Using Charitable Gift Annuities to Generate Retirement Income

Bryan Clontz, CFP®
President, Charitable Solutions, LLC
www.charitablesolutionsllc.com (404) 375-5496

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Agenda

- Charitable Gift Annuities Overview
- Types and Taxation
- Rate Assumptions
- CGA Market Overview
- Potential CGA Traps
- Potential CGA Opportunities
- Charitable Remainder Annuity Trust vs. CGA
- Two CGA Case Studies

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What Are Charitable Gift Annuities?

- Contract providing fixed payments over 1 or 2 lives in exchange for contribution
- General creditor obligation extends beyond original gift
- Simple, one-page agreement offered by public charities or private foundations
- Existed more than 160 years in US
- Exempt from UBTI – acquisition indebtedness

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Types and Taxation of Charitable Gift Annuities

Types

- Immediate – Starts within 1 year
- Deferred – Starts after 1 year
- Flexible Deferred – Donor specifies start date range

Taxation

- Charitable portion of capital gains eliminated, the remaining amount recognized over life expectancy along with return of basis
- Bargain sale calculation:
  FMV-PV Life Annuity = PV Remainder Interest (Charitable Income Tax Deduction) – Must comply with 10% rule

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What are the Rate Assumptions?

- The American Council on Gift Annuities (ACGA) has existed since 1927 to provide gift annuity rate schedules – www.acga-web.org
- Roughly 90% of charities follow the suggested rates.
- Assumptions are:

  50% Future Value/Residuum (of Original Gift)

  5.00% Investment Return (40% Equities, 55% Fixed, 5% Cash)

  1% Expenses

  All annuitants are female using the Annuity 2000 Table and Projection Scale AA

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Charitable Gift Annuity Market Overview

- Estimated $15-20 Billion in CGAs issued by 4,000 Charities
- Average Age 78
- Average Gift $60,000 (Doubled Since 1999)
- Most Popular Form of Life-Income Gift
- Sample Individual Rates:

Age 65 – 5.3%

Age 75 – 6.5%

Age 85 – 8.4%

Age 95 – 9.8%

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Potential CGA Traps

- Must comply with Federal and State regulations for the state of domicile <u>and</u> the residency of the donor.
- Be very careful with terms like "buy" an annuity, "rate of return", "investment", ACGA "sets" rates – can trigger securities issues
- Be very careful about funding capital gain property where the annuitant didn't own property or the annuitants are not married (accelerates capital gain).
- Be careful about the claims-paying ability of the charity – donors and their advisors should conduct appropriate due diligence.

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Potential CGA Opportunities

- UBTI assets don't have a 100% tax like CRTs (mortgaged property and S-Corp)
- Terminating pooled income fund or Charitable Trusts in exchange for a CGA
- Partial or full revocation of CGA interest for immediate gift
- Reinsuring CGA to produce immediate surplus gift
- Donors love them now more than ever

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CGA vs. CRAT

- **CGA flexibility with unique or leveraged assets – related party can buy asset back**
- **Maximum CRAT vs. CGA recommended payout may be similar**
- **No CGA trust documents, trustee, separate accounting or investment management**
- **CGA does not have as many "bells and whistles" as CRAT**
- **Four Tier and Capital Gains Differences**

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Case Study #1: Peanut Butter and Jelly

Facts: Eighty year old single woman has $75,000 of stock with a cost basis of $7,500. She is extremely charitable but she is worried about the stock market and outliving her assets. She wants a guaranteed life-time income. She would love to make a contribution to her church and small college if possible.

Questions?

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Case Study #1 : Solutions

Her church was able to offer a gift annuity through the national office for 7.5%. Her college was able to do it directly for the same rate. She received a current income tax deduction of $32,500, and each of the $5,250 payments

What if the church offered CGAs but was financially unstable?

What if she was in poor health – could you shorten the term?

What if she wanted to do one CGA and gift the remainder to multiple beneficiaries?

What if she wanted to see the money used now?

Case Study #2 – The New Reality

Facts: A wealthy alum is approached for a $2 million major gift for the capital campaign. He wants to help, but says that 2008 "scared me to death." He is in poor health, but his 72 year-old wife is extremely healthy. She is not financially savvy. He owns a $30 million closely-held C corporation and has recently had offers from key employees to buy 20%. His cost basis is only 5%.

Questions?

Case Study #2 – The Solution

He contributed $6 million of closely-held stock for a CGA on his wife. The key employees then purchased it from the university. The university used the proceeds to purchase an immediate annuity for $4 million to match the liability - $420,000/year or 7%. This gave her great comfort knowing the income was guaranteed "no matter what." The university immediately used the $2 million for the campaign.

What if he wanted to contribute back the income each year?

What if the insurance company defaults?

Does the fact that "reinsurance" is used change the deduction?

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CGA Resources

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