TWELVE WAYS TO CLOSE MORE GIFT ANNUITIES

Northern California Planned Giving Council

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According to the 2013 national survey of gift annuities conducted by the American Council on Gift Annuities ("ACGA"), the average number of new gift annuities issued during the latest fiscal year was 16.4. Some national charities issued several hundred during the year, and many colleges and universities were also above average. On the other hand, there were many charities that issued five or fewer in the course of the year.

Whether you are associated with a charity that consistently does a high volume of gift annuities or with a charity that completes a gift annuity only occasionally, you are likely interested in expanding your program. This paper discusses twelve ways to do that. Obviously, some charities have much greater potential than others, but nearly all charities now issuing gift annuities can grow their program by expanding their market and adapting gift annuities to more donor situations. Also, following the suggestions will enable charities launching a gift annuity program to get off to a faster start.

Note: The results of the most recent survey of gift annuities will be published after this paper was prepared. Although that survey may find that the annual number of gifts annuities has changed somewhat, interest in expanding that number will surely continue.

1. Show Why Gift Annuities Are Appealing Under the Tax Cuts and Jobs Act.

The Tax Cuts and Jobs Act could adversely affect charitable giving for the following reasons:

- Ninety percent or more of taxpayers will realize no federal tax benefits from their charitable gifts because they will take the standard deduction rather than itemizing their deductions.
- Higher-income individuals, who make large charitable gifts, will realize somewhat smaller federal tax savings because tax rates have been lowered.
- Since the federal estate tax exemption is double what it was, some individuals may increase bequests to family members and allocate less to charities.
- Certain large corporations will derive smaller tax savings from charitable gifts because their federal tax rate has been reduced to 21%.
- Owners of qualifying pass-through entities will likewise realize smaller tax savings because the Tax Act allows a 20%-of-income deduction.

While the deduction from contributions for gift annuities will be affected the same way as deductions for outright gifts, it is of less consequence because the deduction is often a minor consideration in the decision to establish a gift annuity. More important are the fixed payments for life, the fact that substantial portion of those payments will be tax-free when cash is contributed, and the ability to report capital gain ratably when the donor is an annuitant. Those benefits remain unaffected.

Suggestions:

- Unless you are quite sure that the donor will itemize deductions and can benefit from the deduction, select the lowest Sec. 7520 rate rather than the highest rate so that more of the payments will be tax-free.

- If an individual is disappointed to learn that a charitable bequest will not result in any tax savings because the federal exemption is larger than the estate value, suggest accelerating the bequest – through an outright gift if income is not needed or through a gift annuity if it is. Then there will be income tax savings even if no estate tax savings.

2. Increase Your Donor Base By Expanding the Age Range of Donors.

According to the national surveys of gift annuities conducted by the ACGA over the past two decades, the average age of annuitants at the time an immediate gift annuity was established has fluctuated between 77 and 79. In most cases, the donor was also an annuitant. Based on surveys as well as conversations with gift planners, charities are marketing immediate gift annuities primarily to individuals over the age of 70. Charities also issue deferred gift annuities, which are marketed to mid-life individuals, but deferred gift annuities constitute less than 10 percent of all annuities. Thus, 90 percent of annuities are established by retired individuals, most of whom are over age 70, who want to augment their own retirement income.

In the United States there are approximately 28 million people over the age of 70. Of course, the number of people over age 70 who have financial capacity and charitable intent is much smaller. Suppose that you also marketed immediate gift annuities to donors age 50-70. There are 74 million of them. They are the Baby Boomers, and there are two and a half times as many of them as there are of people over 70. Think of how much larger your prospect pool would be if you marketed gift annuities to this cohort.

You are probably thinking, “I can’t market immediate gift annuities to people in their 50s because my charity’s minimum age for an immediate gift annuity is 65.” That’s a rather common minimum, though some charities set it at age 60 while others have raised it to age 70. Does marketing immediate gift annuities to younger individuals mean lowering the charity’s minimum age for annuitants? No, that would not be a good idea, and it is not recommended. The recommended strategy for expanding the age range of donors is to market not only to donors who want payments for themselves but also to donors who would consider establishing an annuity for someone else.

Sometimes it makes sense for a donor to establish a gift annuity for another person. This means that younger individuals – for example, those who must help support an aged parent and those who want to assist a friend or provide for a retiring domestic worker – could be prospects. Often, such assistance is paid with after-tax dollars, which can be quite costly for the donor. For example, a couple subject to a 40-percent combined federal and California income tax rate must earn $1,667 in order to provide a $1,000 monthly check to one of their parents. It could be advantageous to transfer capital for a gift annuity and name as the annuitant the person whom the donor desires to help. The donor receives an income tax deduction, and the tax paid by the annuitant will probably be minimal because a large portion of the annuity payments will likely be tax-free for a number of years, and the taxable portion of the payments will be taxed at a low rate.

