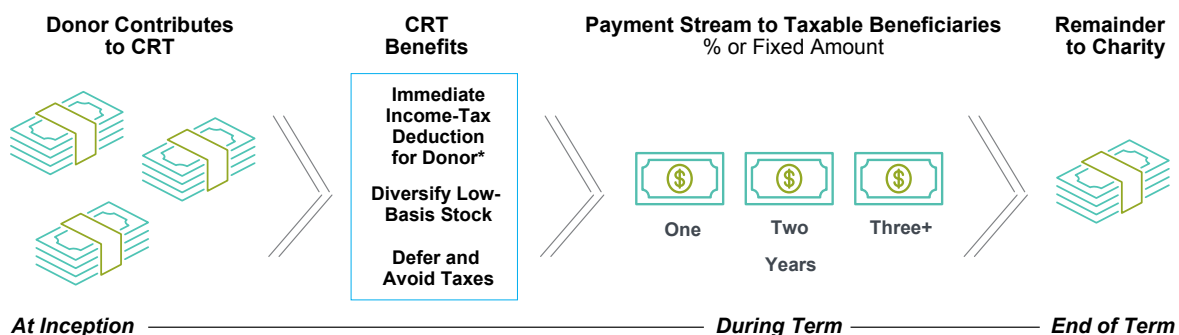
While the tax savings can be large, setting up a CRT can be costly, and there are ongoing legal and accounting fees. As a result, CRTs are typically most economical for sizable contributions. Some charities offer to serve as co-trustees of CRTs, which can lower costs to the donor.

## How the Strategy Works

The donor makes an irrevocable gift to a trust that subsequently makes taxable payouts to the donor or another designated beneficiary (**Display 19**). The donor receives a charitable income-tax deduction for a percentage of the initial gift, equal to the portion of the trust's initial assets that the IRS assumes will go to charity. This amount is based on a calculation that incorporates current interest rates and the beneficiary's life expectancy or the trust's term. When the term ends, any remaining assets pass to charity.

The strategy works best when you contribute assets with a low tax basis, such as highly appreciated stock, that the trust subsequently sells to reinvest in a diversified portfolio. If you have a concentrated position in the stock, this can reduce your concentration risk and

## DISPLAY 19: HOW A CHARITABLE REMAINDER TRUST WORKS



\* The income-tax deduction is not the total amount contributed, but rather the present value of what is expected to pass to charity. The calculation of the present value takes into account the value of the contributed assets, the discount rate (based on the Section 7520 rate), and the term of the trust (for lifetime trusts, a life expectancy table is used). See Sections 7520 and 664 of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder.

Source: IRS and Bernstein

potentially reduce and defer capital-gains tax due. The appreciated assets are removed from your estate, so no estate tax is due on the assets at your death.

Typically, the trust immediately sells the appreciated position. Since the trust is a charitable entity, it does not pay tax on the capital gain. Instead, the income beneficiary pays taxes on the payouts, based on how the income was earned in the trust—as interest, dividends, or short- or long-term capital gains. Generally, the IRS requires that the most highly taxed type of income comes out first.

Careful portfolio management can avoid generating highly taxed income so that only qualified dividends and long-term capital gains, which are taxed at the lowest rates, are distributed from the trust each year.

### The Opportunity Today

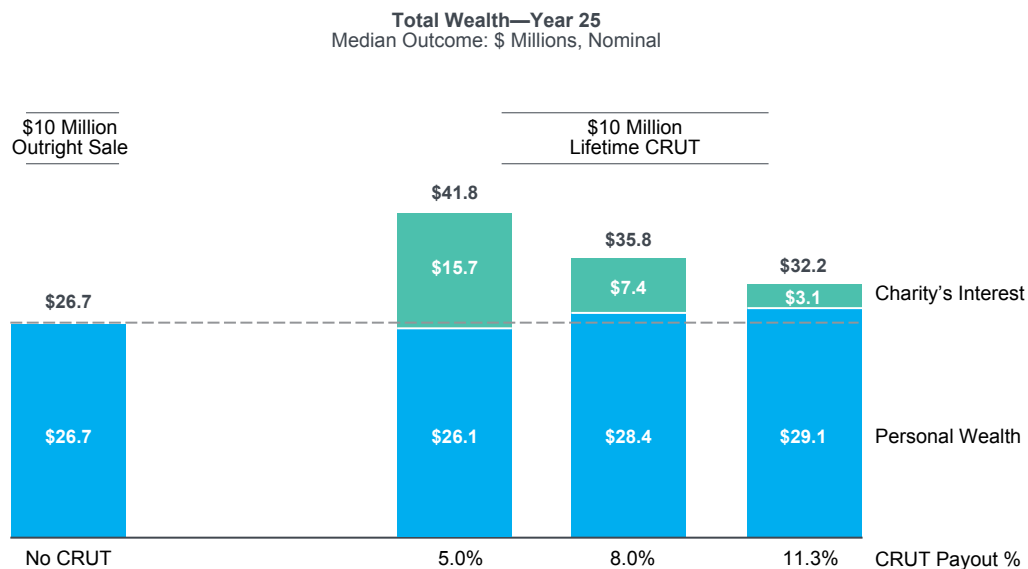
Higher tax rates increase the benefit of the upfront income-tax

deduction and of deferring recognition of capital gains. Thus, the tax benefit of a CRT is substantial, as top federal tax rates on ordinary income and long-term capital gains (including the net investment income tax) are 40.8% and 23.8%, respectively. State rates can lift taxes higher.

The benefit can be very large for the charity and both the donor or other income beneficiary; how large depends on the payout rate, the trust term, and the tax basis of the stock, as well as capital-market returns. To quantify the potential benefit, we sum the values of the charitable income-tax deduction, after-tax payouts, and wealth generated by reinvesting both, and compare it to the after-tax proceeds of selling the stock and reinvesting the proceeds in a taxable environment.

**Display 20** illustrates this for a charitable remainder unitrust (CRUT), which pays out a percentage of principal each year to a 65-year-old couple. The couple funded the CRUT with \$10 million of zero-basis stock that they still held from founding their company.

## DISPLAY 20: CRUT HELPS CHARITY AT LITTLE OR NO COST TO DONOR'S PERSONAL WEALTH



The CRUT is based on a 65-year-old couple contributing \$10 million in zero-basis assets to a lifetime CRUT with annual payouts. Assumes investor is subject to top federal tax rates and state income taxes of 6.5%. All calculations of permissible payouts and associated tax deductions are according to Sections 7520 and 664 of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder. The CRUT and personal portfolios are allocated 70% to global stocks and 30% to bonds. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as intermediate-term municipal bonds. The above figures assume charitable deductions of \$3,406,200 for the 5% CRUT, \$1,861,300 for the 8% CRUT, and \$1,000,000 for the 11.3% CRUT. In all scenarios, the deduction is used to offset ordinary income and is assumed to be used in the first six years of the analysis. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.

Source: Bernstein

The display shows the projected median value of the portfolio in year 25, with and without a CRUT. The blue bar labeled “No CRUT” shows that the couple’s portfolio would be worth \$26.7 million if they sold the stock, paid tax, and reinvested without a CRUT. The stacked bars at right show the value of the portfolio with a CRUT, divided between the couple’s personal wealth from receiving annual CRUT payments and the charity’s interest, for three different payout rates.

If the trust terminates in the early years, the charity is likely to receive the lion’s share of the benefit, whether the annual CRUT payout is 5%, 8%, or the maximum distribution of 11.3% a year for a joint lifetime CRUT for people their age. But as the donors reap the benefit of the tax deferral, their personal wealth approaches—and eventually eclipses—the amount they would have had without a CRUT. We call this the “crossover” point.

Whether or not the CRUT reaches “crossover,” it typically creates more total wealth when you factor in the remainder benefit to charity. In this example, the portfolio with a 5% CRUT payout would have a median total worth about \$41.8 million, including the charity’s interest, even though the CRUT hasn’t reached the crossover point.

The charity will always receive a larger remainder if the CRUT pays a lower percentage rate to the donor than if it pays a higher rate. But after about 25 years, the payout rate makes little difference to the donor’s personal wealth; the donor may even benefit slightly more from a lower payout.

## Key Decisions

**Timing.** The charity is unlikely to receive any financial benefit for many years, particularly from a lifetime CRT. Does the charity that you want to support need the money now, or can it wait? If the cause needs the money sooner, another strategy might be better.

**Payout Rate.** CRUTs must pay out at least 5% of principal a year, recomputed annually, and no more than 50% of the initial fair market value of the trust’s assets. At least 10% of the initial asset value on the date of contribution must be left to charity. The higher the payout, the lower the donor’s charitable income-tax deduction, and vice versa. Our research has shown that for lifetime CRUTs, lower unitrust percentages provide a more balanced expected benefit for the donor and charity; over very long periods of time, they also tend to create more personal wealth for the donor than a higher payout percentage.

**Type of CRT.** Charitable remainder unitrusts (CRUTs) pay out a percentage of principal, revalued annually; the charity and donor/income beneficiary share the benefit of up markets and bear the losses in down markets. Charitable remainder annuity trusts (CRATs) pay a fixed dollar amount each year, and the charity gets the benefit of up markets and bears the losses of down markets.

CRUTs are more common. With today’s low interest rates, it is difficult for lifetime CRATs to meet the IRS requirement that at least 10% of the value passes.<sup>13</sup>

**Cost Basis.** Low-basis assets are generally excellent candidates for funding a CRT. The lower the cost basis, the more powerful the benefit of tax deferral, and the earlier the expected date for crossover. The benefits diminish as the tax basis of the stock rises. For example, if you donate a stock with a 50% basis, it may take many years to reach crossover. If you donate a stock with a higher basis, you may never reach crossover. If crossover isn’t a concern because you are not focused on maximizing your personal wealth, cost basis is less important.

<sup>13</sup> On August 8, 2016, the IRS offered an alternative provision to the existing 10% calculation: If a CRAT annuity payment would cause the trust corpus to fall to less than 10% of the initial contribution to the trust, the trust would terminate prior to the annuity payment, and any remainder would be paid to the charitable beneficiary. This provision could allow younger noncharitable beneficiaries to contribute to a “lifetime” CRAT, with the understanding that the trust may terminate at some point before the end of that lifetime.

