The 23rd Annual

Planned Giving CONFERENCE

presented by the **Northern California Planned Giving Council**

in association with Colonial Consulting, LLC

FUNDAMENTALS TRACK

Session 2: 11:00 am – 12:15 pm

Topic:

An Introduction to Charitable Life Income Plans

Presented by:

Philip J. Murphy

Workshop Summary:

We will review the dynamics common to charitable remainder trusts and charitable gift annuities and look at the similarities and differences between them. With a common understanding of the basics, we will then look at case studies. There will be guided discussions by participants of the use of gift annuities and charitable trusts to meet donor goals. Participants should leave with an increased ability (1) to explain the fundamentals of gift annuities and charitable remainder trusts and (2) to identify opportunities for their donors to help good causes while meeting important family and financial goals.

Workshop Presenter

Philip J. Murphy is an independent planned giving Bay Area based nonprofit organizations for more than thirty years. He is past-president of the Northern California Planned Giving Council. His current clients include educational, arts, environmental, social service, and medical organizations. He began his consulting practice in 1979 with an emphasis in planned giving in which he now specializes. In 2004, he was the first recipient of the Northern California Planned Giving Council's Hoffmire Award for outstanding service in the field of planned giving.

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Northern California Planned Giving Council
Annual Conference Basics Track
April 29, 2015

Understanding Life Income Plans:

The Basics of Charitable Remainder Trusts and Charitable Gift Annuities

I. Charitable Remainder Trusts: Their underlying dynamics

II. A few case studies

III. Charitable Gift Annuity basics

IV. Charitable Gift Annuity resources

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I. CHARITABLE REMAINDER TRUSTS

What the Donor Does:

1. Places an asset (cash, stock, real estate, rental property) **irrevocably** into a charitable trust.

2. Retains a lifetime right to the income the asset produces.

How the Donor Benefits:

1. Receives lifetime income.

2. Gets an immediate income tax deduction.

3. Bypasses capital gains tax on sale of appreciated property.

4. Avoids estate tax.

5. Protects principal and controls income flow.

6. Gains diversity.

7. Provides for a good cause.

How Good Causes Benefit:

1. Receives whatever remains in the trust.

How to Establish a Charitable Remainder Trust:

1. Review your projected tax benefits and income flow.

2. Ask lots of questions to make sure your trust fits your particular needs.

3. Consult your own legal counsel and financial advisers.

VARIATIONS ON A CRT THEME

1. Term-of-years unitrust
Trust lasts for a specified term, not to exceed 20 years, instead of for lives of income beneficiaries.

2. Unitrust plus term-of-years
Trust lasts for the life of the income beneficiaries, and then continues for a term-of-years, not to exceed twenty, for their children

3. Unitrust with a lump sum paid up front
Donor contributes a percentage of an asset, usually real estate. When the real estate is sold, trust gets its percentage in cash, donor gets the rest.

4. Dual Unitrusts
Asset is contributed partly to one trust to benefit the donors, and partly to another trust to benefit their heirs.

5. Testamentary unitrust
Charitable trust goes into effect on death of donor with heir(s) aimed as income beneficiary(ies). This results in an estate tax deduction.

6. Charitable trust and insurance trust
Some of the tax and income benefits from a charitable trust are used by the donor to fund an irrevocable insurance trust benefiting his or her heirs.

7. Pooled Income Fund
A nonprofit organization sets up its own trust for donors who wish to gain the tax and income benefits of a charitable trust but whose gift ($5,000 to $100,000) is not large enough (in their view) to justify the costs of setting up an individual charitable trust.

8. Charitable Annuity Trust
Pays a predetermined fixed amount to the income beneficiary rather than variable income.

9. Charitable Gift Annuity (Requires licensing by state)
Not a trust. A contract between the charity and the donor. Donor makes a gift. Charity pays a fixed amount for life.