Example: *Forrest contributes stock having a fair market value of $100,000 and a cost basis of $40,000 for a gift annuity and names his mother as annuitant, reserving no power to revoke her interest. His mother, age 82, will receive $7,200 per year ($1,800 per quarter) based on the ACGA rate of 7.2 percent.*

Forrest, in the example, will recognize the capital gain allocated to the present value of the annuity, which is $27,601. However, his charitable deduction of $53,998 will offset the taxable gain and reduce taxes on other income, assuming he is able to use the deduction over the next six years.

Since Forrest will already have recognized the taxable gain, no part of his mother's payments will consist of capital gain. For the balance of her life expectancy, $5,710 will be tax-free, and only $1,490 will be ordinary income. The payments to her will be taxed the same as they would have been if Forrest had contributed $100,000 cash.

Forrest makes a gift to his mother of $46,002 (the present value of her annuity payments). As a present-interest gift, it qualifies for the gift tax annual exclusion of $15,000. Thus, assuming he makes no other gifts to her in the year he establishes the gift annuity, the taxable gift to his mother is $31,002 ($46,002 – 15,000). He could have avoided making any taxable gift by retaining in the gift annuity agreement the right, during his life or upon his death, to revoke his mother's annuity interest. Then he will make no completed gifts to his mother until she actually receives the annuity payments, and since each year's payments are under $15,000, they will be covered by the gift tax annual exclusion. Even if he did not retain the right to revoke his mother's payments and reported the entire gift, less the annual exclusion, in the year of the gift, he may not owe any gift tax because of his lifetime gift tax exemption. (Calculations are based on the March Sec. 7520 rate of 3.0%)

In some instances, a company or a nonprofit organization might choose to establish an annuity for an employee, perhaps one for whom no adequate retirement plan has been provided. It may be that an individual has been well served for many years by a domestic worker or gardener who is retiring, and who can count on little retirement income beyond Social Security. That individual could establish a gift annuity for the retiring employee and simultaneously make a gift to a favorite charity.

If a person is employed at the time an employer establishes the gift annuity, the employee will be taxed on the present value of the annuity unless the employer has retained the right to revoke the payments, in which case the employee would be fully taxable on each payment, and the employer would be able to deduct the return-of-capital portion of each payment as employee compensation. In the annuitant is a domestic worker who has retired, where no employer-employee relationship exists, the retired worker would not pay income tax on the present value of the annuity. Instead, the donor would make a gift of the present value of the annuity to the former worker. The donor could reduce the amount of the gift by the annual exclusion of $15,000 since it is a present-interest gift, and the balance would be a taxable gift. However, if the donor has not previously used his or her lifetime gift tax exemption, no gift tax would be payable.

The point is that you should not limit your marketing of immediate gift annuities to retired individuals. Market to both older and younger individuals but with different messages. Tell the older group how they can provide personal security for themselves with a gift annuity. Tell the younger group how they can provide for an aged parent or other individual with a gift annuity.

3. Offer a Tax-Free Gift Annuity.

Gift planners regularly show prospective donors how they can increase cash flow with a gift annuity, and they often compare the after-tax income from CDs, money market funds, or bonds with the after-tax amount from gift annuity payments. Sometimes, prospects will have a portfolio of tax-exempt bonds, and when the gift planner mentions that a substantial portion of gift annuity payments will be tax-free for the duration of life expectancy, the prospect replies that 100% of interest from her bonds is tax-free.

Example*: George, age 76, has been regularly contributing $1,500 per year to your charity. During the visit he complains about the low interest he is earning on his CDs and bonds and the 32% federal income tax rate plus the state income tax rate to which the interest is subject. He remarks that he recently had a conversation with his broker, who suggested that he use the $50,000 from a maturing CD to purchase shares in a municipal bond fund. The broker tells him that the fund is currently paying an interest rate of 3%, and it is all tax free. That is much better, he thinks, than 2% from another CD, all of which taxable. You ask George if he would be interested in a plan that would provide larger tax-free payments than he would receive from the municipal bond fund for the rest of his life expectancy, generate a charitable deduction that would reduce tax on other income, increase his annual support to your charity, and assure that contributions in his name would continue indefinitely. He asks you how this can be. This is what you propose*:

He contributes the $50,000 from the maturing CD for a gift annuity.

Annual payments - $3,000 (6% annuity rate)

Payments taxed as follows for duration of life expectancy:
Tax-free $ 2,211
Taxable   789

Charitable deduction $23,909 (based on a 2.8% Sec. 7520 rate)

Your charity will pay him each year the tax-free portion, $2,211

He will authorize your charity to retain the taxable portion, $789, as a charitable gift until such time as he might instruct you to send the entire $3,000 payment to him.

Each year he will receive a Form 1099-R showing taxable income of $789 and a donation receipt for $789

Assuming that George itemizes his deductions, the deduction offsets the taxable income, so he pays zero tax.

<u>Summary of benefits to George</u>

- Tax-free income of $2,211 from the gift annuity exceeds the tax-exempt interest of $1,500 he would receive from the municipal bond fund. It is much larger than the after-tax income he would receive from another CD.

- He receives an income tax charitable deduction of $23,909 that reduces his federal and state income taxes.