**Asset Allocation.** In most cases, CRT assets should be invested with an overweight to stocks to take maximum advantage of the tax-deferral benefit. Some bond exposure is advisable to preserve principal in down markets and lower the volatility of payouts. If the trust is deferring long-term capital gains, you may want to avoid investing in taxable bonds or real estate investment trusts (REITs), which are taxed at higher, ordinary income rates.

**Assets to Give.** A CRT can also help you to defer gains on the sale of other low-basis assets, such as artwork or real estate, but some charities will not accept artwork or real estate, and the charitable deduction for such gifts may be limited to their cost basis. There are many other complexities to consider.

**Designated Charity.** CRTs often do not distribute the remainder to a nonprofit for decades; the nonprofit that you may designate might not exist when the distribution occurs. Thus, some CRTs authorize the trustee to designate another nonprofit to receive the remainder if the one originally designated no longer exists or is no longer qualified. In some CRTs, the grantor can designate another charity in his or her lifetime.



# CHARITABLE GIFT ANNUITIES

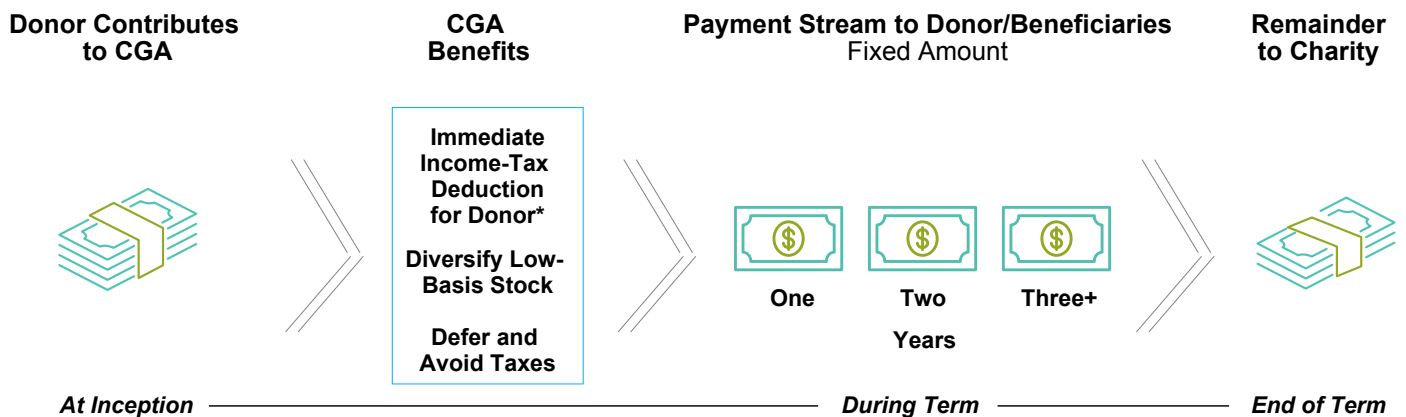
<b>Best for:</b>	Typically, donors over age 60 who want to leave assets to charity but are worried about outliving their assets
<b>When Charity Receives Gift:</b>	<p>Now                      Staged Over Time                      Later</p>
<b>Tax Impact:</b>	Income-tax deferral and avoidance; tax treatment of payments depends on type of assets donated
<b>Distributions to Donor:</b>	Yes, but less income than commercial annuities
<b>Limitations/ Drawbacks:</b>	Only some charities offer them; credit risk

Charitable gift annuities (CGAs) are useful vehicles for donors who want to leave assets to charity but worry that they'll need the assets if they live longer than expected. Like the commercial annuities sold by insurance companies, CGAs are a kind of longevity insurance: They protect against the risk of outliving your assets by promising a stream of annual payments for as long as you live. But unlike commercial annuities, which assume that no principal will be left at your death, CGAs are designed to leave some principal for charity. For this reason, charities that offer CGAs distribute less income to annuitants than commercial annuities; the foregone yield creates the charitable contribution.

## How the Strategy Works

Not-for-profit organizations establish CGAs to provide a low-cost way for people to donate relatively small amounts (say, less than \$100,000). The donor receives fixed payments for as long as he or she lives, and can take a charitable income-tax deduction in the year of purchase for the amount contributed minus the present value of the future annuity payments, based on his or her life expectancy. After the donor's death, any remaining assets pass to the nonprofit (**Display 21**). If the donor lives long enough, the charity might receive nothing at all. That's the risk the charity takes, which it seeks to diversify by selling annuities to many different people.

## DISPLAY 21: HOW A CHARITABLE GIFT ANNUITY WORKS



\* The income-tax deduction is calculated pursuant to Sections 7520 and 170 of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder. Source: IRS and Bernstein



## The Opportunity Today

For the donor, today's relatively low interest rates mean that CGAs currently offer historically modest income streams. While current annuity rates of 5.5% to 6.5% may seem attractive compared to high-quality bond yields, if you buy a bond, you retain the principal. With a CGA, you give up access to the principal: You're giving it to the nonprofit. The CGA is attractive if the 5.5% to 6.5% payout meets your needs, you can use the tax benefit, and you want to support the nonprofit.

## Key Decisions

**Assets to Give.** For donors of low-basis assets, a CGA can provide additional tax benefits because the donor will not recognize a capital gain immediately. Instead, a portion of the annual payments will be considered capital gains, and a portion will be considered ordinary income. If you contribute cash, a

portion of the annuity payments will be treated as tax-free return of principal, and the rest as ordinary income.

**CGA Sponsor.** Like any insurance product, CGAs also pose credit risk. If many donors live longer than the nonprofit sponsor expected when it priced the annuities, the sponsor may be unable to keep making the payments promised. Donors who want to buy a CGA should select a nonprofit in good financial health. Public charities must provide financial information on IRS Form 990, which can be accessed online via sites such as [GuideStar](#) and [Charity Navigator](#).



# POOLED INCOME FUNDS

<b>Best for:</b>	Donors who want to pre-fund a charitable gift while retaining income over time, at a lower cost than establishing a charitable remainder trust (CRT)
<b>When Charity Receives Gift:</b>	<p>Now                      Staged Over Time                      Later</p>
<b>Tax Impact:</b>	Income-tax deduction for a portion of amount contributed, based on donor's life expectancy and anticipated income stream
<b>Distributions to Donor:</b>	Yes; amount can vary year-to-year depending on asset allocation
<b>Limitations/ Drawbacks:</b>	Irrevocable gift; donor (income beneficiary) may outlive pooled income fund

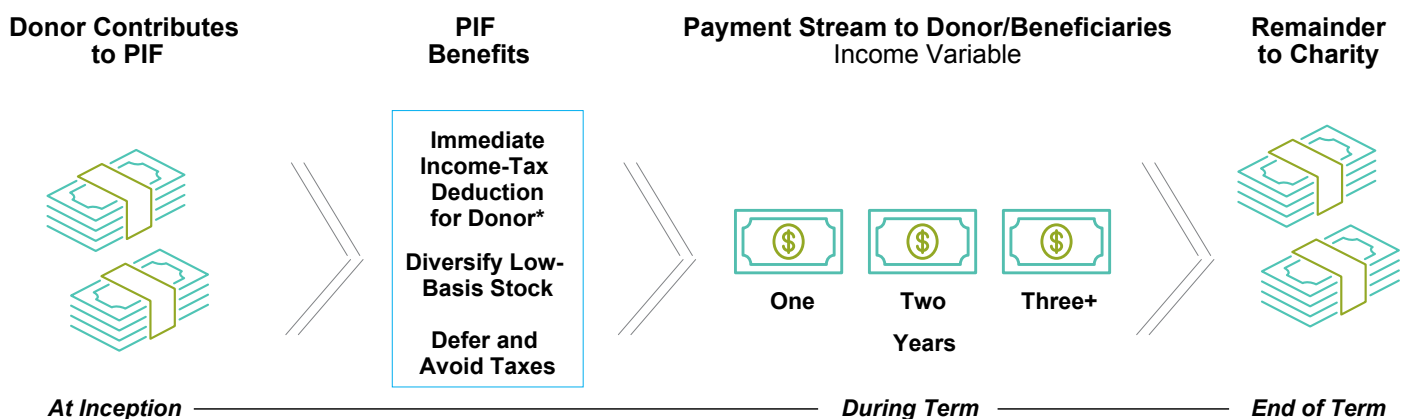
Pooled income funds (PIFs) are far less widely used than other partly philanthropic strategies. As their name suggests, they are collective vehicles. A public charity establishes a charitable trust to invest irrevocable contributions from many donors.

## How the Strategy Works

Donors receive income-tax deductions in the year they make the contributions, equal to a portion of the amount contributed, based on their life expectancy and the anticipated income stream. If the donation is an appreciated asset, such as low-basis stock, the donor avoids capital-gains tax and receives an income-tax deduction.

The charity distributes the dividends, interest, and, in many cases, short-term capital gains from the fund to donors in proportion to the size of their contributions. Long-term capital gains are generally added to the fund's principal, which eventually passes to the charity.<sup>†</sup> The income distributions are likely to vary from year to year. Depending on the asset allocation and market conditions, the income can be substantial. Income distributions are typically taxed as ordinary income. After each donor's death, an amount equal to his or her contribution to the pooled income fund passes to the charity (*Display 22*).

## DISPLAY 22: HOW A POOLED INCOME FUND WORKS



\* The income-tax deduction is calculated pursuant to Sections 7520 and 170 of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder.

<sup>†</sup> Treasury Reg. Section 1.642(c)-s(a)(5)(i). If state law allows, and if the charity and the donor agree, long-term capital gains may be allocated to income and distributed to the income beneficiary.

Source: IRS and Bernstein

## FOR-PROFIT CHARITABLE STRATEGIES

Most charitable gifts go to public charities, private foundations, donor-advised funds (DAFs), and charitable trusts. But in recent years, an increasing number of donors have decided to fulfill their philanthropic goals by investing in, or donating to, for-profit entities, in order to avoid the rules related to charitable giving or to profit while helping a favorite cause, or both. Here are a few of them:

**Benefit Corporations.** A benefit corporation is formed to create a “general public benefit.” Its directors must consider the environment and community, employee, and customer interests, as well as the corporation and its shareholders. “General public benefit” must be measured against a third-party standard; an annual report is required. If a benefit corporation neglects its duty to serve the general public benefit, shareholders and other interested parties may institute an enforcement proceeding.

