Flash! News from the Pomona Plan

A Financial Guide for Friends and Alumni of Pomona College (800) 761-9899

Year-End 2011

The Current Economy Creates Great Opportunities

Although the stock market has slowly climbed from its low in March of 2009 and investors are showing more confidence, the economy is still sluggish and many questions remain. Will the market continue to rise, level off or experience further shocks like those that marked the last decade?

While the market faces an uncertain future and interest rates are close to all-time lows, investors are pondering some crucial questions:

- *How can I lock in any gain I may have realized in my securities?*
- *How can I get a reasonable return on my assets?*

"Your pot o' gold is doing nothing for you sitting at the end of the rainbow. At the very least, you should put it in a no—risk interest–bearing account."

For our friends with important charitable goals, the best answers may be found not at their local banks or brokers' offices, but right here at Pomona College. We offer a number of giving options that allow you to address important financial objectives.

Income for Life

One of the most effective options that can protect your gain and generate an immediate attractive yield is the charitable gift annuity. Gift annuities generate a source of income for life.

You may fund your gift with either cash or appreciated securities; the choice depends on your specific goals.

Payment rates for gift annuities are quite generous and are based on the age(s) of the beneficiary(ies) at the time the gift annuity is established. Typically, payments on gift annuities outpace the returns on traditional fixed-income investments. Our rates for one-life annuities go as high as 13.0% for beneficiaries aged 90 and above.

POMONA COLLEGE

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Unhappy with Current Market Yields? Consider a Gift Annuity

Many people have begun looking for higher-yielding alternatives because fixed-income investments such as certificates of deposit and money market funds are not what they used to be. Many of Pomona's friends who want to support our work have found that our gift annuity program can greatly increase their annual spendable cash.

A charitable gift annuity is a wonderful way to make a gift to Pomona and generate valuable benefits for yourself or other beneficiaries you choose. In exchange for your contribution for a charitable gift annuity, Pomona will make payments for life to one or two beneficiaries based on the value of your gift.

Sample Gift Annuity Rates			
One Life		Two Lives	
Age	Rate	Ages	Rate
60	7.0%	60-60	6.6%
65	7.3%	65-65	6.8%
70	7.8%	70-70	7.1%
75	8.6%	75-75	7.6%
80	10.0%	80-80	8.4%
85	11.5%	85-85	9.7%
90	13.0%	90-90	11.2%

Rates may vary depending on IRS discount rate.

If you choose to use long-term appreciated stock to establish your gift annuity, you effectively lock in your gain in the stock. ***Reason:*** Your annuity payment, *like your charitable deduction*, is based on the full fair-market value of the stock, regardless of what you paid for it.

Better yet, this strategy reduces any long-term capital gains tax you would have faced had you sold the stock. In addition, you get to spread recognition of the gain over your life expectancy if you are a beneficiary.

Example: Betty, 75, owns stock in XYZ, Inc. that has quadrupled since she bought it ten years ago and is now worth $80,000. The value of the stock has bounced around in a fairly wide price range recently, and Betty is nervous about the company's future prospects. However, she is reluctant to sell and incur a taxable gain of $60,000, which would result in a tax of $9,000.

Betty decides to use the stock to fund a gift annuity. Her annual annuity payments are based on the stock's full fair-market value, amounting to $6,880 (8.6% of $80,000) each year for life.

Instead of recognizing and paying tax immediately on her $60,000 paper gain, Betty will have to recognize capital gain of only $4,171 each year for the balance of her 12.4-year life expectancy, a total of about $51,724. She will still receive $1,390 of her payment tax-free each year for that period.

Charitable planning pointer: Because her deduction is based on the stock's full $80,000 value, Betty gets a charitable deduction of $11,034. In her 33% tax bracket, the gift saves her $3,641. Whether a gift of cash or appreciated securities is better for you depends on your particular circumstances. We would be pleased to work with you and your advisors to select the right funding method for your gift annuity.

You may establish a gift annuity at Pomona for an initial minimum of $10,000. ***Note:*** Because the return on a gift annuity is determined by your age at the time you establish it, later annuities will likely have higher yields.

"Instead, let me be your investment advisor and get you eleven-per-cent return, year in and year out, regardless of market conditions."

What *Is* the IRS Discount Rate, Anyway?

You know that something is "technical" when it has more than one name or acronym. In the case of the IRS discount rate, it has four!

- The IRS discount rate
- The applicable federal rate (AFR)
- The charitable midterm federal rate (CMFR)
- The section 7520 rate

Yes, these are all one and the same thing. But you don't need a law degree or to be a CPA to understand it and its importance to life-income and other planned gifts to Pomona College.

The IRS discount rate is set under section 7520(a) of the Internal Revenue Code, and it is used to calculate the charitable deduction for certain gifts to charities such as gift annuities and charitable remainder trusts. It represents the IRS's estimate of the rate of return that gift assets will receive when invested by the charity.

