OBJECTIVES FOR THE NCF 2015 POOLED INCOME FUND - IOUI

The NCF 2015 Pooled Income Fund – IOUI has been created to provide long-term growth of principal with an emphasis on distribution of income to income beneficiaries. Assets of the PIF will be invested in a manner looking to the relative interests of the income beneficiary and the charitable remainderman.

"Total return" provisions ("TRPIF") are designed to provide distributable net income, with a secondary investment objective of reasonable growth of principal over time. It is anticipated that the NCF 2015 PIF – IOUI will appeal primarily to philanthropists looking for better than average income distribution. The NCF 2015 PIF-IOUI will endeavor to achieve risk-adjusted total returns that, over time, are commensurate with more aggressive than usual broad-based market averages. In general, investments will be managed prudently and diversified among asset classes, sectors and securities, taking into account the life expectancy of income beneficiaries, and preservation of principal.

To achieve the income objectives the investment advisor shall have the discretion to make investments, including but not limited to:

1. Short sales, derivatives and margin trading within diversified mutual funds to the extent that it is consistent with the fund's prospectus;

2. Derivative securities to increase the actual or potential risk exposure of the account;

3. Structured notes, principal only or interest only strips, inverse floating securities, futures contracts, uncovered options, short sales, margin trading and such other specialized investment activity;

4. Private equity and other private investments; and

5. Covered call options

6. Sale of Puts on selected issues when it is desirous to purchase a stock at a lower price with the caveat that the funds to purchase the stock must be held as a cash reserve

The NCF 2015 PIF – IOUI may employ investment practices that would emphasize high-yielding positions, that might be more volatile as it looks to achieve reasonably consistent distributions. The secondary objective of growth-over-time should result in a larger charitable remainder, and possibly increased future income through utilization of the TRPIF provisions.

NCF as the Trustee of the NCF 2015 PIF – IOUI *may*, from time-to-time, in its absolute discretion, exercise its TRPIF "power to adjust" by distributing a portion of post-contribution net realized long-term capital gain. This would add to income in a year during which such long-term gains are realized.

The Charitable Total Return Pooled Income Fund

Overview

1. The Pooled Income Fund ("PIF") pays you and/or your beneficiaries, quarterly income for life.
2. Contributions to the PIF are tax deductible. The type and value of your contribution, your age and the age of other beneficiaries, the PIF investment history, IRS rules and Treasury regulations determine how much you are able to deduct.
3. Donors often give appreciated assets to the PIF because the PIF can usually sell these assets without being subject to capital gains tax.
4. After the death of all the beneficiaries named in your PIF Agreement the PIF gift value allocated to your Agreement passes to NCF. The gift amount received is then distributed as follows: 1% to NCF and 99% to your NCF Donor Advised Fund. The gift is not subject to estate tax.
5. NCF is Trustee of the PIF. NCF operates the PIF to function as a total return PIF. Income is paid out to the beneficiaries, quarterly and includes the net dividends, interest, rents and royalties. At the close of the year, all realized net short-term capital gains are paid out to the beneficiaries. Also, at the close of the year under a Power to Adjust, the Trustee is permitted to and may allocate a reasonable apportionment of the net realized long-term capital gains to the income beneficiaries, according to Treasury Regulations and Delaware law. The PIF income will fluctuate, due to the inevitable and continuous changes in investment asset values which are affected by market and economic conditions.
6. The PIF is considered an exempt (from registration) security, and the assets are pooled. However, unlike an investment pool (like a mutual fund), the assets in the pool are fully those of NCF. The units a donor receives are an accounting method to determine how much of the income the donor will receive each quarter; they do not represent a share in the assets, which is an important distinction from an

investment. The PIF could double or triple in value, but if the income did not rise, distributions would not rise either. Moreover, the income beneficiaries will get an accounting of the income, but not a statement of all the holdings.

7. PIF contributions should be looked upon primarily as charitable gifts and not as investments.

8. Pooled Income Funds were created under the Tax Reform Act of 1969, which President Nixon signed into law.

The PIF can create truly significant income tax savings, by generating substantial charitable deductions (not affected by the Alternative Minimum Tax). The tax deduction can be used for post-transaction offsets, or for offsetting other ordinary taxable income. The PIF can be engineered to average down the tax cost of nearly any liquidity event. It can create a virtual capital gains type of taxation on an ordinary income tax transaction, if half of the ordinary income event is sheltered!