**Social Purpose Corporations/Flexible Purpose Corporations.** These vehicles are similar to benefit corporations, except that they permit, but do not require consideration of social and/or environmental goals. A social purpose corporation may consider the interests of the corporation, its shareholders, and any specific purposes set forth in its Articles of Incorporation, as it deems appropriate. In some cases, the annual reporting is less stringent than for benefit corporations.

**Low-Profit Limited Liability Companies (L3Cs).** An L3C’s primary mission is charitable; its profit is a secondary concern. Unlike a charity, an L3C is permitted to earn profits and distribute them to its members. In general, L3Cs are required to significantly further charitable or educational

purposes, as defined by the IRS. Their purpose is not to produce significant income or appreciation of property, or to accomplish political, legislative, or lobbying activities.

**Limited Liability Companies (LLCs).**<sup>14</sup> In some cases, donors decide to create traditional LLCs to accomplish their philanthropic missions, although it means forgoing an immediate charitable income-tax deduction and almost tax-free growth. Most famously, Facebook CEO Mark Zuckerberg and his wife, Priscilla Chan, announced in December 2015 that they will give 99% of their Facebook shares (at the time worth about \$45 billion) during their lives to the Chan Zuckerberg Initiative LLC (CZI).<sup>15</sup> Possible reasons include:

- They will be able to use CZI funds to lobby for and contribute to political causes;
- CZI will not be subject to private foundation rules;
- CZI will not be subject to [unrelated business taxable income](#) restrictions, and any income generated will be taxed at individual, and not corporate, income-tax rates;
- Annual tax returns will not be subject to public scrutiny; and
- If CZI makes charitable gifts in the future, the charitable income-tax deductions will flow through to Zuckerberg and Chan.

<sup>14</sup> LLC and limited partnership (LP) structures are emerging where the donor makes a significant gift of a membership interest or LP interest to a charity, or retains a small interest, and then borrows a large sum from the LLC or partnerships. These strategies are complex and beyond the scope of this guide.

<sup>15</sup> The purpose of CZI is to “join people across the world to advance human potential and promote equality for all children in the next generation.”

<https://chanzuckerberg.com>

# INVESTING FOR IMPACT



## AN ASSET ALLOCATION TO SUPPORT YOUR GIVING

Whether you are the trustee of a charitable vehicle, the fiduciary of a [qualified charity](#), or an individual working with an advisor to develop a philanthropic plan, you may be responsible for making prudent investment decisions. Here, we briefly review the key attributes of return-seeking assets—stocks and diversifying alternatives, for example—and risk-mitigating assets—like bonds and cash—and how they can work together to support your philanthropic mission. As **Display 23** shows, time frame is generally a critical issue when making investment decisions. For many philanthropic strategies, money will be invested for long time horizons. You may have a donor-advised fund (DAF), for example, that you expect to spend down for 10 years, or a family foundation you want to endow for perpetuity, but need to cover the required 5% spending plus inflation rate. To accomplish your goals, you will need to select the optimal mix of stocks, bonds, and diversifying alternatives to hold in your portfolio.

Stocks tend to perform best over the long term, but over shorter time periods, returns can vary widely. High-quality bond returns are far more predictable year to year but are generally lower than stock returns over long periods. Diversifying alternative investments typically require long time horizons, as they often lock up capital for multiple years, even up to a decade. Since you can't know for sure what will happen, the right asset allocation for your philanthropic plan will depend on the time frame for your giving strategies, as well as your appetite for return and risk.

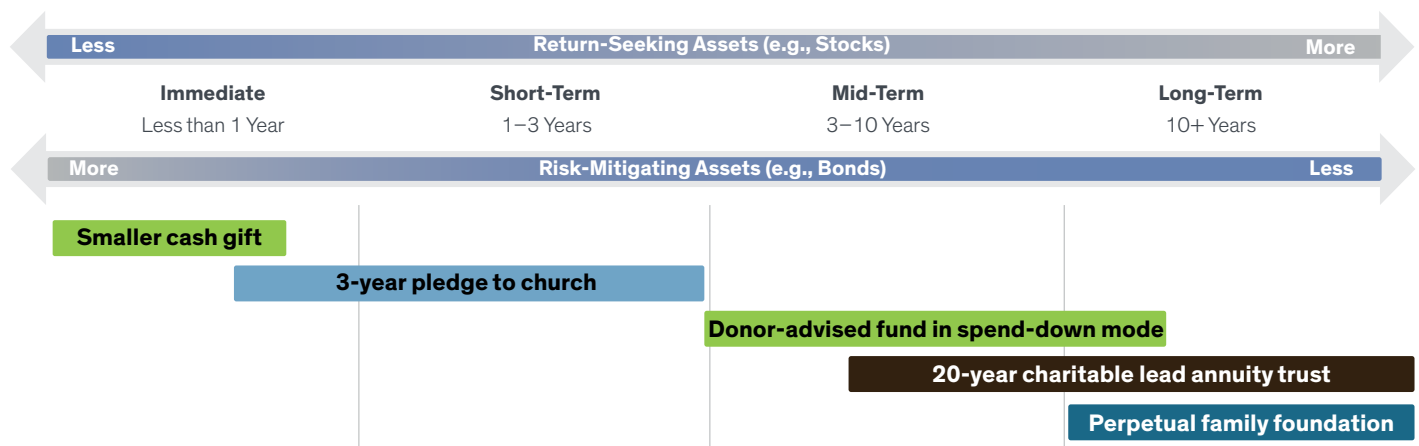
If you plan to use the money to fulfill near-term grants or to make small but numerous gifts throughout the year, it generally makes sense to allocate to cash instruments or fairly short-term bonds. Over longer horizons, stocks, illiquid alternatives, or other return-seeking assets can make sense.

To help you choose an asset allocation that is right for your philanthropic program, we project the range of outcomes for various asset allocations, based on our proprietary Wealth Forecasting System<sup>SM</sup> ([see page 13](#)). Because plans can succeed only if you stick with them in difficult times, we highlight the likelihood of experiencing a large peak-to-trough loss—such as 20%—at some point along the way (**Display 24, next page**).

The left side of **Display 24** shows our projected median annualized return over the next 30 years for various simplified asset allocations. The projected annualized return rises fairly steadily as the allocation to return-seeking assets increases. The portfolio invested only in return-seeking assets is expected to return 8.1% per year for the average portfolio—more than twice the 3.7% return of the portfolio with none.

But it won't be smooth sailing. We project that there's an 89% chance that a portfolio invested 100% in return-seeking assets will lose 20% of its value from peak to trough at some point over the next 30 years. By contrast, the odds of such a large drop are tiny for the portfolio invested 100% in risk-mitigating assets, and for an asset allocation with 70% in risk-mitigating assets.

### DISPLAY 23: IDENTIFYING THE TIME HORIZON—AND ASSET MIX—FOR YOUR GIFTS



Source: Bernstein

For most long-term investors, neither all return-seeking nor all risk-mitigating assets would provide an acceptable trade-off between long-term growth and the risk of large losses. Careful consideration of your goals and time horizon can help you identify the investment mix that's right for your philanthropic mission.

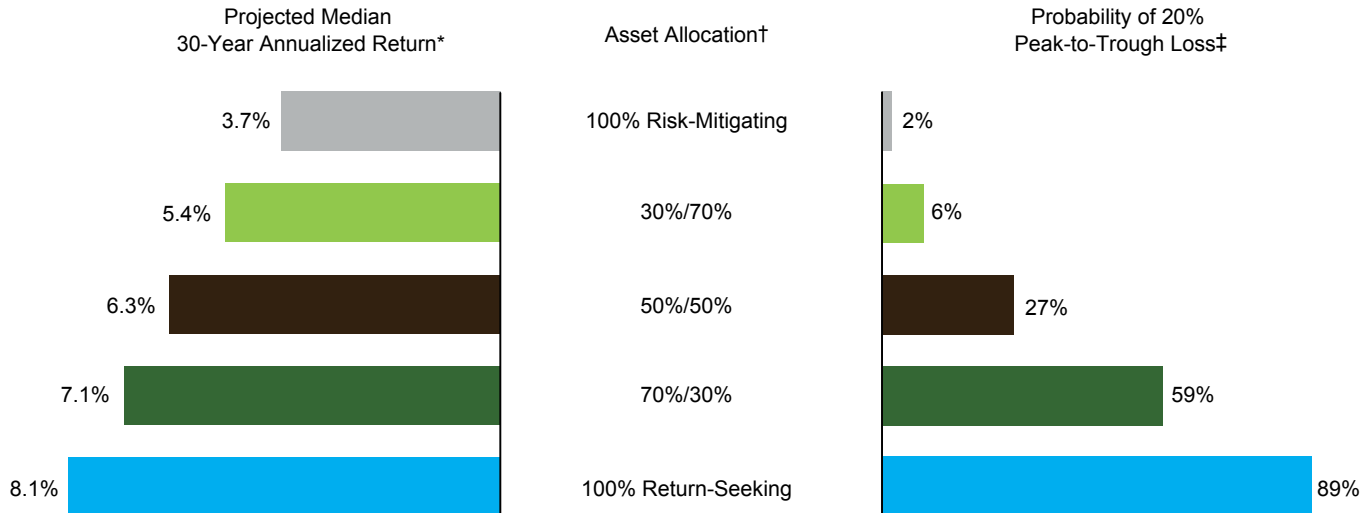
### Going Beyond Stocks and Bonds

Like many investors, we expect lower and more volatile returns from stocks over the next decade. Even though the traditional portfolio of stocks and bonds has worked well over the last 30 years, many believe the markets are at an inflection point. Uncertainty about the outlook for inflation and interest rates contributes to the challenge of sustaining giving levels, and maintaining, let alone growing your portfolio assets by investing in traditional stocks and bonds alone. Instead, we believe achieving above-market returns may require a combination of traditional

assets and diversifying alternative strategies—such as tangible, real assets like real estate, private market investments like private equity or debt, and leveraged public market assets, such as hedge funds.

The reason is that each alternative asset class has drivers of return that differ from traditional bonds and stocks, and from other alternatives. Those unique drivers give rise to return patterns that are dissimilar to patterns of other asset classes, creating a diverse return relationship or correlation with other assets. In other words, when public equity markets rise or fall, private investments tend to continue their path, generally unaffected by the market moves. They can also play a critical role in a fixed income portfolio; in a low-interest-rate environment, private credit can complement traditional bonds by improving returns and reducing interest rate risk. Many also tend to use leverage, although the amount differs

**DISPLAY 24: EXPECTED RETURN AND RISK GROW WITH SIZE OF EQUITY ALLOCATION**



\* Represents projected median compound annual growth rates over the next 30 years.