- He increases his annual giving from $1,500 to $2,289.

- With the residuum of the gift annuity, he could create an endowment, the income from which will perpetuate his gifts.

- If he outlives his life expectancy, he could instruct the charity to send him the entire $3,000 so that there is money to pay the taxes.

- With a gift annuity, unlike a CD or shares in a municipal bond fund, principal is irrevocably surrendered. However, through the additional income, the income tax savings, and earnings on the tax savings over time, he may recover a substantial portion of his capital.

The key feature of this plan is paying only the tax-free portion of the annuity payments to the donor. It is particularly appealing when the Sec. 7520 rate is low because a lower rate results in a higher share of tax-free income. Obviously, the plan works best when cash is being donated, but many older individuals are holding significant amounts in cash and cash equivalents.

The plan could be marketed as the "tax-free gift annuity." It is a blended gift in that it combines a gift annuity and an outright gift.

4. Use a Gift Annuity to Create a Virtual Endowment.

Some individuals would like to create an endowment now and have the satisfaction of seeing the endowment income put to use, but they hesitate for fear that they might need all of the income from their capital in the future. A charity might suggest to those persons that they establish a virtual endowment with a gift annuity. The following example demonstrates how it would work.

Example: *Lois, age 75, has good cash flow and rather significant investments. At present, her after-tax income exceeds her expenditures, so she is growing her investments. While she expects this to continue, she cannot be absolutely certain. She would very much like to fund scholarships now while she is living. She could, of course, simply retain her assets and make an outright contribution of $20,000 each year for scholarships so long as she is able*

Alternatively, she could contribute $450,000 for a gift annuity, but authorize the university to retain the annuity payments for scholarships until whatever time that she directs the payments to made to her. The payments will be reported on a Form 1099-R as if she were receiving them, and she will receive a charitable deduction for the amount of the payments, for she is, in fact, contributing them. The withholding arrangement merely avoids having to make a decision and write a check each time she receives a payment.

Suppose she contributes stock valued at $450,000 with a cost basis of $300,000.

Amount available for annual scholarships	*$26,100*
Initial charitable deduction	*$215,595*

Taxation of payments

Tax-free	*$12,597.60*
Capital gain	*6,298.80*
Ordinary income	*7,203.60*
Total	*$26,100.00*

(These numbers are based on the March, 2018 Sec. 7520 rate of 3.0%.)

Since the annual deduction exceeds taxable income, she will save some taxes each year. At the end of her life, the residuum from the annuity will be used for an endowed scholarship fund in her name.

This alternative, which could be called a "Virtual Endowment," provides more for scholarships in the near term. In the event that her circumstances ever change, she can suspend the scholarships and receive the $26,100 annuity payment. This is also a blended gift, for it combines a gift annuity with outright gifts.

Note 1: Only $20,000 of the $26,100 might be expended for scholarships, and the balance could be invested in an endowment, which would be augmented by the residuum from the gift annuity. By doing this, the eventual endowment is more likely to be enough to sustain the scholarships.

Note 2: A virtual endowment could be established with a charitable remainder trust as well as a gift annuity.

5. Promote Testamentary As Well As *Inter Vivos* Gift Annuities.

Testamentary gift annuities have tremendous potential but are seldom proposed. By contrast, testamentary charitable remainder trusts and charitable lead trusts are relatively common. A testamentary gift annuity could be preferable to a testamentary charitable remainder trust in these instances:

- The amount of the contribution would be too small for a trust to be practical. Although some charities that serve as trustee have only a $100,000 minimum for a charitable remainder trust, others have increased the minimum to $250,000 or more. If an individual deals directly with a bank trust department, the minimum is likely to be still higher. However, the donor may have in mind a more modest gift.

- The donor wants to provide the security of fixed payments to a survivor, but an annuity trust might not qualify. Moreover, the payments from the gift annuity are quite likely to be taxed more favorably.

- The donor wants simplicity. The gift annuity can be established pursuant to a simple paragraph in the will or living trust.

In the will or living trust, a person would designate a specific sum or all or a portion of the residual estate to fund the gift annuity. The size of the payments will depend on the amount transferred to the charity and the annuity rate then in effect for persons the nearest age(s) of the annuitant(s) as of the time of the donor's death.

Here is possible language that could be used in the case of one annuitant:

> I give, devise, and bequeath ($[*amount*]or "the residue of my estate") to [*Charity*] provided that if [*annuitant*] survives me, [*Charity*] shall pay [*him/her*], in quarterly installments at the end of each calendar quarter, a life annuity, the annual payments of which shall be equal to the value of the property transferred to [*Charity*] multiplied by the charitable gift annuity rate suggested as of the date of my death by the American Council on Gift Annuities for a person then [*his/her*] nearest age.

If a donor wants his or her survivor to receive a specific amount, the following language could be used:

> I give, devise, and bequeath to [Charity] the amount [Charity] requires as a contribution to provide a life annuity of $[Amount] to [annuitant] based on the charitable gift annuity rate suggested as of the date of my death by the American Council on Gift Annuities for a person then [his/her] nearest age, and I direct that the annuity be paid in quarterly installments at the end of each calendar quarter.

