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Give and Ye Shall Receive — What Every Athletic Administrator Should Know About the Advantages of Charitable Giving Through Charitable Remainder Trusts

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Abstract

Intercollegiate athletic administrators rely heavily on fundraising efforts to defray the increasing costs of their operations. In fact, donor giving accounts for 16% of athletic departments' budgets (Fulks, 1998). Thus, it is imperative that athletic administrators are aware of charitable giving options available to potential donors. The purpose of this paper is to fully describe one of these options, the charitable remainder trust (CRT). CRTs as a part of a planned giving program could provide athletic departments with hundreds of thousands of dollars while simultaneously providing the donor with significant advantages not found in other gift giving options. This paper describes different types of CRTs, including the charitable remainder annuity trust (CRAT) and the charitable remainder unitrust (CRUT). A hypothetical example is furnished to demonstrate the advantages provided to the donor by establishing a CRT. These advantages include: a) an immediate income tax deduction, b) the ability to diversify assets, c) immediate capital gains savings and an increase in lifetime income, d) a reduction in estate taxes, and e) immediate acknowledgment of the charitable contribution. Some potential disadvantages are also noted and discussed.

Introduction

Intercollegiate athletic organizations continually struggle to generate enough revenue to cover expenses. Greater commitment toward Title IX compliance, less state and federal funding earmarked for intercollegiate athletics, and rising tuition costs have all contributed to the upward climb of intercollegiate athletic organizations' expenses (Howard & Crompton, 1995;

Wilde, 1995). In fact, average annual expenditures for Division IA intercollegiate athletics well exceed $17.5 million and 56% of those intercollegiate athletic programs lose money (Fulks, 1998). The picture is even more bleak for smaller intercollegiate athletic divisions as 89% or more of all institutions within the smaller divisions (i.e., Division I-AA, Division I-AAA, Division II, and Division III) reported a deficit in 1997 (Fulks, 1998).

In order to defray these costs, intercollegiate athletic organizations have delved into revenue generating schemes which have, until recently, been unconventional. Sponsorships, personal seat licenses, luxury suites, and licensed sports merchandise have become the norm, rather than the exception, for most Division IA intercollegiate athletic organizations. However, more traditional modes of raising revenue, such as fundraising, have not been neglected. Indeed, enhanced attention to fundraising efforts has led to a substantial increase in this revenue source. In 1965, private donations accounted for an average of only 5% of Division IA athletic departments' budgets while today contributions account for over 16%; donations supply, on average, $2.8 million yearly per program and have become a consistent source of revenue for Division IA organizations (Fulks, 1998; Howard & Crompton, 1995). In fact, some programs receive a very large proportion of their revenue from private donations. For example, in 1994, Fresno State received $4 million (over 33% of their entire budget) in private donations. Similarly, in 1996 at the University of Texas, 43% of the net operating income for the men's athletic department was comprised of private donations received by the Longhorn Foundation, the annual gift arm of their athletic development office (Howard & Crompton, 1995; University of Texas at Austin Year End Report, 1996).

Athletic departments often focus on generating either annual or major gifts (Howard & Crompton, 1995). Howard & Crompton (1995) note:

> Annual gifts are generally donations solicited yearly from a broad base of donors including alumni and boosters. Usually, they are smaller, lower level gifts, typically ranging from $100 to $10,000. Major gifts are generated from a small, selective group of donors. Generally they are one-time donations of significant monetary value often directed at capital projects, such as a new arena (pp. 373-374).

While intercollegiate athletic departments attempt to generate both annual and major gifts, Kelly (1991) notes that nearly one-third to one-half of all money raised through private contributions is provided by only 1 to 10% of all donors. Thus, a prudent intercollegiate athletic administrator should do all he or she can to solicit major gifts from potential targets.

While Americans donated more than $143 billion to charity in 1995 (Perlson & Ertz, 1997), the present environment makes soliciting such donations difficult, especially for intercollegiate athletic organizations. Intercollegiate athletics face not only shrinking government support and a growing need for charitable donations, they also encounter fierce competition from other charitable organizations (Bendapudi, Singh, & Bendapudi, 1996). These facts, coupled with the recent negative publicity the National Collegiate Athletic Association (NCAA) has received regarding its exorbitant budgets and spending, as well as the public perception that intercollegiate athletics are 'cash cows" in higher education, require athletic administrators to be especially industrious and creative in their fundraising efforts (McGraw, Dillon, & Rock, 1997).