† 100% risk-mitigating allocation is all bonds; 30%/70% allocation is 30% stocks/70% bonds; 50%/50% allocation is 50% stocks/50% bonds; 70%/30% allocation is 70% stocks/30% bonds; and 100% return-seeking allocation is all stocks. Stocks are modeled as 12% US diversified, 16.2% US value, 16.2% US growth, 6% US small- and mid-cap, 9.6% US low vol equity, 23.7% developed international, 9.0% high-risk international, and 7.3% emerging market. Bonds are modeled as 50% intermediate-term taxable bonds and 50% global intermediate-term taxable bonds, hedged.

‡ Probability of a 20% peak-to-trough decline in pretax, pre-cash-flow cumulative returns within the next 30 years. Because the Wealth Forecasting System<sup>SM</sup> uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years.

Based on Bernstein's estimates of the range of returns for the applicable capital markets as of January 31, 2019. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System<sup>SM</sup> at the end of this presentation.

Source: Bernstein

depending on the asset. Leverage is one of several distinct risks that alternatives take on. Illiquidity is another. But before you accept illiquidity, you need to ensure you have adequate cash flow from your portfolio to cover your granting or spending needs.

While alternative investments can add a layer of complexity, and fees tend to be higher than for traditional investments, the benefits can be substantial. Whether you are a family office or an individual, it's hard to plan your charitable giving when your portfolio experiences large drawdowns. Diversification through alternative strategies—especially return diversification—smooths the returns of a portfolio that invests in traditional assets. For example, hedge fund returns over the past 20 years have been similar to those of stocks, but with less than half the volatility. Hedge funds tend to be most effective during equity market downturns, when they often serve their role as diversifiers by declining less than stocks. We note that during the robust bull market for US stocks in the decade following the global financial crisis, the appeal of hedge funds waned due to their tepid returns relative to stocks. However, given the length and magnitude of the US stock recovery since 2009, we think it prudent to look forward rather than backward and consider hedge funds for the protection they should provide against potentially lower and more volatile stock returns. But the length of this strong market is unprecedented and if you believe that markets will be rockier in the future, then hedge funds may be a viable option for your portfolio.

But the trade-offs, namely the long lock-up of capital—illiquidity—and for some, [unrelated business taxable income \(UBTI\)](#), warrant a close look at how alternatives may affect your philanthropic plan. UBTI, which can be generated by using leverage and lines of credit in some alternative strategies, is taxed at corporate rates for tax-exempt organizations (such as private foundations). However, certain charitable trusts, such as charitable remainder trusts, pay a 100% tax on any UBTI received. For these trusts, a structure that blocks UBTI is vital. There are structures, such as a mutual fund or business development company (if it elects to be taxed as a registered investment company), that block UBTI. The rules and regulations regarding UBTI are complex, so it is prudent to consult with a tax advisor.

Even if UBTI is not a factor, since alternatives are less liquid, it's prudent to only hold a portion of your assets in them. That's why an allocation typically complements the traditional portfolio allocation. Determining the optimal allocation for your charitable portfolio depends on your priorities and objectives. **(To read more on asset allocation, [click here](#) and see [Alternative Investment Allocation Model on pages 56-57.](#))**

Some charitable vehicles may not be able to hold diversifying alternative assets. Alternatives are available to qualified investors only—a larger family foundation may qualify but smaller charitable vehicles may not. Even if you are a qualified investor, alternatives may not make sense because of their lack of liquidity. Your private foundation that is spending down over the next five years, for example, may hold little to no alternatives to ensure appropriate levels of liquid cash are available to meet spending needs, but if you have a dynasty trust for your next generation that is focused on growth and doesn't spend, you may hold a higher allocation.

### **Active or Passive?**

Even as you settle on the optimal asset allocation, you may be wrestling with the choice between active and passive investment strategies for your publicly traded stocks or bonds. Luckily, it does not need to be an either/or decision. Rather, active and passive strategies can be combined to balance fees, expected return, and risk as efficiently as possible.

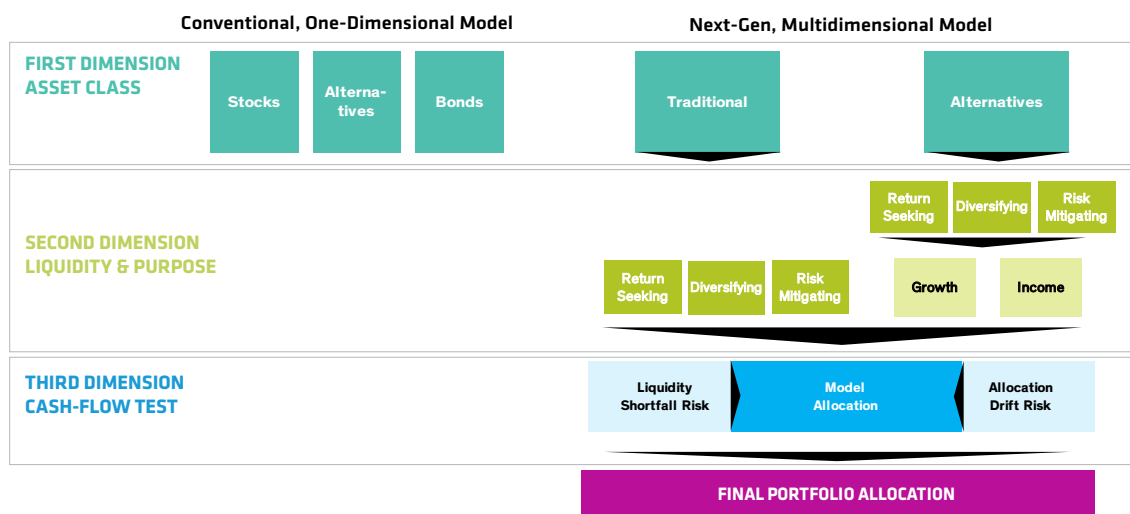
Passive equity index strategies can deliver market-like returns at a low cost, but do not actively manage for risk and have no chance of outperforming benchmarks. While passive equity strategies tend to do well during strong up markets, they can lag in down markets or during periods when indices become over concentrated in recent winners. Conversely, active equity strategies generally have clearly stated objectives for risk and return. Some, which are designed to outperform a specific benchmark, can deliver higher risk-adjusted returns than index funds, but are more expensive to manage and can lag during sustained up markets. Other benchmark-agnostic, active strategies seek to maximize returns with fewer constraints.

## Alternative Investment Allocation Model

Asset allocation is generally modeled based on an efficient frontier. Since the 1950s, the efficient frontier signaled that the 60/40 portfolio—60% stocks and 40% bonds—was the optimal portfolio for most investors. Nearly 70 years later, this allocation still dominates portfolio construction, despite the fact that the investment landscape has changed dramatically with the rise of alternative investments in recent decades. In our view, the allocation models that championed 60/40 portfolios are missing key inputs. They focus solely on the trade-off between risk and return, where risk is defined as the volatility of returns, measured by standard deviation. That’s fine when it’s only stocks and bonds. But when other asset classes with different characteristics are available, how can you assess what is optimal?

The next-generation model needs to consider the unique attributes of alternative assets. While not overlooking the parameters inherent in traditional models, it needs to integrate liquidity, investor purpose, and cash-flow requirements in a multidimensional, layered analysis. Liquidity refers to the level of liquid assets—cash or assets that can be easily converted to cash—needed to meet normal daily use. Consideration of investor preferences such as capital appreciation, stability, or income define purpose, while modeling for charitable distributions ensures that the assets adequately meet your goals, whether those goals are to gift a specific amount each year while maintaining a consistent corpus, or a plan to make grants until your private foundation is spent down. These factors formed the basis for Bernstein’s Alternatives Impact Analysis model (AIA) (*Display 25*).

DISPLAY 25: AIA MODEL



For illustrative purposes only.  
Source: Bernstein



## Alternative Investment Allocation Model (Continued)

AIA is a multi-asset analytics platform that is flexible, broad, and transparent. Its layered analysis is designed to assist long-term allocation decisions across all possible investment choices. It integrates the distinct characteristics of alternatives in allocation decisions and equates all assets—traditional and alternative—so that a portfolio can be analyzed holistically rather than in disparate parts. The multiple layers improve outcomes of asset allocation by:

- Marrying traditional assets with alternative investment allocation;
- Avoiding mismatch in cash use and asset allocation;

- Allocating to cash-flow oriented investments where appropriate, but not at the cost of overall growth;
- Explicitly understanding the liquidity characteristics of the portfolio to avoid a cash shortfall, known as liquidity shortfall risk; and
- Understanding and planning for performance dispersion between liquid and illiquid asset classes, to avoid the risk of allocation drift due to fewer rebalancing opportunities.

The end result is a model that considers the unique risk and return characteristics of diversifying alternative strategies to help you understand and determine how much to appropriately allocate to your charitable portfolio.

The benefits of passive and active strategies differ for bonds. Passive bond strategies lack the flexibility to balance interest rate and credit risk. The benchmark that a passive bond strategy seeks to replicate will be weighted to frequent issuers of debt, and to bond durations that are most popular at the current stage of the cycle. Active managers, on the other hand, are better able to reduce those risks by shifting to sectors that are at a different stage of the credit cycle or by adjusting duration.

Time horizon also plays a role in determining whether a portfolio should be invested in active or passive strategies or a hybrid of the two. Active strategies often take many years to play out, so are often best suited to funds with a long-term time horizon. A hybrid approach can be appropriate, especially for shorter time frames, by generating returns that do not stray too far from benchmarks while still providing some opportunity for outperformance.

### Responsible Investing—What’s Right for You?

Increasingly, investors want to do good and have an impact. Whether you want to provide access to safe drinking water or promote fair labor, there's a way to further your philanthropic mission and ensure your portfolio makes a powerful difference too.

Responsible investing incorporates environmental, social, and governance (commonly known as “ESG”) factors alongside traditional financial metrics. It recognizes that how companies behave along these dimensions can impact both their stock market values as well as society more broadly. Not long ago, investors assumed that putting principles to work in their stock and bond portfolios meant settling for lower returns. Today we know investors can simultaneously pursue both purpose and profits using a wide range of approaches.