(In both cases, the rate could be "the rate then paid by the charity for a person (or persons) of the annuitant's(ts') age(s) at the time of the my death.")

The language could be modified if the testator wants payments to the annuitant to be deferred for a certain number of years following his or her death.

Example: *John wants to provide supplemental income to his sister Joan if she survives him, and he also wants to provide a future gift to a favorite charity. To accomplish both objectives, he provides in his will for a bequest of $200,000 to establish a gift annuity for Joan, the annual payments from which will be $200,000 multiplied by the gift annuity rate then offered by the charity for a person of Joan's age at the time of his death. Joan does survive John and is age 75 at the time of his death. Based on current ACGA rates, she will receive $11,600 for life, and a substantial portion of this amount will be tax-free for her life expectancy, determined at the time. John's estate will be allowed an estate tax charitable deduction for a portion of the $200,000, whereas the entire amount would have been included in his taxable estate if he had bequeathed $200,000 outright to his sister. Whether any estate tax is payable depends on the exemption level at the time and how much of it was used to cover other taxable gifts and bequests.*

One advantage of a testamentary gift annuity is that one is not locking in the current, historically-low gift annuity rates. If they rise in the meantime, the higher rates will apply to the annuity established for a survivor.

This blended gift combines a charitable bequest and a gift annuity.

6. Fund a Gift Annuity With Remaining Retirement Funds.

It is possible to fund a testamentary gift annuity with assets in an IRA or defined-contribution retirement plan such as a 401(k) or 403(b). (See Private Letter Ruling 200230018.) The donor would take two actions. The first is completion of a beneficiary form designating to the charity all or some portion of assets remaining in the retirement plan. Second is execution of a gift annuity agreement according to which the charity agrees to pay a life annuity to one or two named annuitants, which shall be equal to the value of the retirement plan assets transferred to the charity multiplied by the gift annuity rate then paid by the charity for a person (or persons) of the annuitant's(ts') age(s) at the time of the donor's death. (It could also be pegged to the applicable ACGA rate. See above.)

If Congress should ever enact legislation forcing retirement funds of a decedent to be distributed within five years to beneficiaries other than a surviving spouse, a gift annuity might be the only way of stretching out the payments to non-spousal beneficiaries. Even if such legislation is not enacted, a gift annuity is an attractive option for those who want to use retirement funds to provide for survivors for these reasons:

- The donor can assure fixed payments to a survivor for life and make a charitable gift. If the survivor is beneficiary of a retirement plan with payments over life expectancy, the mandatory payments will increase with age, and the fund conceivably could be exhausted. By contrast, the gift annuity payments would continue for life.

- Market risk and management responsibility are eliminated.

This blended gift combines a beneficiary designation with a gift annuity.

7. Propose a Commuted Gift Annuity to Those Who Want Fixed Payments For a Term of Years.

A gift annuity must be initially established for the life of one of two annuitants. According to IRC Sec. 514(c)(5), a gift annuity cannot be for a term of years or guarantee a minimum or maximum number of payments. However, the IRS in certain private letter rulings (e.g. 9042043, 9108021, 9527033, and 200233023) has approved gift annuity agreements that permit an exchange of life payments for a lump sum or for installments to be received during a limited period of time. The actuarial value of the installments must be the same as the actuarial value of the life payments.

In most instances, the commuted payment gift annuity has been used to provide educational expenses for a student attending a college or university, which is why it is often called "the college annuity." A grandparent might establish a gift annuity when a grandchild is young, stipulating that life payments begin when the grandchild reaches 18. Then an authorized person exchanges ("commutes") the life payments for eight semi-annual installments that can be paid at the beginning of each semester the grandchild is in college. The payments could be over a longer period to allow the grandchild more time to complete his or her degree(s). The installments will, of course, be much larger than life payments would have been, and the charity would not have consented to an annuity for a person of such a young age unless the payment period was limited.

The college annuity has the advantage of predictable payments for educational expenses, an income tax charitable deduction for the donor, and, of course, a charitable gift. However, it has these disadvantages:

- Payments will be subject to a 10% penalty tax per IRC Sec., 72(q) because term payments start before age 59½.

- If the annuity is funded with appreciated property, the donor is taxed on part of the capital gain.

A charitable alternative that would avoid these two disadvantages is a term-of-years net-income unitrust that converts or "flips" to a regular unitrust when the student reaches age 18. Prior to the flip date, the trust assets would be invested for growth with the intention of earning just enough income to cover trust administration. Because this alternative is often preferable and because certain non-charitable plans may be a better way to fund a college education, it is probably not a good idea to promote the college annuity.

However, the commuted annuity could be very useful in other circumstances when a person wants income for a certain period of time and it is not practical to establish a term-certain CRT.

The contributed amount might be below the minimum required for a CRT, or perhaps the beneficiary likes the simplicity and assurance of a gift annuity.