II. A FEW CASE STUDIES

1. **Case of the "Pile of Sand"**

A woman, age 74, had purchased a lot at Stinson Beach for $15,000 twenty years ago. She did so simply to protect her view, not as an investment. Her friends thought at the time she was extravagant to have paid $15,000 for "a pile of sand" subject to property tax and other fees. The property was now worth almost 18 times the original purchase price. She had moved from Stinson Beach and wanted to sell the lot, but was not enthusiastic about paying the large capital gains tax due. She spoke with her children, and none of them was interested in the property. She also was finding property taxes and other fees on the lot an irritant. She wanted to have a lump sum to distribute to her children and a supplement to her income as a result of the sale.

Her solution: Unitrust and Sale: 70% to unitrust and 30% kept. Value of lot: $265,000

Benefits:

- Cash to her of $80,000
- Unitrust amount $185,000 bypasses gain
- Unitrust deduction $95,000 (used to offset $75,500 gain built into $80,000 received)
- Income to her from $185,000 unitrust
- Unitrust principal avoids estate tax
- Support an organization she loves

2. **Case of the Dual Trusts**

Several years ago, a couple, now in their late sixties, moved from their house in Tiburon, purchased years before for $250,000, to Sonoma. Because they thought they might eventually move back to Tiburon, they rented their former residence. They now realized that Sonoma was their permanent home and they had no intention moving back to Tiburon. They were also tired of being landlords. They wanted to sell, but were told the home would sell for at least $1,500,000 and they would be faced with a large capital gains tax. They had a daughter, age 37, whom they also wanted to benefit from the sale. They explored the use of insurance to provide a future inheritance for their daughter but wanted to provide her with more immediate benefits.

Their solution: Two Separate Unitrusts

Benefits:

- Immediate income to daughter from her trust
- Income to parents from their trust
- Tax deductions to parents from both trusts
- Capital gain bypassed when home sold
- Principal from both trusts escape estate tax
- Supports a cause they love
- (Parents must report gift to daughter for present value of her projected income flow.)

3. **Case of the Oil and Water Mix**

A man and wife in their early eighties had no further use for a vacation home. If they sold it on their own they would be hit with a harsh capital gains tax. They also wanted dependable unvarying income after the property was sold. They placed the real estate in an <u>annuity trust</u>. This is a blunt, inflexible planned giving instrument. The trustee must come up with income, no matter what, at the agreed upon amount. They also wanted monthly income to begin immediately after the trust was established and the vacation home contributed to it. Question: Where was the money to come from while the property sat unsold on the market? Solution: The donors contributed $30,000 in cash at the same time the real estate was contributed, giving the trustee the cash needed to make the required annuity payments. Fortunately the property sold quickly and for a good price. If the property had not sold and the trust ran through the $30,000, everyone would have been very unhappy.

Benefits:

- Fixed income to husband and wife for life
- Tax deduction from annuity trust
- Capital gain bypassed when home sold
- Principal from trust escapes estate tax
- Supports a cause they care for
- (Trustee suffers anxiety fits until property is sold)

4. **Case of the Retiring Angioplasty**

A successful banker, now in his mid-fifties, had suffered a heart attack five years ago. He had undergone a successful angioplasty. He now wanted to take early retirement and cash in some $500,000 of highly appreciated stock and reinvest for income. Though he wanted to avoid capital gains tax on his stock, he also wanted to provide an inheritance for his three children. His total estate was currently worth more than $2 million.

His solution: Unitrust with Wealth Replacement Trust

Benefits:

- Unitrust amount $500,000 bypasses gain
- Unitrust deduction
- Income for life to husband and wife
- Unitrust principal avoids estate tax
- Supports the American Heart Association.
- Tax deduction and increased income allow purchase of insurance policy to restore inheritance to children.