Consider an environmental challenge like water. How can you invest in ways that encourage preserving it for future generations? Perhaps by investing in companies that provide goods or services that can help ensure a safe and reliable water supply. Or consider water utilities that provide conservation, education, outreach and low-income assistance to disadvantaged customers. These are just two examples. The same applies to other environmental concerns. Or to broader societal issues like diversity, health and wellness, strong corporate governance, and equal access to technology.

We believe that a deep commitment to ESG research and engagement is fundamental to managing active portfolios. There are a variety of approaches to building responsible investing strategies—from using screens to limit exposure to poor ESG performers, to targeting specific responsibility characteristics in a goals-based ESG portfolio (**Display 26**). You can also choose thematic strategies that find companies delivering a wider benefit using a top-down approach meant to address many of the sustainability challenges facing society. Or invest for impact in strategies that deliver measurable and intentional positive environmental or social results.

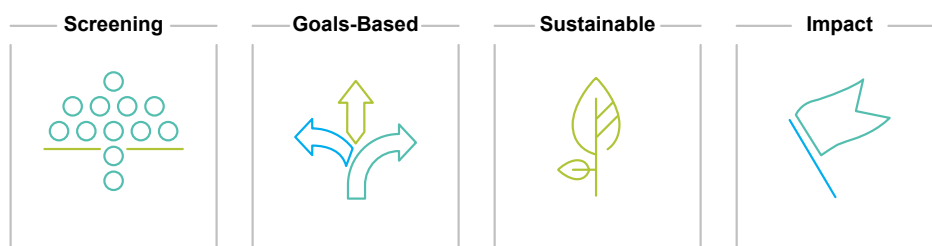
Responsible investing can focus on one of these approaches, or several. In combination, these approaches can provide full diversification by asset class, geography, and market capitalization as well as by type of responsibility focus.

There are several fundamental questions and issues to consider as you look to implement responsible investing in your portfolio. Your answers to these questions will help guide you:

#### What are your priorities for responsible investing?

- What ESG issues are important to you?

## DISPLAY 26: A WIDE ARRAY OF RESPONSIBLE INVESTING STRATEGIES



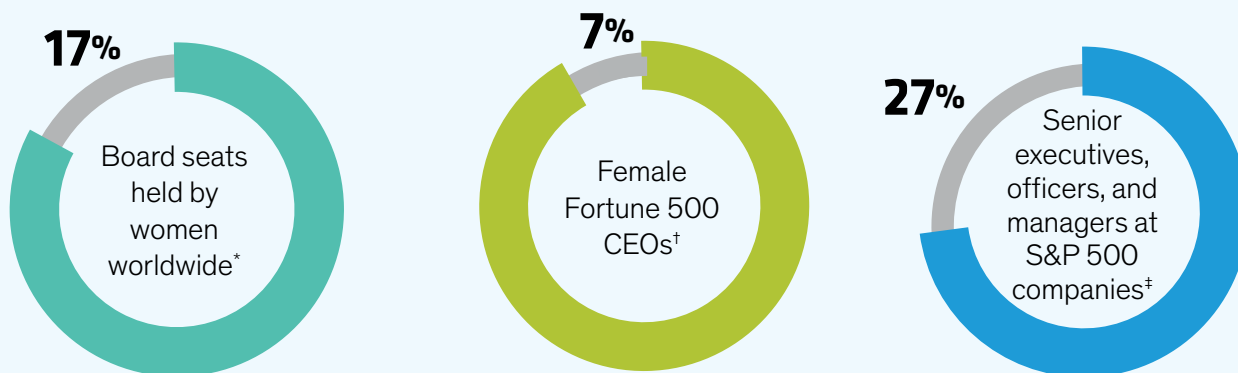
## ACTIVE OWNERSHIP

As active owners, we can use our voting rights and influence with corporate executives and boards of directors to raise environmental, social, and governance issues directly with company management. For example, that means encouraging companies to adopt policies that enable women to earn an equitable living and play leadership roles—especially in fields where women are underrepresented (*Display 27*).

Aside from benefiting morale, there is evidence that inclusive cultures are good for business. Consider McKinsey’s findings that public companies in the top quartile for ethnic and racial diversity were materially more likely to have financial returns above their industry peers.<sup>16</sup> Plus, measuring diversity and inclusion can foreshadow where corporate cultures are heading. Other groundbreaking research has shown that when minority viewpoints are represented by around 25% of an organization, the majority’s views and culture shift to include more perspectives.<sup>17</sup>

Within our own portfolios, we have tangible evidence of a company in the throes of a cultural transition. American Water Works’ total employee base currently stands at just 26% female. But women are more prominent at the top: the board is 62% female and the company is led by a female chief executive. In the next decade, management expects material turnover in its overall workforce (which is currently mature) due to retirement—and has strongly committed to using that turnover to foster a more diverse workforce. By urging others to follow the example set by companies like American Water Works, investors can amplify their impact and help promote important changes in corporate behavior while enhancing shareholder returns.

### DISPLAY 27: ENGAGING WITH COMPANIES CAN ENCOURAGE DIVERSITY IN THE BOARDROOM



\* “Women in the Boardroom: A Global Perspective.” Deloitte, 2019.

<https://www2.deloitte.com/global/en/pages/risk/articles/women-in-the-boardroom-global-perspective.html>

† “The Fortune 500 Has More Female CEOs Than Ever Before.”

<https://fortune.com/2019/05/16/fortune-500-female-ceos/>

‡ Catalyst, Quick Take: Women in Management (August 7, 2019)

<sup>16</sup> “Diversity Matters,” McKinsey & Co., February 2015

<sup>17</sup> “The 25% Revolution: How Big Does a Minority Have to Be to Reshape Society?” Scientific American, June 8, 2018

- What kind of impact do you want to have and why?
- Which specific issues or considerations do you want to incorporate into your investment policy or wealth management plan?

### How do you want to reflect your values or mission in your investment portfolio?

- There are multiple approaches to building responsible portfolios, ranging from simply evaluating the material ESG aspects as part of fundamental analysis, to negative screening and impact investing.
- Do you want to minimize risk, avoid exposure to specific activities, or invest in companies developing solutions to important societal issues?
- Do the portfolio managers overseeing your investments actively engage with companies on ESG issues?
- Active ownership—which includes actively voting proxies, introducing shareholder resolutions and raising ESG issues

### MLPS: A COMPLEX ASSET THAT'S HARD TO GIVE

While most appreciated publicly traded securities are on the simpler end of the spectrum, not all are uncomplicated. A Master Limited Partnership (MLP) is a good example. MLPs are limited partnerships that are traded publicly on an exchange. They combine the tax benefits of a limited partnership with the liquidity that publicly traded securities—like stocks and bonds—offer. But there is one drawback donors must consider—an MLP can generate unrelated business taxable income (UBTI). This can result in a taxable liability that must be paid by the donor's fund. In addition, the charitable deduction, for those who itemize on their tax return, may be reduced due to debt or ordinary income recapture associated with the MLP interest (see UBTI on page 69). In this case, a seemingly simple asset is actually quite complex to give to charity. Other appreciated public securities may be more readily transferable for charitable gifts.

with management teams and boards—is an important tool for influencing corporate behavior.

- Active managers also have the ultimate tool: selling a stock whose ESG indicators are not meeting expectations (unlike index funds or ETFs that must hold a stock in a relevant index regardless of its ESG profile).

### How will you measure the dimension of responsibility?

- Industry standards for measurement are still evolving. Reporting remains in its infancy, but as investors sharpen their focus on ESG issues, voluntary disclosures by companies are on the rise. This will lead to better and more precise measurements of responsibility characteristics over time.

With the answers to these questions and guidance from experienced responsible investing professionals, you can take steps to build a portfolio that aligns your financial priorities with your personal values.

### ASSETS TO GIVE

You can give a wide variety of assets to philanthropic organizations, but some assets are much simpler for the donor to give—and for the nonprofit to receive.

Assets held for less than a year are generally subject to limited charitable income-tax deductions, and any unused deductions can typically be carried forward for five years. In addition, the tax benefit varies widely by type of asset and type of charitable recipient, creating difficult planning issues for donors. For example, giving certain illiquid assets, such as private securities, art, and real estate, typically requires time-consuming and expensive appraisals. Gifts of debt-encumbered real estate may impose the financial and reporting burden of [unrelated business taxable income](#) on the nonprofit. And some simply do not accept certain kinds of assets.

**Display 28, next page**, provides a summary, with the simplest asset to give (cash) at left, and the most complex assets (art and retirement plans) at right.

If you hold complex assets like private securities, real estate, art, or retirement plans, it's imperative to work with a professional as these assets present multifaceted planning issues, not limited solely to the few mentioned above. In addition, it may take significantly longer to donate these assets than cash or publicly traded securities.

**DISPLAY 28: SOME ASSETS ARE MORE DIFFICULT TO GIVE AND TO RECEIVE**

	Cash	Appreciated Publicly Traded Securities	Private Securities	Real Estate	Art and Tangible Property	Qualified Retirement Plans
	Simplest					Most Complex
<b>Overview</b>	Simplest for donor to give and for not-for-profit to receive	Simple; can avoid embedded capital gain by giving to not-for-profit	A little more complex; require qualified appraisals; may not be suitable for some strategies <sup>*</sup>	Can be very complex; requires qualified appraisals; may not be suitable for some strategies; debt can be problematic	Complex; subject to a higher top marginal capital-gains rate (28%); typically limited to cost basis for income-tax deduction unless related use <sup>†</sup>	Complex; typically a bequest, as giving options are limited while IRA owner is alive
<b>Deductions</b>	Yes	Generally based on fair market value of gift, if held for one year	Generally based on fair market value of gift, if held for one year	Generally based on fair market value of gift, if held for one year	Related use: fair market value; unrelated use: lesser of fair market value of gift or cost basis	At death, both income and estate tax can be avoided on contribution to not-for-profit
<b>Public Charity</b>	60% of <a href="#">adjusted gross income (AGI)</a>	30% of AGI	30% of AGI	30% of AGI	Related use: 30% of AGI	Unlimited estate tax charitable deduction for gift at death
<b>Private Operating Foundation</b>	60% of AGI	30% of AGI	30% of AGI	30% of AGI	Related use: 30% of AGI	Unlimited estate tax charitable deduction for gift at death
<b>Private Nonoperating Foundation</b>	30% of AGI	20% of AGI	20% of AGI; lesser of fair market value or cost basis	20% of AGI; lesser of fair market value or cost basis	No related use exception, and deduction is lesser of fair market value or cost basis	Unlimited estate tax charitable deduction for gift at death
<b>Valuation Required?</b>	No	Generally no	Yes, if deduction above \$5,000	Generally yes	Yes, if deduction above \$5,000	Generally no
<b>Exceptions</b>	N/A	Will not realize a capital loss if you give securities with an embedded loss	Private business: may be subject to bargain-sale rules depending on capital structure; deductions for S-corp stock and LP and LLC interests are complex	If the property has a mortgage, the gift will be considered part sale, part gift, and the charity may incur <a href="#">unrelated business taxable income (UBTI)</a> liability	Deductions for gifts of art by a dealer or the creator are limited to cost basis, not including time; if the donor retains copyright interest, there is no deduction	During life, donors over age 70½ can give up to \$100,000 each year to a public charity (excluding DAFs) from a charitable IRA rollover; there is no income-tax deduction for the gift

<sup>\*</sup> Contributing S-corporation stock to a charitable remainder trust (CRT) will cause a corporation to lose its S-corporation tax status.