Example: *Maria, age 60, plans to start withdrawals from a well-funded retirement plan when she reaches 70, and she expects her income from that plan and other sources to be quite adequate. However, she would like to increase her income somewhat between age 62, when she plans to reduce her working hours, and age 70. She would also like to divest herself of some highly-appreciated stock that she thinks may not perform so well in the future. She purchased the stock for $40,000, and it is now worth $200,000. Maria contributes the stock for a deferred gift annuity with life payments starting at age 62 and then commutes those payments to quarterly installments for an eight-year period beginning at age 62.*

Starting two years from now when she attains age 62, she will receive $19,404 ($4,851 per quarter) for eight years. She will receive an immediate income tax charitable deduction of $67,116, and the taxable gain can be reported ratably over the payment period. From the charity's standpoint, it is much better to be able to use the residuum after only 10 years rather than waiting until the end of a 60-year-old's life. (The calculations assume that the gift was made at the beginning of 2018 and that a Sec. 7520 rate of 2.6% was used.)

8. Market the Flexible Deferred Gift Annuity As a Supplemental Retirement Plan.

Many individuals would like to accumulate more for retirement on a tax-deferred basis, but they don't like the idea of having to choose in advance when payments begin. With a 401(k), 403(b), or an IRA they can start to receive payments any time after 59½ without penalty, but with a regular deferred gift annuity they have to look into a crystal ball and decide their state of health and desire to continue working 15 to 20 years from now. The answer for them could be the flexible deferred annuity.

Most gift planners by now are probably familiar with this variation of a gift annuity. Three Private Letter Ruling pertaining to it have been issued (9743054, 200449033, and 200742010). It appeals to donors because they can decide later when to start payments, knowing that the longer they wait the larger the payments will be.

The flexible deferred gift annuity first made its appearance in 1997, and the number of charities issuing flexible deferred annuities has steadily increased since then. In 1999, 5.0 percent of charities issued them, but 31 percent of charities reported using them in 2013 and the percentage apparently continues to grow.

The price of flexibility is a somewhat smaller charitable deduction because the deduction will be the lowest that would result from any possible start state. This disadvantage is offset by the fact that a smaller deduction results in more of the payments being tax-free.

Example: *David, whose date of birth is November 12, 1967, wanted to supplement his income when he retired, but he did not know when he would be ready to retire. On the first of January of 2018, he contributed stock having a fair market value of $100,000 and a cost basis of $60,000* *for a gift annuity, and he reserved the option to start quarterly payments on March 31 or any year during the period 2028-2038.*

The income tax charitable deduction (the lowest deduction resulting from any of the possible payment start dates) was $30,371. The following table shows taxation of payments for full years during life expectancy.

Elective Start Date	*Age at Start Date*	*Capital Gain*	*Tax-free Portion*	*Ordinary Income*	*Total Annuity*
3/31/2028	*60*	*$1,156,56*	*$1,734.84*	*3,208.60*	*$6,100.00*
3/31/2029	*61*	*$1,199.52*	*$1,799.28*	*$3,301.20*	*$6,300.00*
6/30/2030	*62*	*$1,243.44*	*$1,865.16*	*$3,491.40*	*$6,600.00*
6/30/2031	*63*	*$1,294.72*	*$1,942.08*	*$3,563.20*	*$6,800.00*
6/30/2032	*64*	*$1,344.96*	*$2,017.44*	*$3,837.60*	*$7,200.00*
6/30/2033	*65*	*$1,398.40*	*$2,097.60*	*$4,104.00*	*$7,600.00*
6/30/2034	*66*	*$1,459.20*	*$2,188.80*	*$4,352.00*	*$8,000.00*
6/30/2035	*67*	*$1,520.56*	*$2,280.84*	*$4,498.60*	*$8,300.00*
6/30/2036	*68*	*$1,590.36*	*$2,385.54*	*$4,724.10*	*$8,700.00*
6/30/2037	*69*	*$1,667.04*	*$2,500.56*	*$5,032.40*	*$9,200.00*
6/30/2038	*70*	*$1,749.88*	*$2,624.82*	*$5,325.30*	*$9,700.00*

Super-Flexible Deferred Gift Annuity

The disadvantage for David is that once he makes the election, he must start receiving the entire amount. To maximize flexibility, he could simultaneously establish 10 flexible deferred gift annuities, each funded with $10,000. Then he could elect payments as needed. In the event he becomes disabled or ill, he could elect payments from all 10 annuities at the same time.

Example: *Suppose that David in the previous example created 10 flexible deferred gift annuities, each funded with $10,000, rather than a single flexible deferred gift annuity funded* *with $100,000. At age 64, David decides to reduce his work hours to allow more time for travel. Then, at age 65, he retires but continues to do some consulting. He elects to activate two of the annuities at age 64, three more at age 65 and one each year beginning at age 66. His payments would be:*

Beginning at Age	*Annual Payment*
64	*$1,440*
65	*$3,720*
66	*$4,520*
67	*$5,350*
68	*$6,220*
69	*$7,140*
70	*$8,110*

The 10 flexible deferred gift annuity agreements would be identical, so it would not be much work to produce them, and the donor, to maximize flexibility, would sign his name 10 times. The payments from all of the annuities could be combined into a single check or direct deposit, and the charity could send a single Form 1099-R.