One particular type of major gift that could be immensely helpful to athletic administrators is the charitable remainder trust (CRT). Unlike other major gift options such as cash, endowments, or securities, CRT's can provide several immediate benefits to the donor as well as the benefactor. Thus, the CRT may be more appealing to potential donors than other options. In fact, Mark Gorski, product manager for Wells Fargo Bank, states, "The CRT is among the most flexible and attractive charitable giving and estate planning strategies available to individuals" (1992, p. 31). The purpose of this article is to provide a brief overview of the CRT for sport administrators. The article will define and explain the CRT, provide examples, discuss its advan-

tages, and note how it could be considered for use within intercollegiate athletics.

What is a CRT?

A CRT is a legal arrangement in which an individual transfers assets to a trust. A percentage of the income produced by the trust is paid to the income beneficiary. The income beneficiary is the person named by the donor to receive the annual income stream derived from the trust for the remainder of the beneficiary's life. Although the donor could name any person as the beneficiary, he or she often names him/herself. Upon death, the trust's assets are transferred directly to a charity, - in this case, the athletic department (Freeman, 1994; Gorski, 1992; Kohler, 1997; Perlson & Ertz, 1997).

There are two basic types of CRTs: charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs). A CRAT "pays out a fixed dollar amount each year of at least 5% of the initial fair market value of the trust assets" (Kohler, 1997, p. 240). Federal Tax Law provides that a CRAT must pay out 5% but no more than 50% of the fair market value of the trust assets. Depending upon the needs of the beneficiary, market performance projections, current interest rates, and similar variables, a payout rate is chosen and written into the trust document. For example, a CRAT may be designed to pay out 6% of the fair market value of the trust assets. Income produced by the trust is required by Federal Tax Law to be paid out no less frequently than annually (Perlson & Ertz, 1997). To illustrate, assume that the grantor contributes $1 ,000,000 worth of undeveloped land to a trust with a 6% payout. The income beneficiary will receive an annual payment of $60,000 regardless of the investment performance of the trust (Soled, 1996). With a CRAT, no additional contributions to the initial amount are permitted (Perlson & Ertz, 1997).

In contrast, a CRUT (charitable remainder unitrust) "pays out each year an amount generally equal to a fixed percentage- at least 5% as selected by the donor-of the value of the trust assets for a particular year" (Kohler, 1997, p. 241). Thus, the dollar amount paid to the income beneficiary may vary each year. For example, assume the grantor contributes $1 000,000 worth of undeveloped land to a CRUT with a 6% payout. If the investment performance of the trust earns more than the 6% payout and the principal increases to $1 500,000, the income beneficiary will receive 6% of $1,500,000 (or $90,000) in that year. The CRUT is attractive because it guards against inflation; however, the annual payout could also decrease if the investment performance of the trust earns less than 6%. In addition, unlike the CRAT, a CRUT allows for additional contributions to the initial trust from the donor (Perlson & Ertz, 1997).

There are three different types of CRUTs: a) a Standard Trust (SCRUT), b) a Net Income Trust (NI-CRUT), and c) a Net Income Make-up Trust (NIM-CRUT). Although these CRUTs are similar in form, each can be utilized to meet a different goal (Freeman, 1994; Kohler, 1997; Phillips & Robinson, 1997; Soled, 1996).

The value of a standard trust (SCRUT) is evaluated annually. If the actual trust income is more than the stated payout amount, the excess goes toward the principal and the donor will realize an increase in his/her income stream. However, if the actual trust income is less than the payout rate, the shortage is paid from the principal (Phillips & Robinson, 1997). Thus, the donor is guaranteed the stated percentage of the fair market value of the trust assets. A SCRUT is most often utilized when the donor will always need an income or when the donor wishes to invest for total return rather than ordinary income. Thus, those employing a SCRUT are often near retirement age and wish to maintain their standard of living while relying on the trust for income (Perlson & Ertz, 1997).