<sup>†</sup> Considered related use if an organization will use the property in a manner that is related to the philanthropic mission of the organization—for instance, contemporary art donated to a contemporary art museum for public viewing.

Source: Bernstein

# CASE STUDY



## A ROADMAP TO SUCCESS

Jake and Eliza sold their family business this year and met with their Bernstein advisor to discuss their philanthropic plan. Like many business owners, they wanted to understand how they could lessen the bite from income taxes, while supporting causes important to them. In the past, they gave gifts from their \$2 million donor-advised fund (DAF); most of this went to the charities where they sat on the boards. They've had limited conversations about the family's philanthropy, and have not discussed the family's wealth at all with their children: William, 18, Carrie, 22, and Colby, 25. At the meeting with their advisor, they established three goals:

1. Move from ad hoc giving to values and impact-based philanthropy.
2. Involve their children in the family's philanthropy and instill a culture of giving.
3. Use philanthropy to introduce shared values, goals and expectations for their wealth.

**Here is a roadmap of the family's achievements, guided by their advisor, over the following year:**

**Identify Values:** The family, facilitated by Bernstein's philanthropy team, uncovered their core values, and coalesced around four values: **sustainability, compassion, impact, and opportunity.**

**Link Values to Vision:** Using insight from the values exercise and guided by their advisor, they considered causes that reflect their values and what their mission would be along three dimensions—Causes/Passions, Catalysts, and Target Geography—and came up with their giving plan:

- 80% of their total giving would support two main causes:
  - Youth Education and Opportunity—primarily focused on providing underserved children from the local community access to meals, mentoring, and after-school programs
  - Conservation—both within the US and globally, with a focus on African wildlife and clean energy
- 20% would be reserved for reciprocal gifts, appeals, and unforeseen needs like natural disaster relief

**Craft Mission and Vision Statement:** Next, Bernstein worked with the family to create vision and mission statements:

- **Vision Statement:** A world where all people, regardless of financial wealth, can fully employ their talents to ensure a sustainable, thriving planet.
- **Mission Statement:** To address inequality in education and opportunity with the youth in our community, so that they can be empowered to innovate and move our world to a sustainable ecosystem where all living things can thrive.

**Family Unity and Engagement:** Jake and Eliza believe that giving is not simply financial; it should include volunteering.

- William would lead a volunteer activity and use his social network to increase support. For every \$1 raised, the family's DAF would donate \$5
- Carrie and Colby would attend the next investment meeting, and have the opportunity to pitch grants
- Bernstein organized a day of service for the family at a local school; during a school holiday, the family took a trip upstate and worked on a sustainable farm—tending to animals, planting trees, and gardening. Jake and Eliza also made a financial contribution to the farm as well

**Governance and Education:** Jack and Eliza scoped out the roles and responsibilities of each family member, and instituted a formal policy for making grants. Once the investment and spending policies were solidified, they worked with Bernstein to craft an **Investment Policy Statement** to document their investment strategy.

Over the next year, on a quarterly basis, the children would attend educational sessions focused on financial literacy (investments 101, philanthropy 101, and budgeting) hosted at Bernstein.

**Philanthropic Plan in Action:** Based both on planning using Bernstein's Wealth Forecasting System<sup>SM</sup>, as well as a series of practical discussions, Jake and Eliza agreed to implement their philanthropic plan using the following purely philanthropic strategies:

- Fund an \$18 million [private nonoperating family foundation](#)
  - Focus: Youth Education and Opportunity, and Conservation
  - Spending policy: 5% of annual portfolio value. In the event the full 5% was not utilized in a given year, the balance would be given to the family's DAF
  - Time horizon: Perpetual
- Add \$3 million to their existing [donor-advised fund](#)
  - Focus: Reciprocal gifts, appeals, and unforeseen needs
  - Spending policy: Up to 6% of annual portfolio value
  - Time horizon: 15 years, after which the children would take the helm and drive strategy
- Make a gift of \$2 million to a university working on an African conservation project
  - Formalized [gift agreement](#) which outlined family's intent for the gift and expectations
  - Gift to be given in equal installments over the next three years

[Investment Strategy](#): Informed by the [Wealth Forecasting System<sup>SM</sup>](#), time horizon, and spending requirements for their charitable vehicles, they established an investment strategy:

- Family Foundation: Growth-oriented allocation; 70% return-seeking, 30% risk-mitigating with diversifying assets
- Donor-Advised Fund: Growth-oriented allocation; 80% return-seeking, 20% risk-mitigating. No alternatives
- Outright Gift: Conservative-balanced allocation; current year gift held in cash and short bonds, remaining years 30% return-seeking, 70% risk-mitigating
- [Responsible investing](#) is an important tenet that should be reflected throughout the family's strategy

[Measure and Track Impact](#): After one year, Jake and Eliza revisited their plan to assess their impact. Their advisor had tracked their giving over the year. They were:

- Pleased to see the impact of their initial gift to the university

- On budget with educational giving and excited with the impact of a newly formed after-school arts program funded by their gift

Jake and Eliza were intrigued by the following insights:

- They gave significantly more to clean energy than budgeted
- Their DAF granted the max, 6%—grants to friend and community requests were higher than anticipated, and Colby, William, and particularly Carrie petitioned for grants in passion areas of their own (animals and human rights)

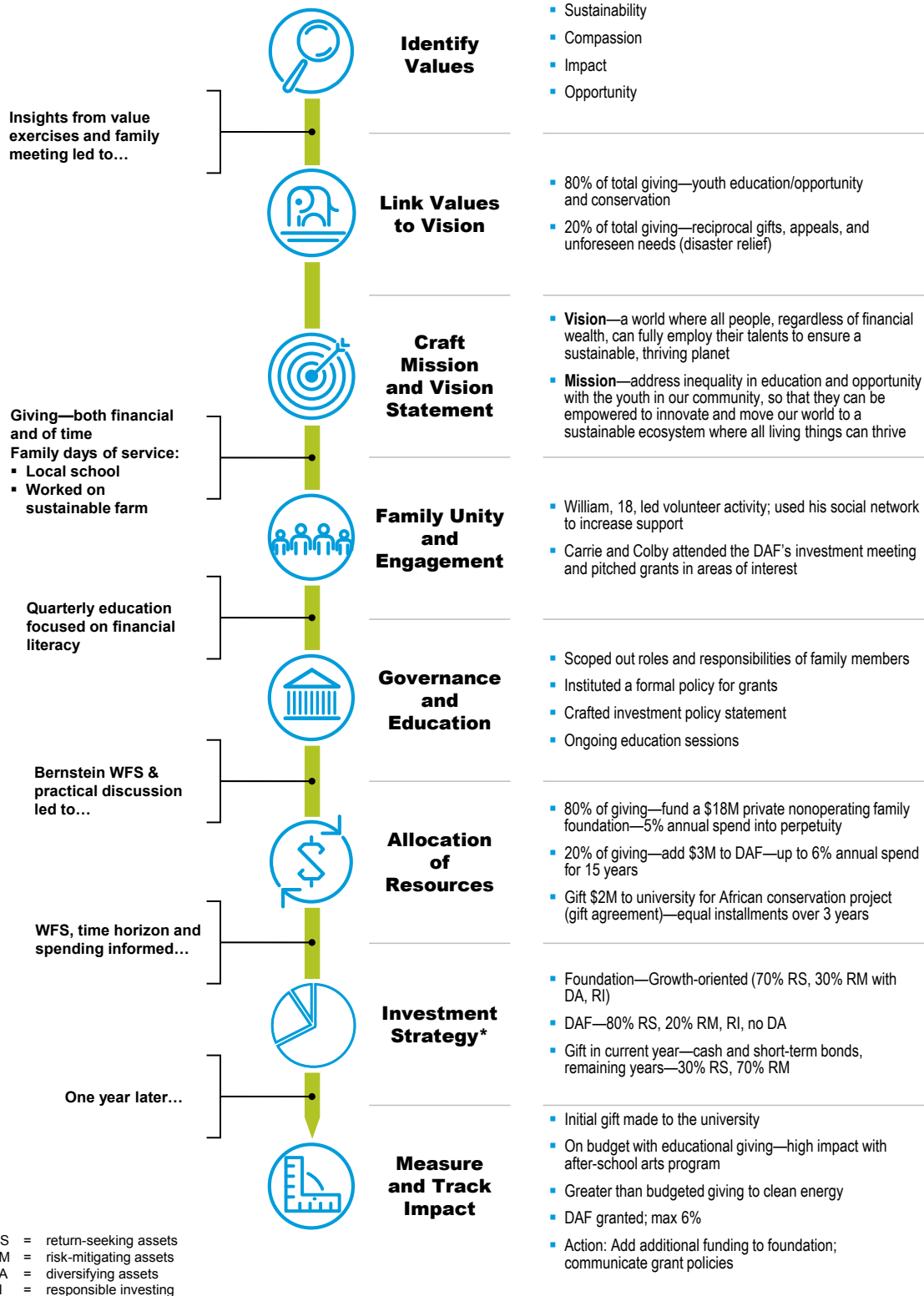
They also revisited the [Total Philanthropic Value, TPV](#), of their giving strategies over the year, as well as projected the impact of their giving over the next 15 years. They realized that the dollar amount gifted to clean energy was too small for what they wanted to accomplish and the amount left in the foundation was probably too small to have the impact they desired. Based on the philanthropic tracker and TPV, they instituted the following changes to the plan:

- Added an additional \$2 million to their foundation to increase the overall dollar impact and TPV of their gifts today and over time, particularly to shift more resources to clean energy
- Realized that “reciprocal” gifts like appeals from friends had ramped up much higher than anticipated. Going forward, they would communicate a formal family process for approving these types of grants
- Agreed that the increased giving from the DAF for the children's passions was a welcome surprise—and adjusted the philanthropic budget to weight more annual giving to these areas instead of reciprocal gifts

They acknowledge that their philanthropic plan will evolve over time, as they learn more about their philanthropy and see it in action and as their children become more involved in the philanthropy. Together with their advisor, they mapped out an action plan for their philanthropy and family engagement for the next 6 to 12 months.