The period over which a person could elect payments may be as long as the donor wishes. The donor could elect a very long period and, if payments are never needed, delay electing them, effectively having an ever-growing bequest.

9. Provide a Step Annuity for Those Concerned About Inflation.

Older individuals who lived through the stock market declines of 1987, 2002, and 2008 appreciate an instrument like the gift annuity that pays a fixed amount for life. However, they have also experienced the high inflation rate of the late 1970s, and they are well aware that fixed payments lose their purchasing power over time. If inflation is 3.5% for the next 10 years, and a person is receiving $5,000 per year, in today's dollars that $5,000 would be worth only $3,545 10 years from now.

The charitable instrument that offers a potential hedge against inflation is the charitable remainder unitrust, but it entails risk. Although unitrusts have done rather well in the last few years, during the first decade of this century payments from many unitrusts decreased.

It is possible to combine the advantages of a gift annuity and a unitrust by designing the annuity so that it has set payments that increase each year by the historical average of the Consumer Price Index. This inflation-adjusted gift annuity is also known as the "step annuity" because payments automatically step up in amount each year. It is actually an immediate gift annuity combined with a bundle of deferred gift annuities.

Example: *Sylvia, age 70, wants her gift annuity payments to increase at a rate of 3.5% per year, which is somewhat more than the average historical inflation rate. The following chart shows how much she would have contributed at the beginning of 2018, if she wants these adjustments annually for 10 years.*

Type of Annuity	*Contribution Amount*	*Payment Beginning Date*	*Payment Increment*	*Total Payment*
Immediate	*$100,000*	*3/31/2018*	*-0-*	*$5,100*
Deferred	*$3,236*	*3/31/2019*	*$185*	*$5,485*
Deferred	*$3,131*	*3/31/2220*	*$192*	*$5,677*
Deferred	*$3,046*	*3/31/2021*	*$199*	*$5,876*
Deferred	*$3,015*	*3/31/2022*	*$206*	*$6,082*
Deferred	*$2,890*	*3/31/2023*	*$213*	*$6,295*
Deferred	*$2,808*	*3/31/2024*	*$220*	*$6,515*
Deferred	*$2,735*	*3/31/2025*	*$228*	*$6,743*
Deferred	*$2,776*	*3/31/2026*	*$236*	*$6,979*

Sylvia's total contribution is $123,637, and her payments will retain their purchasing power for the next eight years (or for whatever period she chose) assuming the future rate of inflation does not exceed 3.5%.)

A charity might hesitate to agree to this plan because the amount contributed for each deferred gift annuity is less than the stated minimum in the Gift Acceptance Policies. However, the charity may be willing to make an exception because the total amount contributed is well above the minimum, the bundled annuities are identical except for the payment beginning date and the annuity amount, and they can be consolidated for the purpose of making payments and tax filing. A single agreement that incorporates the payment adjustments might be possible, but it would be prudent to secure a ruling.

10. Diversify Life Income Plans to Control Risk and Allow for Growth.

Faculty and staff at a college or university, who are covered by TIAA/CREF can choose how much of their funds to allocate to the safe TIAA with its modest interest rates or in one of the CREF alternatives which don't protect principal but offer growth potential. Likewise, investors will generally have a mixture of equities and bonds in their brokerage accounts, and will allocate more to fixed income investments as they age and want to be exposed to less risk.

A similar balance might be considered by a person who is considering a gift through a charitable life income plan. Assuming the gift is of sufficient size, it doesn't have to be all in a charitable remainder unitrust, which offers the potential of increasing payments, or a gift annuity which offers the security of predictable income. The donor could simultaneously establish a charitable remainder unitrust and fund a gift annuity. In some instances, gift planners would be advised to generate a financial illustration that combines these two instruments. This would be another example of a blended gift.

Example: *Sam and Rachel, ages 75 and 74, are considering a $600,000 gift to create an endowment in their names. They need income from all of their assets, but they would like a current deduction. They have read the charity's planned giving literature and have been vacillating between a charitable remainder unitrust and a gift annuity. The planned giving officer asks them if their brokerage account has a balance of stocks and bonds. They reply that it does, whereupon she suggests the same kind of diversification in their charitable giving. Following her recommendation, they decide to divide the stock they had been considering for a gift and contribute one-half of it to the charity for a gift annuity and one half to a charitable remainder unitrust. The stock for each instrument has a fair market value of $300,000 and a cost basis of $200,000.*

From the gift annuity they will receive payments of $15,000, of which for the duration of their life expectancy $7,090 will be tax-free, $3,545 will be capital gain, and $4,365 will be ordinary income. The annuity gift generates a charitable deduction of $121,455.

The unitrust will pay them 5% of trust assets, as revalued each year. Initially, this will be $15,000, but it could be higher or lower in the future. Most likely, the payments will be a combination of capital gain, dividends, and ordinary income. Possibly, there could be some tax-free return of capital, but less than with the gift annuity. The charitable deduction from the unitrust will be 145,557. The calculations for both the unitrust and the gift annuity are based on the March Sec., 7520 rate of 3.0%.