Four keys to success of this strategy:

- Donor insurable at reasonable cost
- High capital gain bypassed
- Vulnerable to estate tax
- Higher income from trust than before

5. **Case of the Shrewd CPA**

A couple, unaccountably, got tired of being landlords in Berkeley. Determined to sell their five unit apartment building, they were appalled at the large capital gain they would face. They liked the bypass of capital gain allowed by a charitable trust, plus they were devoted to an East Bay charity. But what about their three adult children?

Their solution: Charitable trust with term of years added for children

Benefits:

- Income to parents for life from $450,000
- Immediate tax deductions to parents
- Capital gain bypassed when apartment sold
- Trust continues to pay children for a term of ten years upon death of surviving spouse
- Supports a cause they love

(Trust amount not fully deductible for estate tax purposes because of 10 year benefit to children, but a substantial deduction will be allowed.)

6. **Case of the Charitable Contract**

A woman, age 85, had $50,000 of highly appreciated stock. She wanted to benefit a Hospital that served her, but needed additional income. An individual charitable remainder trust might have worked, but she did not think the trouble and expense of setting up and managing an individual charitable trust was worth it for this amount.

Her solution: A charitable gift annuity

Benefits:

- Guaranteed fixed income for life
- Tax deduction from gift annuity
- Simply and swiftly done (full consultation with her attorney, however)
- Some tax-free income
- Income larger than from trust because keyed to age (the older you are, the higher your annuity)
- Supports a cause she cares for

III. CHARITABLE GIFT ANNUITY BASICS

Gift annuities are **contracts** between donors and charity:

1. The donor makes an irrevocable transfer to a charity

2. The charity must pay the donor a fixed annual amount for life

3. The donor receives a charitable income tax deduction

4. The donor may avoid some capital gain and defer some capital gain

5. The payment from the charity is guaranteed by the issuing charity

6. The payment is partially tax-free over the annuitant's life expectancy

7. Payments may be monthly, quarterly, semiannual or annual

8. Gift annuity contracts may be on a maximum of two lives

9. Donors can choose to have their payments deferred into the future

10. Charities usually follow the annuity rates recommended by the American Council on Gift Annuities.

11. Here is an example of a typical gift annuity promotion:

Helping our good cause
with a gift that pays *you*!

A charitable gift annuity provides you with:

- Guaranteed fixed payments for life
- An immediate income tax deduction
- Partially tax-free payments and capital gains bypass
- The satisfaction of making a gift to our cause

An Example: Mary, age 75, funds a $25,000 charitable gift annuity contract to benefit our good cause. Mary's annuity payment is 5.8% of her gift, giving her an annual guaranteed payment for life of $1,450. $1,124 of her payment is tax-free for eleven years. She also receives an immediate income tax deduction of $11,065.

A gift annuity is simple to create. You must be at least 60 when the payments begin and your annuity must be created with an amount of at least $25,000. Payment rates depend on the age of the annuitants.

One-Life	Rate	Two-Life	Rate
60	4.4%	60/66	4.0%
65	4.7%	65/68	4.3%
70	5.1%	70/74	4.7%
75	5.8%	75/78	5.2%
80	6.8%	80/84	6.0%

To find out your tax and payment benefits, contact (name, phone number and e-mail) for a confidential gift annuity analysis with no obligation.

Sample Gift Annuity Cover Letter
(for donor looking for general information)

Date

Name
Address
City, State, Zip

Dear ,

I am pleased to send you information on charitable gift annuities.

The gift annuity program is managed by (our charity or name of nonprofit entity managing the annuity for the benefit of our charity). A charitable gift annuity allows donors to receive an immediate income tax deduction, fixed payments for life, and the satisfaction of making a future gift to our organization. If you have any questions about gift annuities, please call me at (phone number). I will be happy to answer any questions you may have about the nature of annuities. I can also provide you with an estimate of the amount of your annuity payments, the percentage of the payment that will be tax-free, and the charitable deduction you will receive from your gift.

Our charity appreciates your considering a contribution to our cause through a gift annuity.

