Dear Donor, Please Forgive Me:
Avoiding Gift Annuity Mistakes

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I. Introduction

***Dear Donor, Please Forgive Me**. When I solicited your $100,000 gift I did not realize that gifts from the IRA charitable rollover do not qualify to fund life income gifts, including charitable gift annuities. Neither did the staff member in the Planned Giving Office who issued your gift annuity contract.*

In most planned giving offices the above situation would never happen. But it did happen in a large institution with a dedicated planned giving office. Had the proper systems and staffing been in place this situation would have been avoided. This paper addresses areas where mistakes can be made when issuing charitable gift annuities, ways to avoid those mistakes, and how to address situations where there has been a change in the annuitant's circumstances affecting annuity payments.

When discussing a gift annuity with a donor, the goal is to "keep it simple." In exchange for the donor's irrevocable gift of cash or appreciated securities, the charity will pay one or two annuitants a fixed income for life. The gift officer customarily recites the annuity rate the donor will receive, and perhaps the amount of the charitable deduction. Also, in most cases a portion of the annuity payments will be tax-free for a period of time, attractive to almost every donor. So what could go wrong that would require the gift officer to say to the donor at some future date: "Dear Donor, Please forgive me, I made a mistake with your gift annuity." The answer is "plenty."

Most mistakes with gift annuities are avoidable if the issuer takes some basic precautions. Some mistakes are made when the gift annuity is issued, other mistakes during administration, and yet other situations are caused by a change in the annuitant's circumstances over which the charity has no control but affect the gift annuity arrangement.

II. Best Practices in Gift Annuity Issuance and Administration

The greatest likelihood for an error to occur is during the issuance phase of a charitable gift annuity contract. Instituting some basic best practices and checklists can help to reduce the possibility of an error during this phase of the gift annuity process. The minimal amount of additional time spent at the beginning of the process can save the gift officer from having to say: "Dear Donor, Please forgive me." A brief review of the process should be helpful.

A. The Gift Annuity Application

A gift annuity application like the one attached as Appendix A can ensure all of the information required of the donor and annuitant are correct. Keep in mind the donor and annuitant may not be the same person. The information contained in the application will impact the administration of the gift annuity for the life of the annuitants. The application also protects the charity should the donor later have a different recollection of the gift annuity arrangement. If the gift is of appreciated assets, the cost basis on the application is essential for the charity to be able to do the tax reporting for the annuity payments. While it may seem to be donor-friendly to accept information over the phone from the donor, best practice dictates that a gift annuity application completed and signed by the

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donor(s) should be required by the charity. When the gift annuity application is received by the charity, a staff member should be assigned the job of checking all parts of the application to ensure they have been completed.

B. Document Preparation

Accurate document preparation is key to avoiding many of the mistakes that can occur with charitable gift annuities. Entering one bit of inaccurate information such as the payment frequency can result in having to reprocess the entire gift, and with donor dissatisfaction. A complete checklist is one of the most effective ways to discover inaccuracies in the documents. (Schedule B) A checklist should cover the spelling of donor(s) names, address, date(s) of birth for the annuitant(s), social security numbers(s), type of annuity contract being issued, payment pro-rations for the first payment period, taxation of the payments if funded with appreciated securities, beginning payment date if a deferred payment gift annuity, restrictions on the residuum, etc. etc. etc. Even with a comprehensive checklist, it is suggested that a staff member other than the gift processor review the contract before being sent to the donor. It is also helpful if the staff member processing the gift annuity contract has an understanding of how the gift works such that they can identify questionable outputs during the processing of the gift.

C. Administration

1. Maintain Data. Because gift annuities can and frequently do go on for decades, the maintenance of data is the foundation upon which all other administration is built. Charitable gift annuities (CGAs) are governed by a contract between the charity and the donor. The charity is responsible for making payments to one or two income beneficiaries (the annuitants) over their remaining lives. The first and most basic requirement of administering CGAs is to maintain the relevant information pertaining to the gift arrangement – the amount and date of the gift, payout rate, payment frequency and timing, annuitant name, address, social security number, etc. – in a secure and reliable database. If the essential data is not maintained correctly, no other aspect of the administration can succeed. While maintaining “hard originals” of the contract and supporting documents is still prevalent in most planned giving offices, also having secure electronic versions of such documents should be standard operating procedure.

2. Prepare for payments. CGAs pay a fixed amount according to the contract, and they make payments on a monthly, quarterly, semi-annual or annual basis. Ideally, the charity establishes consistent policies regarding payment dates that help facilitate the efficient handling of payments down the line – for example, many charities offer payments only on the last day of the month. This allows the charity to anticipate the flow of payments over each month; in turn, the investment manager can plan for cash needs on a consistent and predictable schedule.

3. Issuing payments. Gift annuity payments must happen like clockwork! The payments must be accurate and arrive on time. It is not unusual for charities to make gift annuity payments slightly before the contractual payment date, which helps to ensure that the annuitants receive their payments “on time” or even early.