## DISPLAY 29: JAKE AND ELIZA'S PHILANTHROPIC PLAN



# APPENDIX



# INDEX

<a href="#">Active or Passive?</a>	55	<a href="#">Granting: Your Capacity to Give</a>	11
<a href="#">Active Ownership</a>	59	<a href="#">Identifying Values</a>	7
<a href="#">Alternative Investment Allocation Model</a>	56	<a href="#">If You Can't Part with a Favorite Stock</a>	18
<a href="#">Asset Allocation to Support Your Giving</a>	53	<a href="#">Investment Strategy</a>	11
<a href="#">Assets to Give</a>	60	<a href="#">Key Questions When Establishing a Donor-Advised Fund (DAF)</a>	27
<a href="#">Bequests</a>	39	<a href="#">Lending a Supporting Hand</a>	28
<a href="#">Case Study</a>	63	<a href="#">Less Than You Think—or More?</a>	11
<a href="#">Charitable Remainder Trusts</a>	44	<a href="#">Maximizing Charitable Income-Tax Deductions</a>	22
<a href="#">Charitable Gift Annuities</a>	48	<a href="#">MLPs</a>	60
<a href="#">Charitable IRA Rollovers</a>	19	<a href="#">Notes on Wealth Forecasting System<sup>SM</sup></a>	70
<a href="#">Charitable Lead Annuity Trusts</a>	40	<a href="#">Our Core/Surplus Framework</a>	11
<a href="#">Charitable Pledges</a>	37	<a href="#">Perpetuity or Spend-Down?</a>	34
<a href="#">Checklist for Establishing a Private Foundation</a>	32	<a href="#">Philanthropy</a>	5
<a href="#">Choosing Philanthropic Strategies</a>	16	<a href="#">Pooled Income Funds</a>	50
<a href="#">Communication and Education</a>	10	<a href="#">Preparing the Next Generation</a>	9
<a href="#">Comparing Vehicles for Purely Philanthropic Giving</a>	36	<a href="#">Private Nonoperating Foundations</a>	29
<a href="#">Compelling Combinations: Donor-Advised Funds and Private Foundations</a>	38	<a href="#">Private Operating Foundations</a>	33
<a href="#">Crafting the Vision and Mission Statement</a>	7	<a href="#">Responsible Investing—What's Right for You?</a>	58
<a href="#">Crafting Your Investment Policy Statement</a>	14	<a href="#">Some Assets Are More Difficult to Give and to Receive</a>	61
<a href="#">Direct Gifts</a>	17	<a href="#">Spending Policy</a>	11
<a href="#">Donor-Advised Funds</a>	23	<a href="#">The Impact of Key Charitable Lead Annuity Trust Decisions</a>	43
<a href="#">Family Engagement</a>	8	<a href="#">Time Considerations</a>	8
<a href="#">Family Responsibilities and Governance</a>	7	<a href="#">Total Philanthropic Value: A Measure of Financial Impact</a>	21
<a href="#">For-Profit Charitable Strategies</a>	51	<a href="#">Tracking and Assessing Your Impact</a>	12
<a href="#">Gift Agreements: Formalizing Your Gift</a>	37	<a href="#">Values-Based Philanthropy</a>	6
<a href="#">Glossary</a>	68	<a href="#">Wealth Forecasting</a>	13
<a href="#">Going Beyond Stock and Bonds</a>	54	<a href="#">What to Consider Before Joining a Board</a>	10
<a href="#">Governance and Family Policies</a>	10		

# GLOSSARY

**Adjusted gross income (AGI):** Gross income minus specific deductions, including alimony payments, contributions to qualified retirement accounts, qualified educational and medical expenses, and, for self-employed people, half of the self-employment taxes you pay.

**Bunching:** Aggregating tax-deductible charitable contributions that would normally be made over multiple years into a single tax year. In the consolidated year, the donor receives an immediate charitable income-tax deduction through itemizing on his or her federal tax return.

**Charitable income-tax deduction:** When you make a contribution to a qualified charity or certain charitable strategies, you may be able to deduct the value of the contribution from your taxable income, and thus reduce your tax bill.

**Conflict of interest policy:** Designed to protect a family foundation or nonprofit organization's interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of one of its directors or officers, or might result in a possible excess benefit transaction.

**Core capital:** A Bernstein term for the amount of capital needed to support a desired level of retirement spending, even if capital-market returns are poor, inflation is high, and you live a long time.

**Disqualified person:** If you are a substantial contributor to a foundation, or act as a director, officer, or trustee of one, you are considered a "disqualified person" who cannot engage in certain acts of self-dealing, including selling items to the foundation, borrowing money from it, or leasing space to or from it. (See definition for "excess business holding.")

**Excess business holding:** A private foundation or DAF can hold up to 20% of the voting stock of a corporation, partnership, or trust, including stock owned by **disqualified persons**; the IRS will consider any amount above 20% an "excess business holding" that will have to be removed from the foundation's balance sheet within five years. If you donate shares in your business to a private foundation in anticipation of selling the business and the sale falls through, you must remove the excess holding from the foundation or a stiff penalty will become due.

**Form 990-PF:** Private foundations are required to file a Form 990-PF each year. The form includes information on the foundation's assets, grants made, financial activities, and the names of trustees and officers.

**Investment policy statement (IPS):** A formal, written document that outlines the strategy for investing the assets of a private foundation or not-for-profit, as well as defines roles and responsibilities of board members, staff, and investment managers. Spending policy guidelines may be included in the IPS or as a separate document.

**Itemized deductions:** Comprised of various types of certain expenses that you incur throughout a tax year. If the total amount of these expenses is greater than the standard deduction amount, then one should itemize instead of taking the standard deduction. As of this writing, charitable gifts qualify as an itemized deduction.

**Mission-related investment:** An investment that supports the mission of a qualified nonprofit, foundation, or donor-advised fund by generating positive environmental or social impact, while generating competitive rates of return. It may not count toward the 5% required annual spending for private nonoperating foundations.

**Mission Statement:** Describes an individual or family's charitable purpose. It communicates the value the charitable endeavor intends to deliver and states the goals and objectives.

**Program-related investment (PRI):** An investment made by a private foundation to support charitable activities, including a loan, a guarantee, and potentially, an equity investment in another charity or commercial venture with charitable purposes. PRIs count toward the 5% required annual spending for private nonoperating foundations.

**Qualified charities:** "Qualified" charities or not-for-profit organizations as defined under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended ("Code").

**Required minimum distribution (RMD):** The minimum amount that you, as a participant in an individual retirement account (IRA), a SIMPLE IRA, a SEP IRA, or a defined-contribution retirement plan (but not a Roth IRA), must take, in a given year, from the retirement account when you reach age 70½ (can be delayed to retirement for a defined-contribution plan).

**Section 7520 rate:** The IRS sets the Section 7520 interest rate each month for use in discounting present values, annuities, or future interests. For example, in a charitable lead annuity trust (CLAT), it is the "hurdle rate" established at funding that is applied to annuity payments paid to charity; any remainder after making all annuity payments passes to noncharitable beneficiaries. The 7520 rate is based off of intermediate-term US Treasury rates.

**Self-dealing:** If you are a substantial contributor to a foundation, or act as a director, officer, or trustee of one, you must act for

the benefit of the foundation or charity, not your own benefit. You may not sell to it, borrow money from it, or lease space to or from it; such actions would be viewed as self-dealing.

**Smoothing rule:** A rule intended to increase the stability of distributions. For example, some private foundations and donor-advised funds base spending on a multiyear average of assets. Private nonoperating foundations have a built-in floor of 5%, since they are required to distribute 5% of assets each year.

**Surplus capital:** A Bernstein term for financial capital in excess of required core capital that may be available to fund other spending, charitable gifts, or wealth transfers.

**Total philanthropic value (TPV):** A Bernstein term for the total value of the distributions over time and the remaining principal of a private foundation, donor-advised fund, or other giving strategy, in current dollar terms.

**Unrelated business taxable income (UBTI):** A foundation or qualified charity can become subject to taxation at the corporate rate (21%) for any UBTI it receives. UBTI can arise through some types of investments in private equity funds, real estate investment trusts (REITs), and other partnership or limited liability company (LLC) structures that use debt to acquire property.

**Vision Statement:** Describes the clear and inspirational change desired resulting from an individual or family's charitable work and mission.

# Notes on Wealth Forecasting System<sup>SM</sup>

## 1. Purpose and Description of Wealth Forecasting System<sup>SM</sup>

AB's Wealth Forecasting Analysis is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client-Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term, and how different asset allocations might impact his/her long-term security; (3) The Capital-Markets Engine: our proprietary model that uses our research and historical data to create a vast range of hypothetical market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of probable returns and asset values the client could experience are represented within the range established by the 5th and 95th percentiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not guarantee results or establish the boundaries for all outcomes. Estimated market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet AB's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized. The information provided here is not intended for public use or distribution beyond our private meeting. Of course, no investment strategy or allocation can eliminate risk or guarantee returns.