The advantage of the gift annuity: Having a certain level of cash flow for household expenses and the fact that over two-thirds of the payments will be tax-free or capital gain.

The advantage of the unitrust: A larger deduction and payments that may increase. For example, if the unitrust realized constant net return of 7.5%, their payments would be $19,201 after 10 years. Having a base of certain income, they might advise their trustee that they would be willing to have unitrust assets invested somewhat more aggressively.

11. Accept Non Traditional Assets for Gift Annuities.

Some charities will accept only cash and publicly-traded securities for a gift annuity. This is unfortunate, for such a restriction forecloses many gifts from individuals who are unable to give these traditional assets. Even if they were able, they may own other types of property they would prefer to give. If they get the impression from examples in a charity's literature, or learn from explicitly-stated policies, that cash and publicly-traded securities are the only acceptable assets, they may remove the gift annuity from consideration.

Non-traditional assets could be divided into three categories: (1) property that can be readily converted to cash and thus entails minimal risk, (2) property the charity wishes to retain for its tax-exempt purpose, and (3) property that puts the charity at more risk because both the selling price and date are uncertain. Generally, a charity should be willing to accept the first two categories of property, and it should consider accepting the third category of property if risk can be managed.

Property that can be readily converted to cash.

Examples of this type of property are precious metals that are traded on the market, life insurance policies with cash value, and commercial deferred variable annuities.

People invest in gold and silver by purchasing coins (American Eagle, Canadian Maple Leaf, Krugerrand, etc.), purchasing bullion, or purchasing Exchange Traded Funds (ETFs). All of these can be sold for at or near the quoted price, which recently was about $1,300 in the case of gold. In 1999, you could have purchased gold for $279 per ounce, and in 2011 you could have sold it for $1,800 per ounce. People who are holding appreciated gold and silver may be concerned about a price decline, and they would be willing to convert it to a stream of payments without being taxed on the capital gain, which could be at a rate as high as 31.8 percent. (The maximum capital gain rate on tangible personal property is 28 percent, and the healthcare surtax of 3.8% could also apply.)

Two other assets that the charity can quickly monetize are a life insurance policy with cash value and a deferred variable annuity issued by an insurance company. In the case of life insurance, the donor could either transfer ownership of the policy or cash surrender the policy and contribute the proceeds. The first alternative may result in a smaller charitable deduction because the deduction will be based on the adjusted cost basis of the policy rather than on its current value. The current value of older policies will likely be larger than the basis. The second alternative will cause the policy owner to be taxed on the gain (subject to his ordinary income tax rate) when the policy is surrendered, but his deduction will be larger and more of his payments will be tax-free. The size of annuity payments is the same with both alternatives. A donor, in consultation with his tax advisor, can decide which alternative is better.

Many people have purchased deferred variable annuities from insurance companies, and in the years since the purchase considerable gain has accrued. The gain will be taxed as ordinary income – over time if the owner elects to receive life payments, or all at once if the contract is surrendered. If the contract is given to beneficiaries (other than charities) when the donor dies, the gain will be taxed as ordinary income to them. Owners of these contracts can transfer them for a gift annuity, save taxes, receive life payments, and have the satisfaction of making a charitable gift. The tax savings do not result from avoidance of tax on the gain, for the gain is taxed as ordinary income whether ownership of the contract is transferred to the charity or the contract is surrendered and the cash proceeds are given to charity. The tax savings result from the fact that the charitable deduction will totally or partially offset the taxable gain.

Property that entails some risk

Some donors inquire about funding a gift annuity with real estate, and more would probably do so if the charity displayed such examples in its literature. Of course, the preferred instrument when a person wants to contribute real estate and receive income is a net-income charitable remainder unitrust, with or without a make-up provision that contains a “flip” provision allowing it to convert to a standard unitrust upon the sale of the property. However, some donors may insist on a gift annuity because they want fixed payments, preferably beginning soon. Also, a gift annuity may be the only practical alternative if the property is subject to a mortgage, the value of the property is below the minimum amount required for a charitable remainder trust, or if a prospective purchaser would be a disqualified person.

A charity is understandably concerned about the risk of accepting real estate for a gift annuity, for it commits to fixed payments, not knowing when the property will sell or for how much. The risk can be minimized by adopting one of the following strategies:

- Offer a lower-than-normal gift annuity rate, based on a conservative estimate of net sales proceeds and the time period the charity would be making payments prior to the sale of the property. For example, if the normal gift annuity rate is 5%, the charity would offer a rate of 4%. If the charity operates in a regulated state to which it has submitted a schedule of rates, it cannot vary from those rates except by the donor's knowledge and written consent.

- Ask the donor to defer payments for a year or two. This does not eliminate risk, but at least the charity is less likely to have to advance its own funds prior to the sale.

- Identify a buyer prior to the date the property is transferred. The charity would enter into a purchase-and-sale agreement with the interested buyer after receipt of the property. The risk is that for various reasons the sale to the interested buyer may not close.