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There has been a steady transition away from the issuance of conventional checks toward the more efficient electronic payments (EFT or "direct deposit"). Some organizations will only do payments electronically with newly issued CGAs. Often gift annuity administrators will send a "deposit advice" via mail which informs the annuitant when the funds were added to their account, and how much.

4. Reconcile and reissue. Whatever type of bank account is used to issue CGA payments, the charity should reconcile the account monthly to identify checks not cashed. Preferably, before the next payment is made, the charity will have followed up on any checks not cashed. The charity should reissue uncashed checks to the annuitant, but it is advisable to undertake some investigation first to determine why earlier checks were not cashed. Multiple uncashed checks indicate a change in status of the annuitant, perhaps relocation to a different living environment, possible mental impairment, or even death. Hopefully, an alternate contact has been provided on the gift annuity application who can then be contacted.

5. Tax Reporting. Tax reporting requirements for CGAs is straightforward – the charity (or its administrator) must provide a Form 1099-R for each annuitant upon the conclusion of each calendar year. Form 1099-Rs for CGAs must be produced and mailed by January 31 with no exceptions. The aggregate reporting of 1099 information for all gift annuitants must be submitted to the IRS by the end of March, either with paper copies or by electronic means, as determined by IRS procedures.

6. Maintain Market Values: Technically there is no requirement to maintain individual market values for gift annuities – the underlying assets for a charity's gift annuity program are usually held in one or a small number of investment portfolio accounts, and the payment obligations are not tied in any way to market values. Charities are increasingly recognizing the benefits of determining the individual market values for each annuity on a frequent and ongoing basis. There may be internal interest in knowing these values for purposes of future resource planning and reporting back to donors; but more importantly, upon the death of an annuitant -- unless there is a successor annuitant -- the charity will need to know the ending market value of the specific gift annuity; the remainder value or "residuum" is the amount that the charity removes from the investment account. If the gift annuity residuum has been restricted to a specific program, by tracking the individual market values of each contract the charity will know upon termination how much should be transferred to the program the donor desired to support. Also, if a gift annuity contract is "under water," (i.e. the residuum has been exhausted), the charity may wish to discuss having the annuitant relinquish their interest in the contract and thus forgo any future payments. Considerable advance thought is needed to determine if this conversation is appropriate for the donor.

7. General reporting and financial accounting: Accurate financial recordkeeping is essential to a charity's responsibility, to their donors and to the public in general, to report consistently and on a regular basis the charitable contributions received and the assets maintained. Each charitable gift annuity consists of a charitable

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gift component and a non-charitable component; the latter represents a liability on the part of the charity to a specific individual. Charities typically follow the specifications of the Financial Accounting Standards Board (FASB) to compute the estimated present value of the total future liability for each CGA.

8. State reporting and compliance: A number of states require reserve calculations and information reporting for charitable gift annuities on an annual basis. California, New Jersey, New York, and Washington are some of the more familiar examples, but there are several more. It is significant to note that the process is one of the major components of gift annuity administration for many charities.

III. MISTAKES INVOLVING THE FUNDING ASSETS

A. Dear Donor, Please Forgive Me: I neglected to get the cost basis of your mutual fund shares.

Gifts of appreciated securities, including stocks, bonds, mutual funds, and ETFs qualifying for capital gain tax treatment (i.e. owned for at least one year) are common funding assets for charitable gift annuities. When a donor funds a charitable gift annuity they are making a bargain sale – a portion of the funding amount is a gift, and a portion funds the purchase of an annuity contract. The capital gain attributed to the gift portion is forgiven. The capital gain attributed to the purchase of the annuity is reported ratably over the life of the annuitant, assuming the donor is also the annuitant. The charity must know the cost basis in order to do the tax reporting for the amount of capital gain to be taxed through the annuity payments. If the gift officer fails to obtain the cost basis from the donor, or the donor fails to complete that information on the gift annuity application form, the administrator cannot process the annuity and payments should not be made.

Apology accepted, but next time...: Thoroughly check the gift annuity application to ensure that ALL needed information has been completed. While in most cases missing information can be obtained from the donor, it delays processing of the gift and in rare cases where required information cannot be obtained the gift may need to be returned.

Some donors have either owned assets for many years or have inherited assets many years ago and have no idea of the cost basis. That does not get the donor off the hook for providing this information. Many donors are comfortable taking the best educated guess they can, but some are reluctant to guesstimate this figure. For the donor who refuses to guesstimate the cost basis, by entering $0 as the cost basis on the gift annuity application they can be assured that they will not have to defend the figure in front of an IRS agent.

B. Dear Donor, Please Forgive Me: I miscalculated the value of your appreciated assets used to fund the annuity.

IRS dictates the methodology for calculating the value of publicly traded securities contributed to charity. They are to be valued as of the date that ownership and control of the assets pass to the charity, which is when the assets arrive in the charity's brokerage account. After the market closes on the date of gift, the gift value is the average of the high and low

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prices for the stock on that day. For mutual fund shares the gift value is the closing value of the mutual fund shares on the gift date.