The IRS discount rate is an important factor because, in order for a gift annuity to qualify under the law, *the remainder value must be greater than 10% of the face value of the original gift*. If it does not reach this minimum threshold, then the gift annuity may not be issued. However, in such cases all is not lost. With the knowledge and consent of the donor, we may negotiate a lower payment rate than our normal rate structure such that we increase the charitable deduction to an amount that exceeds 10% of the gift amount. While these reduced rates may be less than our normal rates, they are often still more generous than those offered by other nonprofit organizations.

Interested in a little more detail? Because the rate constitutes the IRS's prediction of our investment returns, the IRS looks to what it considers a safe harbor of investing, Treasury bills, as the basis for the calculation. The rate is the average annual yield over the past 30 days of Treasury bills with maturities ranging from three to nine years, which is then multiplied by 120% and rounded to the nearest ⅕ of a point. However, most charities do not invest their annuities in Treasury bills; at Pomona we invest annuities in our own endowment with returns closer to 13% per year on average over the past 25 years. This IRS formula tends to result in investment predictions that are significantly lower than Pomona's or any other charity's actual investment performance.

You don't need a law degree to understand the IRS discount rate.

This conservative rate is a key component of the calculation of the charitable deduction. For gift annuities, the deduction is computed by using the AFR to project the investment returns on the gift over the actuarial life expectancy of the beneficiary(ies) and adding that to the original value of the gift. We next compute the predicted dollar value of all the payments we will make over the actuarial life expectancy of the beneficiary(ies). This figure is then subtracted from the gift plus investment value to arrive at the remainder value that would be available to go to Pomona College. This remainder value is considered to be the predicted gift to Pomona, and this is used as the gift value for charitable deduction for tax purposes.

The IRS discount rate is published monthly and is announced on or about the 20th of the month that precedes the month to which the rate will apply. For example, the rate for December is announced around November 20. When you are calculating a planned-gift deduction, you may use the discount rate for the month in which the gift is made or for either of the prior two months, whichever is most beneficial to the donor. This is one of several reasons why our illustrations for *Pomona Plan* annuities may fluctuate from month to month and why we sometimes suggest that prospective donors check with us on or after the 20th of the month for updated information.

Sample IRS Discount Rates Over the Past Ten Years: November Rates

2002	3.6%
2003	4.0%
2004	4.2%
2005	5.0%
2006	5.6%
2007	5.2%
2008	3.6%
2009	3.2%
2010	2.0%
2011	1.4%

As Interest Rates Fall, Younger Donors May Not Qualify for the *Pomona Plan*'s Regular Rate Schedule…

A hallmark of the *Pomona Plan* is that we offer higher gift annuity rates than most charities.

In the current low-interest-rate environment, we are temporarily forced to negotiate lower rates for younger donors, typically for those in their 60s up to their mid-70s. This is because of the impact of the IRS discount rate used to calculate the charitable deduction for an annuity. As you know, the deduction must equal at least 10% of the face value of the gift or it will not qualify.

Over the past months the IRS discount rate has been falling in a series of steps from 2.8% in June (already a historically low rate) to 1.4% for October. Shortly this will mean that individuals as young as age 74 and younger and married couples with one member aged 76 or younger may not qualify for our regular rates.

If you have been considering an annuity with the *Pomona Plan* and are a member of this younger age group, you may want to check on how this might affect your rates so that we can help you qualify for the highest rate possible.

Give us a call at (800) 761-9899, and one of our staff will be glad to assist you with a gift illustration.

FROM THE DIRECTOR:

Do Not Let an Acronym Get You Down. A DGA Just Might Help —Problem Solved!

Mike ('57) and Helen ('58) Georgetown enjoyed wonderful careers following their graduation from Pomona. Mike became a high school math teacher while Helen studied law and then formed her own private practice. Over the years, they built substantial IRA accounts—so much so, they are now finding that the IRA minimum distribution requirements force them to withdraw more from their accounts than they typically need.

They realize that they both have alumni reunions approaching—Mike this year and Helen next. They have been considering a capital campaign gift of $50,000 to their alma mater in gratitude for their educations. They aren't quite ready to give a substantial outright gift to the College, but they remember hearing about the remarkable *Pomona Plan*. They decide to call the Office of Trusts and Estates to learn more about how to make a gift now while continuing to benefit from payments for life at a favorable rate of return.

Feeling good about their prospects, they are crestfallen to learn that something called the "AFR" is low—just 2.0%—and prevents them from qualifying for an immediate gift annuity at Pomona's regular generous rates. The usual rate for a couple their age, 7.6%, would have to be reduced to 7.2%. That is still a good rate, but it was not what they had expected.

Because their IRA provides more income than they currently need, a development officer suggests that they consider a *deferred gift annuity* (DGA) that would begin payments in three years—past the age when the low AFR would affect their rate. This could also boost the rate with an annual compounding factor in the rate calculation. The result? An annuity rate of 9.3%. *Problem solved!*

Would you like more information about gift annuities and how to increase your benefit in a time of low interest rates? Give us a call—we will be happy to share some ideas with you.

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