

**CHARITABLE GIFT ANNUITIES:  
BEYOND THE BASICS**

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## LIFE INCOME GIFT BASICS

In the simplest terms, a “life income gift” is a plan that allows a donor to make a contribution to charity and receive an income in return. Depending upon the plan, the income may be fixed or variable and it can go on for one or more lifetimes, a term of years, or a combination of the two. While there are a number of different types of life income gift plans, they have the following features in common:

- are irrevocable once the contribution has been made
- provide a current income tax deduction for the calculated value of the charitable gift
- can be made during lifetime or included in a Will or other testamentary instrument
- subject to both Federal and state laws

Life income gifts offer distinct advantages—and disadvantages—for both the donor and the charity:

- **For the donor** – the ability to receive income, avoid capital gains tax, and shift investment strategies are advantages. However, donors must also consider that these gifts are irrevocable and there is very little flexibility should the donor wish to make changes after the gift is made
- **For the charity** – the irrevocability of these gifts is an advantage compared to other planned gifts which can be changed or even revoked without the charity being aware. However, the charity must consider that it will need to establish relationships—sometimes lifelong—with the donor and beneficiary and take responsibility for fiscal and fiduciary matters

### Types of Life Income Gifts

#### Charitable gift annuity

- Money, property, or other assets are irrevocably given to a charity now in exchange for a contractual promise to pay a fixed amount each year to one or two beneficiaries
- The amount of payment is set at the time the gift is made and cannot be changed
- One or two annuitants are named at the time the gift is made and cannot be changed
- The date of the first annuity payment may be delayed (deferred payment gift annuity)
- Payments are backed by the charitable organization that issues the gift annuity

#### Charitable remainder trust

- Money, property, or other assets are irrevocably transferred to a trustee with instructions to pay income to one or more income beneficiaries for a period of time and then to transfer the funds remaining in the trust to charity
- Two types:

- **Annuity trust** – pays a fixed dollar amount to the income beneficiaries
- **Unitrust** – pays a fixed percentage of the value of the trust, as re-determined annually, to the income beneficiaries
- Trustee may be the charity, a trust company, an individual, or others
- Payout method (annuity or percent of trust value), rate or amount of payout, income beneficiary(ies), and other terms of trust are set at the time the gift is made and cannot be changed

### **By the Numbers**

Since a life income gift donor contributes only a partial interest (the donor retains the right to income), the income tax charitable deduction is less than the fair market value of the property or money contributed. Following is a brief overview of the calculation of the deductible amount:

- In general, the charitable deduction is for the estimated value of the contribution to the charity—the value of the money or property contributed, minus the value of the right of the income beneficiary to receive income
- Formulae, factors, and other variables are specified by U.S. Treasury Regulations
- Charitable Gift Annuity
  - Begin with the amount of cash or the fair market value of property or other assets contributed
  - Then subtract the present value of the lifetime annuity (which represents the value retained by the donor)
  - The result is the amount of the charitable deduction
- Charitable Remainder Trust or Pooled Income Fund
  - Begin with the amount of cash or the fair market value of property or other assets contributed
  - Then subtract the present value of the income expected to be paid to the beneficiaries (which is the value retained by the donor)
  - The result is the amount of the charitable deduction
- General rules of thumb:
  - **Older beneficiaries, lower payouts = larger deduction** – the older the beneficiary and/or the lower the payout, the larger the deduction because the charity can be expected to pay less to the income beneficiary thus leaving more for charity
  - **Younger beneficiaries, higher payouts = smaller deduction** – the younger the beneficiary and/or the higher the payout, the smaller the deduction because the charity can be expected to pay more to the income beneficiary. It is also true that more beneficiaries leads to a smaller deduction.

## CHARITABLE GIFT ANNUITY BASICS

A charitable gift annuity is a contractual promise issued by the charity to pay a fixed dollar amount annually for the lifetime of one or two individuals. The contract is issued in exchange for a contribution. Gift annuity contracts are fully backed by the financial assets of the charity that issues the annuity.

### Annuity Payments and Amount

Payments to the income beneficiary (annuitant) must be at least annual but can be more often. Quarterly is a common payment schedule. Payments can start now or at some fixed date in the future (a “deferred payment gift annuity”).