While not common, the calculation of the value of the assets transferred to the charity to fund the gift annuity are at times miscalculated. The information used for the calculations may have been incorrect, or the individual performing the calculations wasn't aware of IRS methodology for the calculations.

If the asset valuation is incorrect, there are three results that may occur: (1) the charitable deduction for the annuity could be either higher or lower; (2) the amount of the annuity payments could be either higher or lower; and (3) if 1099R's have been issued for payments made the tax reporting could be wrong.

Apology accepted, but next time...: The charity should issue a new gift annuity contract with the correct valuation and payments. A new illustration should be generated with the accurate charitable deduction and annuity payment amounts. Payments must be adjusted to reflect the accurate amount and a further adjustment made for incorrect earlier payments. If the donor has already filed an income tax return with the incorrect charitable deduction and for an incorrect annuity amount, the remedy is more complicated. The charity should issue a corrected Form 1099-R. The donor should consult tax counsel to decide whether to amend tax returns for prior years that were reported incorrectly.

C. Dear Donor, Please forgive me. I did not realize that the stock you used to fund the gift annuity was "loss property."

Appreciated securities owned for at least one year are often marketed as a tax-wise funding asset for charitable gift annuities, and they are. The donor gets a charitable deduction and a portion of the capital gain is forgiven, with the remaining gain reported ratably over the annuitant's life expectancy. Even if the donor is not the annuitant, the capital gain realized is less than what would otherwise be due if the donor had sold the stock.

Apology accepted, but next time...: Unfortunately, there is no remedy or forgiveness in this situation. Most charities sell stock or securities as soon as they arrive in the charity's brokerage account. Securities that are sold by the donor for less than what was paid can be used to offset realized capital gains. The securities are considered a capital loss and can be netted against capital gains. There is a five year carry-forward if the donor can't use the entire loss in the year of the sale. The donor should have sold the securities, and reported the capital loss on her/his taxes. Had the Gift Planning office reviewed the Gift Annuity Application carefully and seen that the asset being used to fund the annuity was loss property, this situation could have been avoided.

C. Dear Donor, Please forgive me. I did not realize that your broker transferred: (a) the wrong securities; or (b) more of the securities than you wanted to give and we have already liquidated the securities.

While not a frequent occurrence, it has been known to happen that a broker will either transfer securities that the donor had not intended to use for the gift, or an incorrect number of shares, with the error being that too many shares were transferred. As with the "loss property" example above, most charities immediately liquidate shares of stock or mutual funds once the shares arrive in the charity's account.

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Apology accepted, but next time...: There is no easy remedy for this situation. However, this is another situation where a review of the Gift Annuity Application and communication with the charity's finance office or broker receiving the securities could avoid this situation. Some organizations have a procedure where the Gift Planning Office has to authorize the sale of the securities once received in the charity's account. This process acts as a check between the information supplied by the donor on the Gift Annuity Application and what has actually been received by the charity.

D. Dear Donor, Please forgive me. The funding assets arrived on different days and I should have done a better job of informing you how we will handle this situation.

It is not uncommon for the funding assets for a gift annuity to arrive on different days. This situation typically happens when the donor uses appreciated securities to fund the annuity, but wants to either "round-up" the amount of the gift or to add a substantial amount in cash to get to the desired gift amount. The issue then arises as to how the charity should determine the gift date and the impact on charitable deduction calculations and the gift annuity agreement to be issued.

Apology accepted, but next time…: The preferred approach from a legal standpoint is to have a separate gift annuity agreement for each day a contribution takes place. However, depending on the understanding reached between the donor and the charity, a single gift agreement could be executed depending on all surrounding circumstances.

If securities are involved and if the charity wishes to sell each security as soon as it is received, then for the purposes of calculating the amount of the total contribution, each of the assets transferred is valued as of the date of its contribution. If the charity and the donor concur, the obligation to pay the annuity can commence on the date of the last transfer. In that case, the annuity agreement would be made effective on the date of the last transfer, and the first payment would be prorated from that date to the end of the period. The agreement should recite that the fair market value of each asset contributed for the gift annuity was determined as of the date it was contributed. The charitable deduction will be calculated using the date of the last transfer and the amount of the total contribution.

It is advisable for the charity to consult its legal counsel, who may wish to check the applicable state laws to ensure compliance. Whichever route the charity decides to follow, the donor and the donor's advisor should be kept informed during the process to ensure agreement for how the charity is handling the gift.

IV. MISTAKES INVOLVING THE DONORS AND/OR THE ANNUITANTS

A. Dear Donor: Please forgive me. I didn't realize there are potentially costly tax issues since you are not the annuitant for the gift annuity you just funded.

