Wisconsin DIVIDENDS

UNIVERSITY OF WISCONSIN FOUNDATION FALL, 2002

Overcome Low Interest Rates and a Volatile Market with High-Minded Planning

Sometimes It Pays to Be Charitable

Low interest rates make charitable strategies appealing.

Often people are surprised to learn that there are many ways to make a gift to charity *and* receive a stream of income in the process. You may have been vaguely aware of the possibilities but never examined in detail how such a charitable gift could fit your own long-term financial needs. The current period of low interest rates makes several of these charitable planning strategies more appealing than ever.

The oldest and most popular gift arrangement is the **charitable gift annuity,** which returns to the donor, or one or two beneficiaries, a stream of income for life, based on a fixed percentage of the amount of the gift.

The following chart shows the rates the University of Wisconsin Foundation is currently paying donors at selected ages. The rate in effect when you acquire the annuity never changes. It is guaranteed for life.

Viewed in the light of current market conditions, these rates are very appealing. But there are other factors that enhance them even more. You receive an income tax deduction in the year you fund the annuity, and each year, for the duration of your life expectancy, a portion of each payment you receive is tax free. These tax benefits effectively increase your yield, as the following example demonstrates.

Example: *Mary J, 70, contributes $10,000 to the University of Wisconsin Foundation in exchange for a gift annuity that will pay her $720 annually. The gift produces an income tax deduction*

$10,000 Gift Annuity

Age(s)	Rate (%)	Annuity Payment	Tax Free	Tax Deduction
60	6.4	$640	$305	$2,665
65	6.7	$670	$345	$3,137
70	7.2	$720	$404	$3,573
75	7.9	$790	$482	$4,021
80	8.9	$890	$586	$4,497
60-60	6.1	$610	$278	$1,759
65-65	6.3	$630	$313	$2,199
70-70	6.6	$660	$357	$2,685
75-75	7.0	$700	$412	$3,244
80-80	7.7	$770	$492	$3,755

Note: The rates are somewhat lower if the annuity is for two annuitants—payable for the duration of both lives.

of $3,573 that, in her 30 percent marginal income tax bracket, saves her $1,072 (30 percent of $3,573). Thus, her out-of-pocket cost for the annuity is $8,928, and the $720 annual payment to her is equivalent to an 8 percent return.

Because part of the annual payment Mary J receives from the annuity is tax free ($404 of the $720 is not taxed), her return is the equivalent of $893 of taxable income. Measured against her out-of-pocket cost ($8,928), this represents an equivalent, fully taxable yield of 10 percent.

You should not select a gift annuity merely for a higher return, since you are irrevocably committing the principal to us. But if you are looking for a way to make a significant gift and generate increased cash flow, gift annuities are very appealing—perhaps even more so in current economic conditions.

Bonds: Good News, Bad News

As interest rates have plummeted, the price of bonds has soared. *The reason:* Since bonds pay a fixed amount of interest, the bond market is seeking price levels where the yield-on-investment more closely reflects current returns on other investments. That means higher bond prices.

For example, a long-term bond with a face value of $100,000 and a coupon rate of 10 percent issued a number of years ago will pay $10,000 interest each year, regardless of its market value. Because the 10 percent nominal rate is significantly higher than current rates, investors are willing to pay a premium—perhaps more than $175,000—to get the bond's $10,000 annual income. Those who bought high-interest bonds at par several years ago have probably seen their value go up substantially—if they haven't been called in the meantime. This is the good news.

The bad news comes in two parts. First, if an investor holds on to a bond until maturity, it will be redeemed for its face value, which will be considerably diminished by inflation. Second, if the investor sells the bond at the current appreciated price, part of the gain will be lost through capital gain tax.

Here again, if you are a person with charitable goals, you have some attractive options. You could contribute a bond that has appreciated in value to fund a **charitable remainder annuity trust**. Because the trust is tax exempt, it could sell the bond without incurring capital gain tax, thus preserving the entire market value for reinvestment. You would be able to take a deduction based on the full fair market value of the bond and avoid any tax on the appreciation.

Example: *Tom and Ruth H, both 65, fund a charitable remainder annuity trust with a bond worth $175,000 they bought years ago for $100,000. It pays $10,000 in interest each year. A comparable bond can be bought at par that will yield 5 percent. Accordingly, they structure the trust to pay themselves $10,500 each year (6 percent of $175,000) as long as either of them lives. After their deaths, the principal will pass to the University of Wisconsin Foundation.*

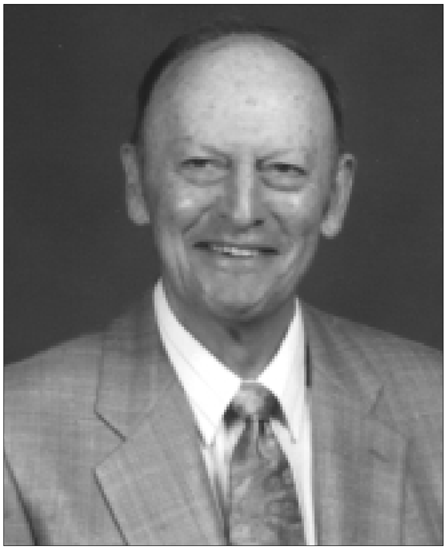
The gift produces a charitable income tax deduction of $44,984. In their 35 percent marginal income tax bracket, this saves them $15,744 in taxes (35 percent of $44,984). Tom and Ruth invest the tax savings at an average of 5 percent to generate an additional $787 of income.