The amount of the annuity is fixed at the time the gift is made and cannot be changed. Although the amount can be negotiated between the charity and the donor, in most cases the amount is set by referring to the rates suggested by the American Council on Gift Annuities (ACGA). For example, following are the ACGA suggested (as of March 2016) maximum rates for a single-life gift annuity for various ages:

Age	Rate
5-10	2.0
11-15	2.1
16-19	2.2
20-23	2.3
24-26	2.4
27-29	2.5
30-32	2.6
33-34	2.7
35-36	2.8
37-38	2.9
39-40	3.0
41-42	3.1
43	3.2
44-45	3.3
46	3.4
47	3.5
48-49	3.6

Age	Rate
50	3.7
51-52	3.8
53-54	3.9
55	4.0
56-57	4.1
58	4.2
59	4.3
60-61	4.4
62-63	4.5
64	4.6
65	4.7
66-67	4.8
68	4.9
69	5.0
70	5.1
71	5.3
72	5.4

Age	Rate
73	5.5
74	5.7
75	5.8
76	6.0
77	6.2
78	6.4
79	6.6
80	6.8
81	7.0
82	7.2
83	7.4
84	7.6
85	7.8
86	8.0
87	8.2
88	8.4
89	8.7
90+	9.0

Current suggested gift annuity rates for both single and two-life gift annuities are available at the American Council on Gift Annuities Web site: <http://acga-web.org>

### **Annuitants (Beneficiaries)**

There can be no more than two beneficiaries of a charitable gift annuity contract, and they both must be named at the time the gift annuity is issued.

### **Taxation of Annuity Payments**

The payment to the beneficiary of a gift annuity is taxed as follows:

- **Part tax-free** – a portion of each payment is deemed to be due to the donor’s “investment in the contract,” and return of that which already belongs to the donor which is therefore tax-free
- **Part taxed as capital gain income** – if long term capital gain property was contributed and the donor is the annuitant (which is usually the case), then the portion of the payment deemed to be “investment in the contract” that is attributable to the capital gain will be taxed as capital gain income. (If the donor is not the annuitant, then the donor must report all of this capital gain in the year of the gift and the tax-free portion of the annuity payments becomes greater.)
- **Ordinary income** – the remainder of the payment is taxed as ordinary income

Payments after the end of the donor’s actuarial life expectancy are taxed entirely as ordinary income because the donor is assumed to have recovered his or her entire “investment in the contract.”

### **State Regulation**

Charitable gift annuities are subject to regulation under state law. Many states exempt charitable gift annuities from regulation, while others require registration of the gift annuity and some require annual reporting. Some states regulate only the charities in the state, other states take the position that out-of-state charities must comply with state regulations if a state resident makes a gift in exchange for a gift annuity. The American Council on Gift Annuities is a good resource for current state regulations. Charitable organizations should consult their own advisors before issuing gift annuities, especially if donors reside out of state.

Note that certain states require the organization to file copies of their prototype agreement forms as part of the registration process to issue charitable gift annuities. As of February 2015, the following states require prototype agreements to be filed: Alabama, Arkansas, California, Maryland, New Jersey, New York, North Dakota, Tennessee, and Washington.

### **Required Disclosure**

The Philanthropy Protection Act (1995) exempts most life income gifts from securities registration requirements provided that (among other things) full and complete disclosure is made to prospective donors prior to the making of a gift.

### STANDARD CHARITABLE GIFT ANNUITY

The standard charitable gift annuity provides a fixed amount annuity for the lifetime of one or two annuitants with the payments beginning within one year of the date of the contribution. The date of the first payment must be fixed at the time the annuity contract is issued and cannot be changed.

Assume a donor, age 72, wishes to make a contribution of \$25,000 in exchange for a charitable gift annuity, naming herself as the annuitant. Following are the results for a contribution of cash:

**Example: Charitable Gift Annuity Funded with Cash**

**Assumptions:**

Annuitant Age	72
Cash Donated	\$25,000
Annuity Rate	5.4%
Payment Schedule	quarterly

**Charitable Deduction (CMFR = 2.2%)** **\$10,378**

<b>Annuity</b>	<b>\$1,350</b>
Tax-free Portion	\$1,008
Ordinary Income	\$342

After 14.5 years, the entire annuity becomes ordinary income.

Now assume the donor funds the gift annuity with appreciated securities now worth \$25,000 for which she paid \$5,000 a number of years ago. Note that the only difference is in the taxation of the annuity payments.