In most gift annuities the donor is also the annuitant. However, there is no requirement that the donor be the annuitant. So long as there are no more than two annuitants, the donor can designate the individual(s) to receive the annuity payments. Donors have been known to name a spouse, an elderly parent, a sibling, an aunt or uncle, or other loved one as the annuitant(s). By funding a charitable gift annuity the donor can support a favorite charity

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while also providing a supplemental source of income for a family member, or non-family member, too. Whenever a gift annuity is funded by one person and the annuitant is not the donor, tax issues potentially arise.

Transfer taxes: Gratuitous transfers of assets (i.e. gifts) between individuals are potentially subject to either gift or estate tax. There is an unlimited gift and estate tax exemption for lifetime or testamentary transfers between spouses. Such is not the case for non-spouses. There is an annual exclusion from gift taxes for transfers between non-spousal individuals that is $15,000 in 2018, but will be indexed for inflation in future years. Gifts in excess of the available annual exclusion must be reported to IRS on a gift tax return. The gift and estate tax exemption in 2018 is projected at $11.2 million per individual ($22.4 million per married couple), thus subjecting only the very wealthiest of donors to possible gift taxes. When the donor and annuitant are not the same, the donor makes a present interest gift to the charity of the gift value and a present interest gift to the annuitant of the present value of the annuity. To the extent the gift to the individual exceeds the gift tax annual exclusion, it must be reported to IRS on Form 709. Because the gift planner is seldom privy to all aspects of a donor's tax and financial situation, it is essential that the donor be told in writing to consult their professional advisors before making the gift.

Capital Gains taxes: If a gift annuity is to be funded with appreciated property qualifying for long-term capital gain tax treatment, the portion of the capital gain allocated to the charitable gift is forgiven, but that portion of gain allocated to the present value of the annuity is subject to tax which can be spread over the life expectancy of the donor so long as s/he will also be the annuitant. If the annuitant is not the donor, reportable capital gain from an annuity funded with appreciated property must be paid in the year of the gift.

Apology accepted, but next time...: The gift planner should be vigilant in any case where the donor is not the annuitant. Attention to the capital gain tax consequences of the gift *prior* to the gift being established may avoid potential tax traps and embarrassing donor relations issues. Have good gift acceptance procedures. Review carefully the Gift Annuity Application prior to completing the gift.

Transfer taxes: When a donor funds a gift annuity and is not the annuitant, the donor can postpone until the donor's death having to report a potentially taxable gift by inserting a provision in the annuity agreement reserving the donor's right to revoke the annuitant's payments. This effectively transforms what would have been a single transfer for gift tax purposes into a series of smaller annual gifts followed by a possible subsequent transfer (typically of a reduced amount) for estate tax purposes. Merely reserving the power to revoke the annuity payments means for gift tax purposes: (1) the present value of the annuity payments is not a completed interest such that gift taxes are due; but rather (2) the annuity payments are a series of annual gifts, each of which equals only the amount paid in any given tax year. The power to revoke can generally be designed for exercise either during the life of the donor or upon death. State laws should always be consulted.

Capital Gain tax issues: By informing the donor when the donor will not be the annuitant that by using capital gain assets to fund the gift there will be an immediate tax liability, the donor may choose to use cash to make the gift. Depending on the donor's tax situation, appreciated property may still be a good choice for funding the annuity in this situation. The capital gain attributable to the gift portion of the annuity is completely forgiven, reducing the

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amount of capital gain realized. In addition, depending on the amount of gain reportable, the income tax charitable deduction may be sufficient to offset the capital gain.

B. Dear Donor: Please Forgive Me. I didn't realize that only one spouse owned the stock used to fund the gift annuity for the other spouse, and now capital gain taxes are due.
Gift annuities are frequently established by married couples using jointly-owned or community property. Nevertheless, sometimes an asset that two spouses regard as being owned by both of them turns out to be owned by only one of them, meaning that one spouse alone will be the donor. In short, would-be donors sometimes claim to own assets that either are not theirs at all or that they own along with others. This is particularly a problem with appreciated assets insofar as the triggering of capital gains. Whenever an annuity is funded by one person or persons and the annuitant is not the same person, tax issues arise concerning the reporting of capital gain taxes that may be due in the year of the gift, even if the donors are spouses.

If a gift annuity is to be funded with appreciated property, a gift planner must keep in mind that the taxable portion of the gain can be spread over the life expectancy of the donor only so long as he or she will be the annuitant as well, receiving the annuity payments initially. This means that if spouses establish a gift annuity with capital gain property they own jointly but annuity payments are made to only one of them initially, half of the taxable gain will be realized in the year of the gift. Conversely, if a spouse uses separate capital gain property to establish a gift annuity for the benefit of both spouses, the gain can be spread only over the donor spouse's life expectancy (assuming all of the gain can be paid out over that period). Thus, in such a situation, the annuity is best structured so that payments are made initially strictly to the donor spouse and then to the other spouse if that spouse survives the donor.