Imagine being able to create a charitable deduction without forgoing the income from the donated asset that was used to fund the PIF. Consider, as an example, that the PIF could be used to fund an ILIT as a down payment, or create a sheltered income stream, to fund life insurance premiums, in the following situations:

- Shelter qualified retirement plan distributions
- Sale of a portion of closely held stock (outside of a PIF)
- Exercise of RSU, ISO and NQ stock options
- Deferred compensation payouts
- Distribution of retained earnings in a "C" corporation that might not be Qualified Dividends
- Windfall distributions from a pass-through entity
- Large bonuses
- Shelter the recapture from the sale of depreciated real estate
- Shelter the taxable portion of a part sale / part gift transaction
- Sell a portion of ESOP Qualified Replacement Property

Examples

Post-Sale PIF

One advantage of a post-sale PIF for a highly appreciated asset, is that the cash contributed to the PIF creates a charitable deduction, that is deductible up to 50% of AGI versus 30% for a long-term capital gain ("LTCG") asset. This would work very well where the donor gets $5M for a stock/real estate sale with a $3M cost basis. The LTCG would be $2M with the $5M of cash proceeds. An older donor (50+) could put $3M in a PIF and get a deduction offsetting virtually all of the gain. He or she would have $2M of after-tax cash for any use, and a $3M PIF, with income for life (or lives).

Substantial Rollover IRA

A wealthy high-income donor has a very substantial rollover IRA, and does not want or need the IRA Required Minimum Distributions (RMD). The donor resists a Roth conversion because of the 53% tax cost (in CA). We are assuming that anyone not needing his or her IRA likely has a large income-producing investment portfolio outside of the IRA.

If he or she were 70, with 40 year-old children, she could roll, say, $1M to a Roth and transfer $2M of other assets to a PIF. The 2-generation PIF would create a deduction that would offset the Roth conversion. The children would get the Roth, with all its growth, income tax-free, and the lifetime income from the PIF after the parents' lives. Also, most of the LTCG trading gains in the PIF would remain tax-sheltered, whereas in their current taxable accounts, all realized gains are taxed, even if not distributed.

Disposition of Non-Qualified Stock Options

This planning strategy combines the disposition of a Non-Qualified stock option ("NQ"), which is fully taxable as ordinary income, with the contribution of 1.2 to 1.5 times the owned shares to a PIF. The stock contributed to the PIF need not be sold immediately, but it could easily create a 50% deduction that would offset the entire NQ exercise. Now, the donor has a "tax-eliminated" exercise, a reduced single-stock concentration, and a PIF with their favorite stock still intact. Assuming the donor is not an insider, the stock could be sold in tranches when it met certain target prices, without tax, and without the need to create a "shelter" to sell the stock in the future.

If the donor wanted to optimize this planning approach, they could combine it with the Roth conversion technique (explained in the previous example),

by purchasing the favorite stock in the Roth IRA.

What is a Pooled Income Fund ("PIF")? How does it work?

In a nutshell, a PIF is a Trust that operates like a charitable mutual fund.

When you invest money in a mutual fund, you are given mutual fund units in exchange. Like stock shares, the units have constantly changing values, so the number of units you receive for your investment depends on the current unit value and how much you invest.

By comparison, you donate irrevocably a gift to the PIF. You get a tax deduction and you are given PIF units in exchange. Like stock shares, the units also have constantly changing values, so the number of units you receive for your gift depends on the current unit value and how much you donate.

Only charitable organizations are allowed to set up and serve as the trustee of a PIF. Donors irrevocably contribute money, securities, real property and other assets to the PIF. Their gifts are invested and commingled together. The donor, or another beneficiary (or beneficiaries) the donor chooses, receives annually a share of the PIF's current earnings, in quarterly payments.

When an income beneficiary dies, the value of their units in the PIF is transferred to the charity to be used for the charitable purposes that were previously agreed to.

A charitable contribution deduction is allowed based on the Treasury Regulations used for IRS valuations and IRS Publication 1457. (Remainder interest factors contained in IRS Tables S (one-life) and R(2) (two-life) are used to determine the charity's interest in each dollar contributed to the Fund. (Interpolation is needed to calculate deductions for funds older than 3 years.)

The income beneficiary's age and the highest annual payout rate during the PIF's previous 3 years are the key factors. For "young" PIF's that have not reached their third anniversary and do not have 3 years of investment performance experience, the deemed payout rate will be 1 percentage point less than the highest annual average of monthly midterm rates for the past 3 calendar years (Treas. Reg. §642(c)-6(c)). For PIFs created in 2016, the assumed rate is 1.2%.

The donor's charitable deduction is based on the assumed payout rate. So, the deduction could be considerably larger than if based on the fund's actual rate of return, if the fund earns more than that amount (IRC §642 (c)(5)).

A PIF income beneficiary receives units of participation. In determining the number of units that are allocated to a beneficiary, the value of a unit at the time of the gift must be calculated and that unit value must be divided into the amount of the gift.