**Example: Charitable Gift Annuity Funded with Appreciated Property**

**Assumptions:**

Annuitant Age	72
Principal Donated	\$25,000
Cost Basis	\$5,000
Annuity Rate	5.4%
Payment Schedule	quarterly

**Charitable Deduction (CMFR = 2.2%)** **\$10,378**

<b>Annuity</b>	<b>\$1,350</b>
Tax-free Portion	\$202
Capital Gain Income	\$807
Ordinary Income	\$341

Total reportable capital gain of \$11,698 must be reported over 14.5 years, the expected lifetime of the donor age 72.

After 14.5 years, the entire annuity becomes ordinary income

### DEFERRED PAYMENT CHARITABLE GIFT ANNUITY

The deferred payment gift annuity is a variation on the charitable gift annuity in which the date of the first annuity payment is delayed until one or more years after the date of the gift. The date of the first payment must be fixed at the time the annuity contract is issued and cannot be changed. Other than the deferred first payment date, the deferred payment gift annuity agreement is similar to the regular charitable gift annuity. Since the first annuity payment is deferred, usually for several years, the charity can agree to a higher annuity amount than a regular immediate payment annuity.

**Example: Deferred Payment Charitable Gift Annuity Funded with Cash**

**Assumptions:**

Annuitant Age at Date of Gift	50
Age at Date of First Payment	65
Cash Donated	\$25,000
Annuity Rate	7.6%
Payment Schedule	quarterly
<b>Charitable Deduction</b> (CMFR = 2.2%)	<b>\$7,993</b>
<b>Annuity</b>	<b>\$1,900</b>
Tax-free Portion	\$855
Ordinary Income	\$1,045

After 19.9 years, the entire annuity becomes ordinary income.

### COMMUTED PAYMENT CHARITABLE GIFT ANNUITY

**NOTE: Beware of State Notification Requirements**

California and certain other states require the charity to file copies of their gift annuity agreement forms as part of the registration process to issue charitable gift annuities. The commuted payment gift annuity requires special additional provisions in the gift annuity agreement. If your organization is registered in California or one or more of the other states that require the filing of prototype agreements, then you may need to file updated prototype agreements before you solicit commuted payment gift annuities.

The commuted payment charitable gift annuity is a modified deferred payment charitable gift annuity. Like a deferred payment charitable gift annuity, in exchange for an irrevocable gift of cash, securities, or other assets, the charity agrees to pay one or two annuitants a fixed sum each year for life, with payments starting at least one year after the gift. However, the commuted payment charitable gift annuity contract includes language that gives the annuitant the option to

commute the lifetime of payments into a fixed number of payments of equivalent value. The annuitant has the right to commute the payments immediately or at any time prior to the date of first payment.

The commuted payment charitable gift annuity agreement must include specific language providing for the commutation of payments. Following is an example:

**Irrevocability; Non-assignability**

This annuity is irrevocable and non-assignable except under the following circumstances:

- a. It may be assigned to [name of charity].
- b. At any time between [first possible date to commute payments] and [last possible date to commute payments] the Annuitant may assign the annuity to [name of charity] in return for [monthly, quarterly, semi-annual, annual] installments to be paid at the end of each installment interval commencing on [date of first payment] and continuing for a period of not less than [fewest # of years over which payments may be commuted] years nor more than [greatest # of years over which payments may be commuted] years. The amount of each installment shall be such that the present value of the installments for the period of years selected shall equal the present value of the life annuity if the assignment had not been made, based, in both cases, on the starting date of the annuity payments or installments and on the charitable midterm federal rate and mortality tables in effect at the time of the assignment.

The commuted payment charitable gift annuity is sometimes promoted as a “tuition assistance plan,” where the annuitant is typically the donor’s child or grandchild, who is expected – but not required – to use the commuted payments to pay tuition with the annuity commuted to four or five years of payments. The donor receives an income tax deduction in the year in which the contribution is made and secures fixed number of payments to the child or grandchild in the future.

In most cases, part of each payment is tax-free, increasing each payment’s after-tax value. If the donor gives appreciated property, the donor will need to report only a portion of his capital gain, but if the donor is not the primary annuitant, she or he will need to report this capital gain in the year of the contribution.

**Example: Commuted Payment Charitable Gift Annuity Funded with Cash**

A donor, age 72, contributes \$100,000 cash for a deferred payment charitable gift annuity with payments commencing five years after the date of the contribution. The gift annuity agreement reserves the right to commute payments. Prior to the date the first annuity payment is made, the donor elects to commute the payments to four equal annual payments.