Apology accepted, but next time...: As detailed in the Section IV(A), the gift planner must be vigilant when the donor is not the annuitant and appreciated assets are used as the funding source. However, many gift planners do not realize that this can be an issue even if the donors are spouses. Where only one spouse owns the securities and the non-owner spouse will be the annuitant, there will be reportable capital gains in the year of the gift. The solution is for the spouse who owns the securities to transfer the securities to the spouse who will be the annuitant, and for the annuitant spouse to then make the gift. Unfortunately, when suggested to donors they usually do not want to be inconvenienced with retitling the securities, especially since they will be transferring the securities to charity within weeks or even days. The issue also holds true where the securities are owned by both spouses jointly, but only one spouse will be the annuitant. Or conversely, where one spouse owns the securities but both spouses will be joint annuitants. The solution in all of these situations is for the securities to be retitled prior to the transfer to charity so that the ownership of the securities matches those who will be the annuitants.

C. Dear Donor, please forgive me. I put an incorrect payment frequency in your gift annuity agreement.
The key to accurate gift processing is ensuring that you have the gift information you need, supplied by the donor in writing, which in the case of a charitable gift annuity is provided in the Gift Annuity Application. Of course, the information supplied by the donor must be checked against the documents *before* the donor signs the gift annuity agreement and the gift

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administration is put in place. It can happen that an incorrect payment frequency is entered in the software during gift processing. Perhaps the donor wanted monthly payments, but quarterly payments is what was fed into the software and generated in the gift agreement. This type of mistake can have negative donor relations implications. That said, it is possible to correct the mistake in certain circumstances.

Apology accepted, but next time...: If the payments will be made less frequently (i.e. quarterly instead of monthly, semi-annually instead of quarterly), and the total amount paid each year remains the same, the present value of the annuity under the new payment arrangement will actually be lower than it had been. Since the annuitant receives no added benefit, the new arrangement poses no problem. If, however, the annuitant wants payments to be made more frequently, the present value of the annuity will increase if the total paid annually remains unchanged. Such a result would be inconsistent with the charitable deduction claimed by the donor when the gift annuity was established. Consequently, when the annuity payments are made more frequently, it is necessary to reduce the total amount paid annually to keep the present value of the annuity the same. It is not a problem to change an annuity's payment frequency, so long as the new schedule of payments does not result in an increase in the present value of the annuity and so long as the charity and the annuitant document that they have agreed to a new payment frequency.

D. Dear Donor: Please forgive me. By giving you a higher annuity rate than the American Council on Gift Annuities (ACGA) suggested rates, I may have violated state regulations and increased the risk that our organization will not realize any funds from your annuity.

Gift planning fundraisers will periodically encounter this scenario: a donor wants to know what gift annuity rate your institution will give for her/his age. You offer the ACGA rate, and the donor informs you that another charity s/he supports will give a rate that is .3% higher. That may or may not be true. If you match the rate, the donor will do a six-figure gift annuity. There are two primary issues a charity faces deciding whether to exceed the ACGA suggested gift annuity rates: (1) possibly violating state regulatory requirements; and (2) increasing the risk of the annuity going "under water" and thus the financial risk to the organization.

(1) *State regulatory*: A charity needs to consider if offering a donor a higher annuity rate violates requirements in any states in which the charity is offering gift annuities. New Hampshire specifically prohibits offering rates higher than the ACGA. Certain other states – Alabama, Arkansas, California, Maryland, New Jersey, New York, and Washington – require that a charity put on file a schedule of its maximum rates, and once filed the charity is not authorized to offer rates higher than those in the schedule (until/unless it files a revised schedule of rates with the state). California has emphasized the inability to exceed the filed schedule, and it views offering a higher rate as a discriminatory rating practice.

(2) *Financial risk*: Issuing an annuity at a higher rate than those suggested by the ACGA can cause an annuity to exhaust the principal donated before the payment obligation terminates. Offering unsustainably high gift annuity rates is one of the main reasons that a gift annuity pool will lose money on individual annuities. It is also the main reason a

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charity may need to transfer assets into a gift annuity reserve fund to ensure there are sufficient funds in the reserve to meet state imposed requirements.

Apology accepted, but next time...: This situation depends largely on the gift acceptance policies adopted by the charity for charitable gift annuities, and the willingness of development office leadership to forgo a gift in order to abide by the adopted policies. Organizations that follow ACGA rates and administer their gift annuity programs following best practices have a greater likelihood that their gift annuity programs will yield resources to support the organization's mission. By not offering higher rates than suggested by ACGA, the likelihood of financial success of the program is increased and that the gift annuity program will not need periodic infusions of funds to sustain the reserve fund. Also, no charity should entertain a gift that will place it in violation of state laws.