- The charity secures a pledge from the donor and then seeks a purchaser. In the pledge agreement, the donor commits to transferring the property for a gift annuity per x terms at whatever time the charity consents to accept the property. Before notifying the donor that it is prepared to accept the property, the charity, acting on its own with no involvement of the donor, will have entered into a purchase-and-sale agreement with a buyer contingent on the charity's receiving the property by gift. If the charity is unable to find a buyer, it simply would never consent to accept the property.

- Exercise a "put" agreement with a prospective buyer in advance of accepting the property. This is conceptually similar to the approach immediately above. The difference is that upon receipt of the property, the charity can, in its own discretion compel the buyer to purchase the property for the agreed price.

Sometimes the rental income from the real property may approximate the annuity payments the charity agrees to pay. That eliminates advancing any of the charity's own money and significantly diminishes the risk.

Other assets, entailing risk, which might be contributed for a gift annuity, are **closely-held C stock, closely-held S stock, LLC interests, and commodities.** They would be evaluated on a case-by-case basis by the Gift Acceptance Committee.

Concern for California Charities: In California foreign and closely-held stocks, real estate, and other illiquid assets cannot be used to satisfy required reserve funds held in the California trust account. Thus, if a charity accepts these assets for a gift annuity, it must be prepared to transfer other funds to the California trust fund equal in value to the required reserve.

Suppose, for example, that it accepted real estate valued at $500,000 for a gift annuity and that the required reserve for this annuity was $350,000. The charity could transfer the $350,000 to the trust fund, sell the real estate and recover the funds it had temporarily transferred. Surplus funds (those in excess of required reserves) can be invested however the charity wishes.

12. Create Compelling Gift Annuity Illustrations.

In many instances, the financial illustrations generated by a software program will be quite sufficient. However, it may be useful to prepare a customized illustration when the program does not address a particular set of facts, or when one wants to provide a more detailed plan and the steps for illustrating it. In that case, the illustration would be customized, but pertinent numbers would be imported from the software program.

Possible elements of a customized illustration.

An illustration for a more complex gift annuity or charitable remainder trust could contain these elements:

- Statement of donor's objectives.
- List of assumptions or data on which the illustration is based.
- Description of the proposed gift plan.
- Explanation of the income the beneficiary and/or others will receive.
- The tax implications of the plan.
- Graphic illustration of the plan so that it can understood in a glance.
- How the gift will advance the charity's mission.
- Procedure to complete the gift. The gift plan seems less daunting if steps to implement are clearly stated.
- Sometimes, you may wish to list advantages and disadvantages. A donor will appreciate this full disclosure.

Comparison of alternatives

A donor will often be weighing whether to retain control of a certain asset, such as stock or cash, or whether to contribute it for a gift annuity or other life income plan. In that case you may want to compare a gift and no gift. Suppose, for example that a donor has a maturing $50,000 CD and is wondering whether to invest in another CD or contribute the $50,000 for a gift annuity. The alternatives could be displayed as follows:

	Invest in CD	Contribute for a Gift Annuity
Amount	$50,000	$50,000
Interest	1,250	N/A
Annuity payments	N/A	$3,000
Taxation of interest or Annuity payments		

Ordinary income	1,250	789
Tax-free	-0-	2,211*
Estimate federal and State income tax	375	237
After-tax cash flow	875	2,763
Charitable deduction	-0-	23,909
Estimated tax savings	-0-	7,173
Retention of $50,000 capital	Yes	No

*At the end of life expectancy, the entire gift annuity payment becomes ordinary income, which would reduce after-tax cash flow somewhat.

Note: In this sample comparison, the donor is assumed to be age 76, and the assumed Sec. 7520 rate is 2.6%.

Responding to complaints that gift annuity rates are too low

Suppose the donor is age 70, in which case the ACGA gift annuity rate is 5.1%. The annual payment from each $10,000 contribution is $510. Of this $359.04 is tax-free, and $150.96 is taxable as ordinary income. The charitable deduction is $4,287 (based on a 2.8% Sec. 7520 rate) and tax savings of $1,286 (assuming 30% combined federal and state rate).

Amount contributed	$10,000
Tax savings	1,286
Net cost of gift	8,714
After-tax cash flow	465
After-tax cash flow as % of net cost	4.65%

To generate an equivalent after-tax cash flow, the pre-tax return on a high-quality, fully-taxable bond or cash deposit would have to be 6.64%, which, of course, does not exist in this low-interest environment. Again, there is a surrender of capital, but over time much of this will be recovered because of the extra cash flow, and the donor will have the satisfaction of making a gift. The point is that you can demonstrate the appeal of gift annuities even when gift annuity rates are historically low.

Closing word:

The list of 12 ways to close more gift annuities is illustrative but not exhaustive. With creative imagination you can add other ideas to the list. Many of those ideas, like five of the above, will entail blending a gift annuity with another type of planned gift. The gift annuity, which at first seems simple and straight forward, can be an extremely versatile planned giving instrument.