## 2. Retirement Vehicles

Each retirement plan is modeled as one of the following vehicles: Traditional IRA, 401(k), 403(b), Keogh, or Roth IRA/401(k). One of the significant differences among these vehicle types is the date at which mandatory distributions commence. For traditional IRA vehicles, mandatory distributions are assumed to commence during the year in which the investor reaches the age of 70.5. For 401(k), 403(b), and Keogh vehicles, mandatory distributions are assumed to commence at the later of (i) the year in which the investor reaches the age of 70.5 or (ii) the year in which the investor retires. In the case of a married couple, these dates are based on the date of birth of the older spouse. The minimum mandatory withdrawal is estimated using the Minimum Distribution Incidental Benefit tables as published on [www.irs.gov](http://www.irs.gov). For Roth IRA/401(k) vehicles, there are no mandatory distributions. Distributions from Roth IRA/401(k) that exceed principal will be taxed and/or penalized if the distributed assets are less than five years old and the contributor is less than 59.5 years old. All Roth 401(k) plans will be rolled into a Roth IRA plan when the investor turns 59.5 years old to avoid Minimum Distribution requirements.

### 3. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs, and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

### 4. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted.

Liquidations may result in realized gains or losses, which will have capital gains tax implications.

### 5. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled as...	Annual Turnover Rate (%)
Cash Equivalents	3-month Treasury bills	100
Intermediate-Term Diversified Municipals	AA-rated diversified municipal bonds of 7-year maturity	30
Intermediate-Term Taxables	Taxable bonds of 7-year maturity	30
Global Intermediate-Term Taxable Bonds—Hedged	7-year 50% sovereign and 50% investment-grade corporate debt of developed countries	30
US Diversified Stocks	S&P 500 Index	15
US Value Stocks	S&P/Barra Value Index	15
US Growth Stocks	S&P/Barra Growth Index	15
US Small-/Mid-Cap Stocks	Russell 2500 Index	15
Developed International Stocks	MSCI EAFE Unhedged Index	15
Emerging Market Stocks	MSCI Emerging Markets Index	20
US Low Vol Equity	MSCI US Minimum Volatility Index	15
High-Risk International Stocks	Country Fund	15

### 6. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital-Market Projections page at the end of these Notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.8%. With intermediate government bonds, if

the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. AB's forecast of volatility is based on historical data and incorporates AB's judgment that the volatility of fixed income assets is different for different time periods.

## **7. Technical Assumptions**

AB's Wealth Forecasting System<sup>SM</sup> is based on a number of technical assumptions regarding the future behavior of financial markets. AB's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of January 31, 2019. Therefore, the first 12-month period of simulated returns represents the period from January 31, 2019, through January 31, 2020, and not necessarily the calendar year of 2019. A description of these technical assumptions is available upon request.

## **8. Tax Implications**

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. AB does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

## **9. Tax Rates**

Bernstein's Wealth Forecasting System<sup>SM</sup> has used various assumptions for the income-tax rates of investors in the examples included in this guide. See the assumptions in each example (including footnotes) for details. The federal income-tax rate represents AB's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is represented by the lesser of the top marginal income-tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The state income-tax rate represents AB's estimate of the "average" rate calculated based upon the applicable state's marginal tax schedule. Where an applicable state tax code permits the exclusion of a portion of capital gain income from gross income for purposes of calculating state income-tax, such exclusions have been included in the calculation.

## **10. Core Capital Analysis**

The term "Core Capital" means the amount of money necessary to cover anticipated lifetime net spending. All non-Core Capital assets are termed "Surplus Capital." AB estimates Core Capital by inputting information supplied by the client, including expected future income and spending, into our Wealth Forecasting System<sup>SM</sup> which simulates a vast range of potential market returns over the client's anticipated lifespan. From these simulations we develop an estimate of the Core Capital the client will require to maintain their spending level over time. Variations in actual income, spending, applicable tax rates, lifespan, and market returns may substantially impact the likelihood that a Core Capital estimate will be sufficient to provide for future expenses. Accordingly, the estimate should not be construed as a promise of actual future results, the actual range of results, or the actual probability that the results will be realized.

## **11. Mortality**

In our mortality-adjusted analyses, the life span of an individual varies in each of our 10,000 trials in accordance with mortality tables. To reflect that high-net-worth individuals live longer than average, we subtract three years from each individual's age (e.g., a 65-year-old would be modeled as a 62-year-old). Mortality simulations are based on the Society of Actuaries Retirement Plan Experience Committee Mortality Tables RP-2000.

## **12. Endowment**

The Endowment is modeled as a non-taxable permanent fund bestowed upon an institution to be used to support a specific purpose in perpetuity. The endowment may receive an initial donation and periodic funding from either the personal portfolio modeled in the system or an external source. Annual distributions from the endowment may be structured in a number of different ways, including: 1) an annuity or fixed dollar amount, which may be increased annually by inflation or by a fixed percentage; 2) a unitrust, or annual payout of a percentage of endowment assets, based on a single year or averaged over multiple years; 3) a linear distribution of endowment assets, determined each year by dividing the endowment assets by the remaining number of years; or 4) the greater of the previous year's distribution or any of the above methods. These distribution policies can be varied in any given year.



### **13. Private Foundation**

The Private Foundation is modeled as a charitable trust or not-for-profit corporation, which can be either a private operating foundation or a private non-operating foundation. The foundation may receive an initial donation and periodic funding from either the personal portfolio modeled in the system or an external source. Annual distributions from the foundation may be structured in a number of different ways, so long as the foundation distributes the minimum amount required under federal regulations, including: 1) only the minimum amount; 2) an annuity or fixed dollar amount, which may be increased annually by inflation or by a fixed percentage; 3) a unitrust, or annual payout of a percentage of foundation assets, based on a single year or averaged over multiple years; 4) a linear distribution of foundation assets, determined each year by dividing the foundation assets by the remaining number of years; or 5) the greater of the previous year's distribution or any of the above methods. These distribution policies can be varied in any given year. For non-operating foundations, the system calculates the excise tax on net investment income.

### **14. Charitable Remainder Trust**

The Charitable Remainder Trust (CRT) is modeled as a tax-planning or estate-planning vehicle, which makes an annual payout to the recipient(s) specified by the grantor, and at the end of its term (which may be the recipient's lifetime), transfers any remaining assets, as a tax-free gift, to a charitable organization. Depending on the payout's structure, the CRT can be modeled as either a Charitable Remainder Unitrust (CRUT) or a Charitable Remainder Annuity Trust (CRAT). The CRUT's payout is equal to a fixed percentage of the portfolio's beginning-year value, whereas the CRAT's payout consists of a fixed dollar amount. In the inception year of the CRT, its grantor receives an income-tax deduction typically equal to the present value of the charitable donation, subject to the applicable Adjusted Gross Income (AGI) limits on charitable deductions and phaseout of itemized deductions, as well as the rules regarding reduction to basis of gifts to private foundations. Unused charitable deductions are carried forward up to five years. Although the CRT does not pay taxes on its income or capital gains, its payouts are included in the recipient's Adjusted Gross Income (AGI) using the following four accounting tiers: Tier 1—Ordinary Income (Taxable Interest/Dividends); Tier 2—Realized Long-Term Capital Gains; Tier 3—Other Income (Tax-Exempt Interest); and Tier 4—Principal. CRTs are required to pay out all current and previously retained Tier 1 income first, all current and previously retained Tier 2 income next, all current and previously retained Tier 3 income next, and Tier 4 income last.

### **15. Charitable Lead Trust**

The charitable lead trust (CLT) is modeled as a portfolio that receives its initial funding from the grantor and transfers payments to one or more charitable recipients each year for a specified number of years or for the life or lives of certain individuals. The annual payments may be a fixed dollar amount (charitable lead annuity trust or CLAT) or a percentage of the trust's assets as valued every year (charitable lead unitrust or CLUT). In the case of a CLAT, annuities may be fixed (the same amount each year), or increasing. The annual payment is generally made first from available cash and then from other trust assets in kind. In a non-grantor CLT, the trust itself is subject to income taxation, and generally pays income tax with respect to retained income and receives a charitable income-tax deduction with respect to certain income paid to the charitable recipient(s). Realized capital gains may be taxable to the trust or treated as a distribution to charitable recipient(s) (and therefore eligible for a charitable income tax deduction), depending upon the provisions of the trust instrument and other factors. In a grantor CLT, the trust is a "grantor" trust for income-tax purposes, such that the grantor is personally taxed on all items of trust income. The grantor is entitled to a charitable income tax deduction upon funding for the portion of the CLT then calculated to be payable to the charitable recipient(s) over its term (often the entire funding amount). This charitable income-tax deduction is subject to recapture rules if the grantor dies during the term of the CLT. For both the non-grantor and grantor CLT, when the CLT term ends, the remainder, if any, may be transferred as directed by the trust agreement, including to a non-modeled recipient, a taxable trust, or a beneficiary's portfolio. The assets transferred from the CLT will have carryover cost basis.

## 16. Capital-Market Projections

	Median 30-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	30-Year Annual Equivalent Volatility (%)
Cash Equivalents	3.1%	3.5%	3.5%	0.5%	9.9
Intermediate-Term Diversified Municipals	3.0	3.3	3.3	4.3	7.8
Intermediate-Term Taxables	4.0	4.4	5.2	5.5	8.4
Global Intermediate-Term Taxable Bonds—Hedged	3.3	3.6	4.3	4.5	9.2
US Diversified Stocks	7.2	8.8	2.9	16.3	19.4
US Value Stocks	7.4	8.9	3.2	15.9	19.1
US Growth Stocks	6.9	8.9	2.5	18.1	20.8
US Small-/Mid-Cap Stocks	7.1	9.2	2.5	18.7	21.8
US Low Volatility Equity Stocks	6.8	8.0	3.3	14.2	16.7
Developed International Stocks	8.6	10.7	3.5	18.1	20.4
Emerging-Market Stocks	7.4	11.3	4.9	26.1	28.2
High-Risk International Stocks	8.5	11.6	2.5	22.1	24.6
Inflation	2.7	3.1	n/a	1.2	10.9

### Note to All Readers

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast, or opinion in this material will be realized. **Past performance does not guarantee future results.** The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product, or service sponsored by AllianceBernstein or its affiliates.

### Information About Morgan Stanley Capital International (MSCI)

MSCI makes no express or implied warranties or representations, and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This document is not approved, reviewed, or produced by MSCI.

Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

*Based on 10,000 simulated trials each consisting of 30-year periods. Reflects AB's estimates and the capital market conditions as of January 31, 2019. Does not represent any past performance and is not a guarantee of any future specific risk-levels or returns, or any specific range of risk-levels or returns.*