THE CHARITY'S GIFT ANNUITY PROGRAM
A Summary

Here are some highlights of Our Gift Annuity Program:

1. A gift annuity is a contract whereby a donor transfers cash or securities to (our charity or name of nonprofit entity managing the annuity for the benefit of our charity). The contract requires the charity to pay the donor lifetime annual income of a fixed amount.

2. The payment to the donor is determined by the age of the life income beneficiary. Our annuity program follows the rates recommended by the American Council on Gift Annuities. Payments remained fixed. For an estimate of your annuity payment, call ….

3. One or two persons can be designated to receive the annuity payments. In the case of two-life agreements, payments are made either to one for life and then to the survivor, or made jointly to both and then to the survivor.

4. Gift annuity contracts provide a charitable deduction for those who itemize for that part of the annuity that is considered a gift. If the deduction is not used fully in the year of the gift, it may be carried over up to five additional years.

5. Part of your annuity payment will be tax-free. If you live beyond your life-expectancy, however, the entire payment becomes taxable as ordinary income. .

6. The Gift Annuity Fund is a segregated fund which is conservatively and prudently invested under the auspices of the (name of contracting organization).

7. There is no direct fee levied against the donor. A modest administrative fee is charged each year against the total assets in the gift Annuity Fund.

8. The minimum Gift Annuity is ($ amount).

9. A Deferred Payment Gift Annuity allows the donor to make a gift now, enjoy a deduction, and delay income. This annuity provides annual income beginning at a pre-determined date in the future.

10. To find out your estimated annuity amount, your charitable tax deduction, the percentage of your annuity payment that would be tax-free and the answers to other questions you might have about charitable gift annuities, call ….

March 15, 2010

Mary Edwards
123 Main Street
Little Place, CA

Dear Mrs. Edwards,

I appreciate your interest in making a gift to Our Organization through our annuity program. This annuity is an agreement between you and Our Organization. In exchange for your value of $10,000, you will receive fixed payments of 6.3% Fixed quarterly payments of $157.50 will be sent to you for your lifetime. Your yearly annuity is $630. $450.45 of this annual amount is tax free until the year 2021. You also will receive an income tax deduction of $4,416.

Depending upon your tax bracket, this deduction could reduce your income taxes. Our Organization and I strongly encourage you to talk with your own tax advisor about your actual tax savings.

Again, these numbers assume a March 31, 2010 gift date and may be somewhat different if the gift is made later. This letter and the accompanying materials are for educational purposes only and are not meant as financial or legal advice. Our Organization and I encourage you to seek independent counsel in this matter and to examine the enclosed disclosure statement about the investment of your gift annuity funds.

I enclose an application for a Charitable Gift Annuity Agreement. Please complete the application. Once you are ready to make your gift, please sign and date the application and return it to Our Organization using the enclosed envelop along with a check, payable to Our Organization. If you would like your annuity payments directly deposited, please fill out the enclosed Authorization Agreement for Direct Deposits form.

Please sign the two tax forms (IRS form W-4P and California form DE-4P) which allows you to elect **not** to have tax withheld from your annuity payments.

Upon receipt of your application, Our Organization will provide you with an Annuity

Contract to sign. Our Organization will also provide you with a revised calculation of your financial benefits. This calculation will reflect the actual numbers rather than the estimated amounts on the proposal. Once Our Organization has received the signed contract from you and it is approved, Our Organization will deliver the contract to you.

If you have any questions, please do not hesitate to call me at (number). I would be pleased to meet with personally and review these materials with you if you would find that helpful.

Thank you again for your support of Our Organization.

Sincerely,

Enclosures:

IV.

IV. GIFT ANNUITY RESOURCES

American Council on Gift Annuities
Partnership for Philanthropic Planning
www.acga-web.org
www.pppnet.org
233 McCrea Street, Suite 400
Indianapolis, IN 46225
317-269-6271 acga 317-269-6274 ppp

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