[Note: In certain instances, donors are looking to enhance the charitable benefit of a gift annuity – and their charitable deduction - and will accept a lower annuity rate than the applicable rate based on the charity's published schedule. In those circumstances, there should be documentation that the donor was made aware of the standard rate and voluntarily accepted the lower rate. California requires an addendum to the agreement signed by both the donor and a charity representative. This would be a good practice in every situation where a donor accepts a lower annuity rate than published rates.]

E. Dear Donors, Please forgive me, but this was not my mistake. How was I to know that you would get a divorce after funding the gift annuity?

The life circumstances of donors change. It may be a change in employment, income, finances, and even divorce. If donors divorce after funding a charitable gift annuity, the charity could find itself in an awkward situation, from both donor-relations and legal perspectives. In almost every case the charity will need to deal somehow with the situation after being notified of the divorce.

Dear Gift Officer – I apologize to you, but life happens. When a charity learns that spouses who are both annuitants under a gift annuity agreement have divorced, adjustment in its administration of the annuity will depend on the terms of the annuity agreement itself unless perhaps the annuity has been specifically addressed in the divorce decree, property settlement agreement, or by applicable state law. The first step a charity should take upon being notified of a divorce is to inquire if the annuity has been addressed as part of the divorce decree or the settlement agreement. If that is the case, the charity will want a copy of the applicable document. It is entirely possible that the annuity has not been addressed as part of the divorce proceeding.

Usually spouses have established a joint-and-survivor annuity, with each party being entitled to one-half of the annuity payment. However, from an administrative perspective, typically with such annuities a single payment is made and also a single Form 1099-R is issued under one Social Security number. Assuming no other arrangement has been specified in the divorce decree, the charity should begin sending a payment one-half of the full amount to each spouse-annuitant, and there would be two Forms 1099-R, one to each spouse reflecting their half. If the annuity has been set up with successive rather than joint payments, then the payments would continue in accordance with the annuity agreement, unless otherwise indicated in the final property settlement.

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Regardless of whether the charity had heard from both parties with respect to the divorce or just one, it is advisable for the charity to communicate in writing with both individuals regarding its understanding of the situation and how payments are to be made going forward. The way in which the annuity payments will be taxed going forward depends partly on how such taxation was calculated originally and partly on how the payments are to be made once the divorce becomes final.

F. Dear Donor, Please forgive me. I was not aware that you were contemplating applying for Medicaid after funding a charitable gift annuity with our charity.

It is almost impossible for a gift officer to know that a donor might find it necessary to apply for Medicaid at some future date and that establishing a gift annuity could have an impact on their eligibility. Periodically, a donor may inquire about how establishing a gift annuity could affect their current or future eligibility to obtain Medicaid coverage for expenses such as those associated with a nursing home. Also, some well-intentioned donors may want to establish a gift annuity to supplement the income of a family member who is currently receiving government assistance. Gift officers should have an awareness, if asked, that establishing a gift annuity may impact a donor's application for Medicaid.

Apology accepted, but next time………Medicaid is ultimately a federal program, administered primarily by the states. The requirements for Medicaid eligibility are a function of both federal law and the law of the state in which the donor lives. To qualify for Medicaid, a person's income and assets must be below a certain level, and those levels vary by state. There is a five year "look-back period" for transfers of assets, including gifts. Gifts made by the donor to charity or family members could delay the time frame in which the donor could qualify for Medicaid benefits. Donors with a concern should be told to consult their professional advisors.

If a donor wants to establish a gift annuity for a family member who has disabilities, it is possible for the gift annuity payments to be made to a special needs trust, established for the benefit of an individual with disabilities. Distributions from the trust would be at the discretion of the trustee. If the trust is properly designed so that distributions are limited to those associated with meeting special needs and cannot be used for basic care, then the individual may not be disqualified from continuing to receive governmental assistance. The annuity payments would be made until the death of the disabled individual, whereupon the obligation would terminate. The donor should be counseled to consult their advisor or the advisor of the family member to have the benefit of the annuity payments, to ensure that the payments from the annuity will not impact the benefits being received by the annuitant.

G. Dear Donor, Please forgive me. I did not make you aware of other opportunities with your charitable gift annuity when you wanted to do more to help our organization.

(1) *Assigning the Right to Annuity Payments to the Charity*. Some annuitants realize that they do not really need the income from their annuity payments. This is frequently the case with smaller gifts where the payments are not substantial. These annuitants are willing to forfeit permanently their right to the annuity payments. Once the annuitant assigns her or his right to the payments, the charity's obligation to make payments under the contract will terminate, and it will be free to use the residuum. An assignment of an annuity interest can raise several questions.

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(2) *Allowing the Charity to Receive the Payments.* Some annuitants don't need the annuity payments they receive, but are reluctant to assign their right to payments permanently to the charity. These annuitants are more comfortable temporarily allowing their charity to receive the payments, retaining the right to have the payments directed back to them if needed.