If you have highly appreciated bonds and are not concerned with receiving a return from your gift, you would still find them an excellent choice for an **outright gift**. You can deduct the full fair market value of a bond given outright and avoid any tax on the appreciation. This is another wonderful way to capture the benefits of a bond's increase in value while supporting our work.

Equities: Playing It Straight with Unitrusts

Many informed investors are willing to accept today's low interest rates because they realize that the real return after inflation

Walter Wittich Delivers a Lesson in Giving



Dr. Walter Wittich

Walter A. Wittich, ('32 BA Bus, '34 MA Educ, '44 PhD Educ) comes from a long line of teachers. His grandfather, father and two of his uncles were teachers so it seemed only natural that he would follow in their footsteps. "I wanted to do something to improve education and not just talk about it," said Walter. His strong belief in the importance of a good education led him to establish the Wittich Scholarship Fund in the UW-Madison School of Education. This fund supports UW-Madison students pursuing master's degrees in the Department of Curriculum and Instruction with the School of Education. The scholarship is a perfect fit for Walter, since his gift will be used to train the next generation of teachers. "I hope this will help continue the good work of the University in the field of education," said Walter.

Walter also has established the Dr. Walter A. Wittich Family Fund for students in the recreational sports programs. The fund was established in memory of his grandfather, George Gottlieb Wittich, supervisor of physical education in the Milwaukee Public Schools from 1902 to 1922, and his father, Walter Julius Wittich, director of the School of Physical Education at the UW-LaCrosse from 1917 to 1953. Both men gave lifelong professional support to the development and organization of recreation-intramural sports programs in Wisconsin and elsewhere. The Dr. Walter A. Wittich Family Fund will provide merit awards to intramural sport participants. Consideration is given to participation level, leadership, sportsmanship and a growing appreciation of the lifelong value of physical activity.

Walter has worked in just about every area of education. He was a professor of education at the UW-Madison for more than 25 years, an author at Harper and Row and is a retired emeritus professor of education from the University of Hawaii. A resident of Sun City West, Arizona, he remains dedicated to education and volunteers at the local high school dropout center.

Walter has made use of charitable gift annuities in planning his gifts to the University. "The Foundation staff helped me find the way to do the most I could afford and still protect myself financially," said Walter.

The federal government provides a charitable deduction to those who transfer money or securities in exchange for a charity's agreement to pay the donor (and / or another survivor beneficiary, if desired) a fixed income for life. Donors receive an attractive rate of return and have the pleasure of making a meaningful charitable gift. The amount of the annuity received (i.e., the rate of return) depends upon the beneficiary's age at the time of the gift. A donor also enjoys additional income tax advantages, as a portion of each annuity payment received may be considered tax free depending on the asset used to fund the gift. The best way to arrange the gift annuity depends on the donor's wishes and obligations. At the death of the donor, probate and estate administration costs also are avoided on the assets used to fund the gift annuity. Money management worries are eliminated for you and any surviving beneficiary. "The UW has treated me amazingly well; I couldn't have asked for more. This is a thank you from me," said Walter.

Planning *(continued from page 2)*

is still competitive with levels of recent years. What is disturbing, though, is the possibility of tying money up and seeing the principal stagnate should interest rates go back up.

Almost certainly, this type of thinking has led to interest in the stock market. Many people would rather risk the fluctuating prices of equities than risk locking into low rates. There is a good reason for this: Over the last 50 years, the stock market, despite its ups and downs, has produced an average return nearly three times that of fixed-income vehicles such as CDs.

Charitably minded investors willing to accept some risk might consider a **charitable remainder unitrust** invested in equities as an alternative to a low-interest CD.

While a $100,000 CD paying 5 percent offers a secure income each year for its entire term, because of inflation that $100,000 will not have the same purchasing power it has today.

With a unitrust, on the other hand, you can fix the payout rate *and* have the possibility of growth. If you select 5 percent (the same rate as the CD), each year you receive 5 percent of the value of the trust assets; and if that value increases or decreases, your income fluctuates likewise.

Assuming that you are willing to structure a trust heavily invested in equities, the historical odds are that the value will grow more quickly than a trust invested in fixed-income instruments, given sufficient time. The 5 percent return should ultimately be 5 percent of a larger number.

As with any equity investment, there is risk that the value of the trust could decrease during a beneficiary's life. On balance, however, this strategy is likely to achieve more growth, and risk also is balanced by the significant tax deduction generated when the trust is created. A gift of appreciated, long-term securities can be a particularly appropriate way to fund a charitable unitrust.

For your complimentary copy of ***Charitable Solutions to Investment Dilemmas***, please return the enclosed postage-paid card or call **Russ Howes,** vice president, planned giving and legal affairs, 608-263-0371; **Bonnie Bruce,** senior director, planned giving, 608-263-2135; **Scott McKinney,** director, planned giving and real estate, 608-262-6241 or **Mikel Domnitz,** planned giving officer, 608-265-8068.

Unitrusts may offer higher returns than CDs.

You should consult your attorney about the applicability to your own situation of the legal principles contained herein.

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Philanthropy makes the difference