The net income trust (NI-CRUT) also requires an annual evaluation of the trust assets. If the investment performance of the trust is less than the stated payout, the donor receives the lesser amount. For example, if the stated payout rate is 7% but the actual trust income is only 3%, the donor receives only 3%. Thus, the NI-CRUT is seldom utilized and is most often practiced by those who wish to make larger donations to charity and who do not need a steady stream of income (Perlson & Ertz, 1997; Phillips & Robinson, 1997).

Finally, the net income make-up trust (NIM-CRUT) also requires an annual evaluation of trust assets, and similar to the NI-CRUT, the donor receives the lesser of the value of the trust assets times the stated payout rate, or actual ordinary income. However, unlike the NI-CRUT, the NIM-CRUT calls for a make-up of the shortfalls in subsequent years when ordinary income exceeds the payout rate. Thus, the NIM-CRUT is often utilized by younger donors who hope to better control the timing and amount of income received and who have less need for immediate income (Perlson & Ertz, 1997; Phillips & Robinson, 1997).

Advantages of CRT's

People may satisfy their desires to give to charitable institutions in a number of ways. However, by utilizing some form of a CRT, these desires can be met while simultaneously accruing important benefits. The advantages of a CRT include: a) immediate income tax deduction, b) diversification of assets, c) immediate capital gains savings and a subsequent increase in lifetime income, d) a reduction in estate taxes, and e) immediate acknowledgment of the charitable contribution (Gorski, 1992). The following represents a hypothetical example that illustrates the use of a CRT and its benefits.

Assume Mr. and Mrs. Brown are both in their early 60's. Mr. Brown has just retired from a successful computer company where he enjoyed a lifetime career in management. During his years there, he accumulated a great deal of stock in the company. Recently, the value of this stock increased significantly, so much so that his $150,000 investment is now worth over $1 million. Together the Browns have analyzed their current financial situation and realize that they would like to meet several goals. First, they wish to increase their current income as the yield from Mr. Brown's company stock through his retirement benefits is a paltry 1%. Second, they would like to diversify their assets but want to avoid some of the capital gains tax that would apply if they sold their current stock holdings and converted them to other resources. Finally, they would like to give money to charity. In particular, they would like to give to the university athletic department where the Brown's daughter was a student-athlete on the softball team.

The Browns consult their financial advisor along with an estate planning attorney and decide to put the $1 million of stock into a CRUT. They name their financial advisor as the trustee (the person charged with managing the trust assets), the university athletic department as the charitable remainderman (where the trust assets are transferred at the end of the trust terms), and themselves as the income beneficiaries. According to the terms of the trust, the Browns will receive 6% of the trust's value for the rest of their lives and, upon their deaths, all assets within the trust will go to the university athletic department. Additionally, assume the trustee's reinvestments earn 9% annually, a reasonable assumption in today's market. By taking such action, the Browns will receive several benefits (Gorski, 1992; Perlson & Ertz, 1997).

Immediate Income Tax Deduction

Although the Browns donated $1,000,000 to charity, they will generate income from this asset base for the rest of their lives, thus, they are not able to receive all of the $1,000,000 as an income tax deduction. However, they are allowed to deduct the net present value of the athletic department's future interest in the trust. This figure is determined by a number of factors (e.g., the payout rate, the number of income beneficiaries, the ages of the income beneficiaries). Based on the facts of the case, the present value of the remainder interest going to charity is almost $300,000. The Browns can immediately utilize this amount for an income tax deduction. While the IRS prohibits them from using the entire amount in one year (it is often limited to 50% of their adjusted gross income if donating to an educational institution), they may carry forward the unused portion for up to five more years. Such a deduction would produce a savings of over $93,000 for a couple in the 31% tax bracket (Gorski, 1992; Perlson & Ertz, 1997; Phillips & Robinson, 1997).

Diversification of Assets

Not only would the Browns recognize an immediate charitable income tax deduction, they could diversify their assets through the use of a CRUT. Because the Browns are top-heavy

with the company stock, they can have the trustee sell some of the stock and acquire new investments. This would ensure greater balance in their asset base (Gorski, 1992).