Apology accepted, but next time…

(1) *Assigning the Right to Annuity Payments to the Charity.* The amount of the income interest in a charitable gift annuity is the present value of the remaining annuity payments computed as of the date of assignment. However, in the case of an assignment of an annuity interest to charity, the income tax charitable deduction will often be less than the amount of the gift. Although there are no revenue or private letter rulings specifically on point, it seems reasonable to conclude that the income tax charitable deduction for surrender of a charitable gift annuity would be limited to the remaining payments that would have been paid tax-free or as long term gain (undistributed investment in contract) over remaining life expectancy if the annuity interest had not been assigned. It follows from this that no deduction is permitted for persons who have lived long enough that they are no longer receiving tax-free or long- term gain income. There are no rulings or case law addressing the contribution ceiling for the deduction resulting from the assignment of a gift annuity. If the annuity was funded with cash, and the deduction does not exceed the unreturned capital investment in the contract, it would seem that the ceiling for taking deductions for cash gifts would apply.

A qualified appraisal is required if a gift of a surrendered income interest will generate an income tax charitable deduction of more than $5,000. This is because the income or annuity interest is a non-cash asset. The appraiser will complete IRS Form 8283 and have the Form countersigned by the charity acknowledging receipt of the gift. Someone can perform a qualified appraisal with the education and experience to perform such appraisals. The appraiser must demonstrate verifiable education and experience in valuing the type of property subject to the appraisal. The appraisal should describe the gift that resulted in the deduction claimed by the donor and indicate how the present value of the interest in question was determined. It should also address the qualifications of the appraiser.

(2) *Allowing the Charity to Keep the Payments.* It is permissible for the annuitant to have the annuity payments retained by the charity. Each payment will result in an income tax charitable deduction for the annuitant, provided the charity furnishes the annuitant with a gift acknowledgement for each payment. The annuitant will be taxed on each annuity payment as though she or he received them. The charity will need to send a Form 1099-R annually. The annuitant has not assigned irrevocably their income interest to the charity. The annuitant can terminate having the charity receive the payments and can start to receive the payments again when they wish. A letter should be signed by the annuitant(s) formalizing the arrangement.

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G. Dear Donor, Please forgive me. I should have been more proactive in reminding you that you have the option to start receiving payments on your flexible deferred gift annuity.

When a flexible deferred gift annuity is established, there is a range of possible dates on which the annuitant can elect to begin payments, with the agreement requiring that the annuitant provide notice to the charity within a certain period of time prior to the desired date. The question arises as to how proactive the charity should be in reminding the annuitant of the ability to start the annuity payments. Charities that offer this type of gift annuity differ on this question.

Apology accepted, but next time…It is not required for the charity to send any type of annual reminder to a donor/annuitant with a flexible deferred gift annuity reminding them of their option to start to receive annuity payments. However, some charities send a notice each year, viewing it as good stewardship; others do nothing until the last possible commencement date at which time payments begin to be sent. At a minimum, some type of correspondence should be sent to the annuitant at least every few years, especially to ensure that contact information for the annuitant is current. From a stewardship perspective, an annual letter is preferable. When the gift is entered into the charity database, it is advisable to use the last possible commencement date as when payments should begin. That will help the charity to avoid missing the start of payments when required should the annuitant not send a notice to begin payments. While payments are still in deferral, this default date may need to be adjusted to address reserve calculations.

V. CHALLENGES IN GIFT ANNUITY ADMINISTRATION

A. Dear Donor, Please forgive me. Our organization doesn't track the market value of each annuity contract and now we can only estimate at termination how much of the residuum of your gift annuity should be used as you instructed.

There are reasons why a charity would want to track the value of each annuity contract. If the charity permits the donor to designate the residuum of the annuity to a specific program, then by tracking the value of each contract the charity is able to allocate the residuum at the termination with some degree of certainty. Also, even if the residuum is to be used for "general purposes," tracking the value of each contract enables the charity to remove the residuum from the gift annuity reserves at termination with a degree of certainty. Also, gift annuities can "go dry," meaning that the residuum has been exhausted while the donor is still living, and annuity payments must continue per the terms of the annuity contract. This is potentially useful information for the charity.

Apology accepted, but next time...: It is a best practice to track the value of each contract. The charity should adopt a system of fund accounting to track the market value of all annuities, with particular relevance for those annuities that have been restricted to a particular program at the charity. Also, in the case where an annuity has exhausted the residuum, it is useful information for the charity to have so that, while payments must continue until the death of the annuitant(s), the charity can determine if a discussion with the donor/annuitant might be warranted.

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It is possible to estimate the market value of terminated annuities even if those values have not been tracked. Note that in most cases these calculations will only be an estimate, but they are a good faith effort. To estimate the values for existing annuities the charity will need investment performance figures for the annuity pool on at least an annual basis for prior years. The date of gift, date of death, annuity amount, and distributions for completed annuities will help to make the estimate more accurate.

B. Dear Donor's Executor, Please Forgive Me. I neglected to inform you that because the annuitant died before her life expectancy, her estate was entitled to an additional income tax deduction on her final tax return.