Example: A PIF has issued 500 units in prior years and has a value of $140,000. So, a unit has a value of $280. If the donor gives the PIF $20,000, the income beneficiary receives 71.4 units. PIF investment income is divided among beneficiaries according to the number of units they individually own. After the beneficiary's life the amount of principal, reflected by the units the deceased beneficiary owned, is distributed to the PIF charity.

Example: Years later, when the donor dies, the value of the PIF is $840,000 and there are 2,000 units outstanding. Because the value of each unit is $420 and because the donor owned 71.4 units, $29,988 is paid to the charity.

PIF's cannot invest in tax-exempt securities, according to IRS and SEC rules. Only a public charity is permitted to maintain a PIF. Multiple PIFs can be created by a public charity. An independent trustee (like a bank) may also be appointed by the charity to serve as the trustee of the PIF.

PIF Income Tax Characteristics

Notably, the PIF is not a tax-exempt trust and is taxed under ordinary trust rules, except there is no tax on long-term capital gains that are added to principal. If the PIF distributes all its ordinary income, net short-term gains and net realized long-term capital gains allocated to the income beneficiaries, no income tax to the PIF is incurred.

There is also no capital gains tax or net investment income tax triggered when the donor transfers appreciated assets to a PIF. There is also no capital gains tax to the donor if the PIF sells the appreciated assets, so long as it is not subject to any indebtedness. However, there is an exception for property that has been owned by the donor for more than 5 years, and the debt has been on the property for more than 5 years (IRC § 514(c)(2)(B)). In this case, the PIF may receive the property and there will be no acquisition indebtedness for a period of 10 years. Therefore, if the donor passes the "5 and 5" test, then the PIF may receive and sell the property

within the 10 year period, without payment of any unrelated business income tax.

However, the self-dealing rules additionally require that the donor must have owned the property for more than 10 years.

There is one important pitfall here for the PIF to avoid. The PIF may receive the property subject to the debt, but may not assume the debt obligation. The PIF may receive title and make payments on the debt to defend its position and title, but it may not contractually obligate itself with the lender to pay the indebtedness secured by the mortgage.

Unique Planning Opportunities with the PIF

- Receive payments with the potential to increase with inflation, including net realized short-term gains
- Transfer qualified debt-encumbered assets to the trust
- UBTI subject to trust tax rates—not CRT 100% rate
- Involve multiple family members as concurrent or consecutive future income beneficiaries
- No minimum or maximum payout rate
- No 10% minimum charitable remainder interest requirement
- Enjoy lifetime income that may be taxed at favorable long-term capital gains tax rates (see the "Total Return" PIF section below)
- Receive deductions significantly higher than a comparable CRT and GA

The Total Return PIF

In December 2003 Treasury Regulations were adopted that went into effect in January 2004 (Treas. Reg. §1.643(b)-1). The regulations allow an allocation of a portion of long-term capital gains to PIF trust accounting income (TAI), which is the amount distributed to income beneficiaries, as permitted under the Revised Uniform Principal and Income Act ("RUPIA").

Capital gains can be distributed under the RUPIA either by defining TAI as a unitrust amount or by granting the trustee a "power to adjust" TAI by adding some long-term capital gains. However, the treasury regulations referred to above clearly state that a PIF cannot define trust accounting income as a unitrust amount without losing the charitable deduction for long-term capital gains permanently set aside for principal. But the regulations also state that the capital gains deduction will be disallowed "To the extent that the trustee distributes proceeds from the sale...of the fund's assets" as TAI (Reg. §1.643(c)-2(c)).

Nevertheless, it should be possible for a PIF trustee with a Power to Adjust that is valid under state law, to invest for total return, allocate a portion of net realized long-term capital gain to TAI, and still take a charitable set-aside deduction for long-term capital gains that are not paid out, but instead permanently allocated to principal.

The key sections of the National Community Foundation PIF trust documents, that are intended to allow the PIF to function as a Total Return PIF, are those sections governing the trustee's power to allocate trust receipts and disbursements between the principal and income accounts of the trust. The following principles guide National Community Foundation's PIF trust language in these sections:

- The trustee is to be given the power to exercise the Power to Adjust between principal and TAI, to the maximum extent allowed under Delaware law, without regard to the fact that National Community Foundation is both the trustee and remainder beneficiary of the trust
- Realized capital losses must be netted against realized capital gains
- When exercising its power to allocate capital appreciation to TAI, only realized net capital gain may be allocated to TAI
- Pre-contribution gain may never be allocated to TAI
- Once realized capital gain has been allocated to the principal account, it may not be reallocated to TAI

The above information is designed to help Donors work through their own maze of creating their charitable gift. However, the National Community Foundation does not render tax or legal advice, and no Donor should proceed with making a charitable gift of this nature without relying on the advice of legal and tax counsel.

Funny Money Radio
The POWER of the 664 TRUST

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