Immediate Capital Gains Savings and Increased Income

If the Browns sold their stock for its present value in order to reinvest and diversify their assets, there would be a capital gain of $850,000 ($1 000,000 -$150,000). After paying a capital gains tax, the Browns would have only $830,000 ($1,000,000 less 20% of the capital gain of $850,000; sales of capital assets after May 7, 1997 are subject to a capital gains tax rate of 20% if the asset has been held 18 months or more) for reinvestment purposes. Assuming the Browns received a 9% return on that reinvestment, they could generate an annual income of $74,700.

In contrast, with the Browns investing in a CRUT, there is no capital gains tax assessed to their stock sale because the trust has a charitable remainder and charities are tax-exempt entities. Thus, the Browns will receive 9% on $1,000,000, thereby realizing greater income under the conditions of the CRUT than if they had sold their stock on their own ($90,000 compared to $74,700) while simultaneously giving to the charity of their choice (Gorski, 1992; Kohler, 1997; Perlson & Ertz, 1997).

Reduction in Estate Taxes

By utilizing the CRUT, the Browns can also reduce their estate taxes. Estate taxes start at 37% (for estates over $625,000) and can increase quickly to over 55%. "By transferring an asset to a CRT, it is 'removed' from the client's estate for purposes of estate tax calculation" (Kohler, 1997, p. 241). Thus, because the Brown's have given $1 ,000,000 to charity, the value of their estate is reduced and their estate tax will be correspondingly reduced upon their deaths.

Immediate Acknowledgment of the Gift

The lifetime CRT provides an irrevocable gift. Thus, the athletic organization can legitimately recognize the donors in some fashion while they are still living. Although the athletic organization will not actually receive the gift until the death of the donors, they will be notified of the gift at the time it is established. Therefore, the donors often receive credit and recognition for their gift soon after the CRT is established. Other types of gift giving do not allow for such recognition as often the athletic department is not notified of the gift until some time after the donor's death.

Potential Disadvantages of CRT's

CRT's Are Irrevocable

Careful thought should be given before bequeathing money to charity through a CRT. Creating a CRT is an irrevocable decision; once the money is transferred to the trust it is absolutely committed to the charitable agency. In addition, the terms involved in the trust and the payout amounts generally cannot be changed (Gorski, 1992; Kohler, 1997).

Decreasing Family Inheritance

Many potential donors worry about the ramifications that the CRT will have on the family's inheritance as there will be fewer assets to channel to offspring or other family members. However, compared to other charitable giving options, the CRT provides an advantage. Because the CRT establishes an income stream (whereas an outright gift does not), and because of the tax savings it affords, the grantor has more money available to set up other funds for family members. For example, the Browns could utilize the money they save through the establishment of the CRT to purchase life insurance which could benefit the family, free of income taxes, and if properly possessed, free of estate taxes as well (Gorski, 1992; Kohler, 1997).

Costs

In addition to the money being donated, there are costs involved in establishing and maintaining the CRT. The establishment of a CRT usually costs between $1 500 and $5,000. Maintenance fees include such costs as those incurred to prepare a tax return ($500 to $1,000), annual fees paid to the independent trustee ($500 to $1,500), and investment advisor fees (generally 1% or more of the value of the trust) (Kohler, 1997). Given these costs, it is recommended that CRT's only be utilized if the donation is $100,000 or more (Gorski, 1992).

Summary

Considering all of the advantages of a CRT, it appears to provide a wise choice for wealthier individuals who wish to donate a portion of their money to charity. Many nonprofit agencies have taken advantage of this remunerative fund-raising strategy for years. While athletic development offices may be new to the planned giving game, they can benefit from this strategy, too. In fact, the University of Texas Women's Athletic Department received one of its most generous pledges recently through a CRT. The parents of a University of Texas All-American swimmer made the women's swim team the beneficiary of a "high six figure" trust. Upon the death of the parents, the money will be utilized to provide endowed scholarships in the donor's name (Halliburton, 1996, p. C8).

Intercollegiate athletic administrators should do all they can to make potential donors aware of the CRT as its advantages could serve as the needed nudge toward giving. Alumni meetings, booster newsletters, and scheduled seminars could be utilized to inform alumni, boosters, community leaders, and parents of the advantages of the CRT as a planned giving option (Gorski, 1992). CRTs can provide an athletic department with future viability while providing donors with tax benefits and a steady income stream in addition to satisfying their philanthropic desires.

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