admin - Thu, 6/18/2015 - 10:23

So, you have a pooled income fund (PIF). How’s your fund doing? We hear a variety of stories from our clients. Some clients have PIFs that are doing well, but many others are looking for ways to close their PIF.

Once upon a time, when PIFs were in favor, their attraction was in their relative simplicity compared to charitable remainder trusts. No trust document was needed because it was already in place; the documentation was a simple one or two page Instrument of Transfer. A second advantage of the PIF was the relatively low cost of administration. Charitable remainder trusts require the creation the filing of tax and informational returns for each individual trust. In contrast, the charity was required to file only one set of returns for a PIF, regardless of the number of participants. The reporting requirements to the participants involved a relatively simple Schedule K-1. A third advantage of PIFs was that they could accept smaller contributions than charitable remainder trusts. These features made the PIF arguably the most popular form of life income gift in the 1980s and early 1990s.

Oh, how times have changed! The popularity of PIFs has significantly diminished from their peak. PIFs have not been the gift to promote for years largely due to historically low interest and dividend rates. The statistics from the IRS are telling. In 2001 there were 4,571 PIF form 5227 forms filed. Just 7 years later the number of PIF form 5227 forms filed with the IRS had declined to 1,488. (http://www.irs.gov/taxstats/charitablestats/article/0,,id=97066,00.html,)

In 1978, Kenny Rogers released a song titled “The Gambler”. The chorus goes in part,

You got to know when to hold 'em, know when to fold 'em,

Know when to walk away and know when to run.

These lyrics pretty much sum up the status of PIFs.

Some charities continue to promote their PIFs. They represent the *“hold ‘em”* charities. Those with established PIFs understand that they need to promote their fund if the fund is to be managed effectively and efficiently. While the payout is

relatively low, those charities with mature PIF programs that have applied prudent investment strategies, have fund values that represent excellent remainder value to the charity.

However, many funds are more than fifteen to twenty years old but have only a handful of donors. These funds were generally set up for one specific donor, and then nothing more was done to market the fund. PIFs with only a few participants are generally more expensive to manage than charitable gift annuities. In addition, the current market trend of low interest rates means low yields for PIFs. Donors can typically secure a substantially higher payment rate from a charitable gift annuity than from a PIF. The market volatility of recent years has also made the fixed payments offered by gift annuities an attractive alternative to the variable payments of PIFs.

These factors -- small fund, low yield, and relatively high administrative costs to maintain the fund -- give rise to Mr. Roger's second charge, *"know when to fold 'em". But, w*hat options are available to a charity that wants to *'fold* '*em'*?

Three of the most often suggested options for closing a PIF are:

1. Offering beneficiaries the chance to renounce their remaining income interest in the PIF in exchange for an additional charitable deduction,
2. Allowing beneficiaries to exchange their income interest in the PIF for a charitable gift annuity or charitable remainder unitrust, and
3. Letting beneficiaries cash out their income interest in the PIF.

Renounce Income Interest

Some or all of the PIF income beneficiaries might be encouraged to make an outright gift to the charity of their income interest in the PIF. Each donor will be allowed an income tax charitable deduction for the full value of their renounced income interest. The donor's income interest in the PIF is a capital asset with a zero tax basis, so the deduction will be subject to the 30% limitation for contributions of appreciated capital assets.

Exchange Income Interest for CGA or CRT

In some instances, some participants may not want to surrender their right to life income. The charity could suggest that participants contribute their PIF income

interests in exchange for gift annuities. The annual annuity would be the gift annuity rate multiplied by the present value of the beneficiary’s income interest in the PIF.

Sometimes it would be necessary to pay a gift annuity rate higher than the American Council on Gift Annuities (ACGA) rate for gift annuity payments to equal the payments from the PIF. This is possible if the present value of the annuity is less than 90 percent of the present value of the beneficiary’s income interest, as required by IRC Sec. IRC Sec. 514(c)(5)(A). However, if the annuity is established in a regulated state to which the charity has submitted a schedule of rates, the charity must be able to demonstrate to the state’s satisfaction that the rate offered, taking into consideration the amount added to the reserve fund, will be acceptable.

The donor will be entitled to a charitable deduction equal to the value of the PIF income interest less the value of the gift annuity. Because the income interest in a PIF is considered a capital asset with a zero basis, the payments from the gift annuity will be partly long term capital gain and partly ordinary income, with no tax-free component. While the lack of a tax-free component makes these payments more highly taxed than most gift annuities, this taxation of the payments is nevertheless a major benefit to offer the PIF participant -- a typical PIF beneficiary receives distributions characterized as 100% ordinary income.

As an alternative to the exchange of the beneficiary’s income interest for a gift annuity, the charity could offer an exchange of the income interest for a charitable remainder trust (CRT) in instances where the PIF participant's income interest is equal to or greater than the charity's minimum acceptable funding amount for a CRT. The donor will be allowed a income tax charitable deduction for the value of his or her interest in the PIF, less the value of the income interest that the donor receives in the CRT. Distributions from the CRT to the income beneficiary will be characterized for tax purposes under the normal four-tier system.

Whether the beneficiary renounces the income interest or exchanges it for a gift annuity or CRT, if the donor claims a charitable deduction of more than $5,000.00, the donor must substantiate the value of the contributed property with a qualified appraisal. Furthermore, the qualified appraiser must sign a Form 8283 - Noncash Charitable Contributions information return that is filed with the donor's individual income tax return.

Cash Out

Some PIF participants may prefer to renounce their income interest in the PIF in exchange for a cash payment from the charity, rather than donate it or exchange their interest for a new life income plan. The amount of the cash payment typically is equal to the present value of the relinquished interest. There is no charitable deduction available in this case and the payment is generally taxable to the participant entirely as ordinary income.

Terminating a PIF

Possible alternatives for termination of a PIF depend on state law governing termination of trusts. Regardless of the method of termination, the trustee will be required to file a final return for the PIF. For the final year, the trustee will issue final forms K-1 to the income beneficiaries. Regardless of the method of termination, the K-1s will reflect distributions made during the year, if any, prior to termination. In addition, if distributing the actuarial value of the income interest to one or more participants terminates the PIF, the K-1s issued to those participants will need to reflect the cash payments as additional amounts reportable.

Print
Categories
PG Calc Featured Articles
Pooled Income Fund
Definitions - General Gift Planning