	Deferred Payment	Commuted Payments
Charitable Deduction	\$53,817	\$53,817
Annual annuity	\$7,200	13,514
Tax free portion	\$4,313	\$11,546
Ordinary income	\$2,887	\$1,968
Number of payments	Lifetime (Lx = 10.7)	4 years



## FLEXIBLE CHARITABLE GIFT ANNUITY

### **NOTE: Beware of State Notification Requirements**

California and certain other states require the charity to file copies of their gift annuity agreement forms as part of the registration process to issue charitable gift annuities. The flexible charitable gift annuity requires special additional provisions in the gift annuity agreement. If your organization is registered in California or one or more of the other states that require the filing of prototype agreements, then you may need to file updated prototype agreements before you solicit flexible charitable gift annuities.

A flexible charitable gift annuity is a modified deferred payment charitable gift annuity that allows the annuitant to select the start date for the annuity payments from a predetermined range of dates. The flexibility to choose when payments start can be appealing to annuitants who, at the time of the gift, are not certain when they want to start receiving income.

Like a deferred payment charitable gift annuity, in exchange for an irrevocable gift of cash, securities, or other assets, the charity agrees to pay one or two annuitants a fixed sum each year for life, with payments starting at least one year after the gift. However, in the case of the flexible charitable gift annuity the annuitants may elect to start receiving payments on any one of a range of dates in the future. Possible dates and their corresponding payment amounts must be listed in the agreement.

The flexible charitable gift annuity agreement must include specific language providing for the selection of the payment date. Following is an example:

#### **Payment of Annuity**

In consideration of the property transferred by the Donor, [name of charity] shall pay to the Donor an annual annuity continuing for the rest of [his/her] life, the amount of which shall be based on the year in which payments commence, as determined under the table contained in Schedule B attached hereto. The annuity shall be paid in [monthly, quarterly, semi-annual, annual] installments at the [end/beginning] of each period. If the Donor dies before the commencement date of payments hereunder, [name of charity] is released from all obligations under this Agreement.

#### **Election of Commencement Date**

To elect irrevocably the commencement date of payments hereunder, which shall be the [day] day of [month] and which shall not be earlier than [first possible commencement date] nor later than [last possible commencement date], the Donor during [his/her] life shall deliver written notice to [name of charity] no later than ninety (90) days prior to the desired commencement date. If no election is made, annuity payments will commence on [last possible commencement date].

The longer the annuitants elect to defer payments, the greater the fixed annuity the charity can agree to pay. As is the case with any charitable gift annuity, the donor receives an income tax deduction for the difference between the amount transferred and the value of the annuity. The deduction the donor receives is the same, regardless of when the annuitants elect to start receiving payments. In general, however, the sooner the earliest elective payment start date, the lower the deduction. For example, the deduction for a flexible gift annuity whose earliest elective payment

start date is in 2016 will tend to be lower than the deduction for a flexible gift annuity whose earliest elective payment start date is in 2026.

Note: The elective payment schedule of a flexible gift annuity, although not described in the internal revenue code, was approved by the IRS in Private Letter Ruling 9743054. While a Private Letter Ruling can be relied upon only by the taxpayer who requests it and cannot be cited as precedent by other taxpayers, many practitioners are comfortable enough with this positive ruling and its logic to recommend the flexible charitable gift annuity to prospects. Like all planned gifts, each donor of a flexible gift annuity should seek his or her legal counsel.

**Example: Flexible Payment Charitable Gift Annuity Funded with Cash**

A donor, age 72, contributes \$100,000 in cash for a deferred payment charitable gift annuity with the first payment at least one but not more than twenty years after the date of the contribution.

The donor receives an income tax deduction of \$45,238.

Depending upon the year in which the annuitant elects to begin annuity payments, the annuity amount will be as follows:

2017	\$5,600	2022	\$7,700	2027	\$10,400	2032	\$13,900
2018	\$6,000	2023	\$8,200	2028	\$11,100	2033	\$14,900
2019	\$6,300	2024	\$8,700	2029	\$11,700	2034	\$15,900
2020	\$6,800	2025	\$9,300	2030	\$12,400	2035	\$16,400
2021	\$7,200	2026	\$9,800	2031	\$13,100	2036	\$16,900

(Text adapted from the book *Planned Giving in a Nutshell* and used with permission of the author.)