Annuitants sometimes die before their life expectancy. An annuitant of a one-life annuity who dies before the end of her life expectancy is entitled to a posthumous income tax deduction for the unrecovered investment in the contract. The same is the case for the surviving annuitant of a two-life annuity who dies before the joint life expectancy of the annuitants. It is the annuitant's final income tax return that is entitled to the additional tax deduction, even if the annuitant was not the donor. It is anticipated that few executors - and even many estate professionals - are aware of the tax treatment for annuitants who die before their life expectancy.

Apology accepted, but next time...: It is good donor-relations by the charity to notify the executor of the deceased annuitant's estate of this tax implication, if applicable. The deduction equals the total investment in the contract that would have been returned over the annuitant's life expectancy, minus the portion of the investment in the contract returned as of the date of death. If cash was contributed for the gift annuity, the investment in the contract would have been the present value of the annuity payments at the time the annuity was established (the non-deductible portion of the contribution). The tax-free portion of each payment would have been a return of the investment in the contract. For example, if $50,000 cash was donated for the gift annuity, and if the gift value was $20,000, the present value of the annuity is $30,000. Whatever portion of the $30,000 had not been returned in the form of tax-fee payments at the time of the annuitant's death could be claimed on her/his final income tax return.

Present Value of Payments	Gift Value
$30,000	$20,000

If appreciated assets had been donated for the gift annuity, only the remaining portion of the *basis* allocated to the present value of the payments - not the *gain* allocated to the present value of payments - that had not been returned as of the date of death is subject to the income tax deduction on the annuitant's final income tax return.

Present Value of Payments $30,000		Gift Value $20,000	
$6,000 Basis Allocated to Present Value	$24,000 Gain Allocated to Present Value	$4,000 Basis Allocated to Gift Value	$16,000 Gain Allocated to Gift Value

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For the purpose of determining the deduction per IRC Sec. 72(b)(3)(A), only the $6,000 is the investment in the contract, and the deduction on the donor's final income tax return is limited to the portion of the $6,000 that had not been returned by the time of death. (Note: Some authorities believe that the deduction on the final return would be the same whether the annuity was funded with cash or appreciated property. Donors should always be advised to consult their professional advisors for determinations in such matters.)

The deduction for the unreturned investment in the contract is not a charitable deduction. The tax law passed by Congress and signed by the president that took effect on January 1, 2018 appears to preserve the deduction for the unrecovered investment in the contract. The deduction for the unrecovered investment in the contract is not included in the category of Miscellaneous Deductions on lines 21-27 of Schedule A of Form 1040 that are no longer permitted as deductions under the new law. However, even though the unrecovered investment in the contract remains an itemized deduction, since many more taxpayers will be claiming the standard deduction on their final tax return, the unrecovered investment in the contract will have diminished tax consequences on the annuitant's/decedent's final income tax return.

C. Dear Donor, Please forgive me. Your annuity checks are no longer being cashed, your 1099-R has been returned, and despite our efforts we have had no success in locating you.

Annuitants disappear. It's not a frequent occurrence, but it happens. Checks are returned with no forwarding address, checks go uncashed, or direct deposits are rejected due to an account being closed. Any of these situations may be an indication that the annuitant has died or perhaps moved to another living situation and has neglected to inform the charity. Often some basic investigative work will resolve the matter. However, there are situations where regardless of how many avenues the charity pursues, the annuitant has simply disappeared without a trace. What does the charity need to do regarding past payments, future payments, and tax reporting? In certain situations, the charity may need to consult its legal counsel.

Dear Gift Officer, My apologies to you…: How the charity should proceed will be a matter of applicable state law. This can present challenging issues, especially if the donor is domiciled in one state, the annuitant in another state, and the charity is registered in yet other states to issue gift annuities. The inquiry will likely need to focus not only on what is required under statutes and regulations applicable to gift annuities, but also under those dealing with financial, accounting, and unclaimed property.

Consensus may exist on certain issues, depending on the states involved. Generally, a charity would not be obligated to keep sending payments to an annuitant who, although not yet confirmed to have died, has ceased taking receipt of payments. The charity would be expected to make any back payments still owing, based on whether the annuitant remains alive or, if not, when she has died. The safest approach is to regard the payment obligation as continuing to exist, even if payments have been halted for the time being, until all applicable legal authority confirms that the obligation can be regarded as terminated.

States may diverge on other matters. One state may require the charity to continue to include the annuity in its reserve report for a period of years, whereas another allows the charity to

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delete the annuity from its reserve, subject to potentially adding the annuity back at some later date if the annuitant is found to be alive.

The issue also exists for how to handle the tax reporting. IRS has indicated it expects a charity to file a Form 1099-R for all annuitants, including those who are missing. In other words, taxable income is reportable in the year it is payable, regardless of whether the payment was actually received by the taxpayer. If the charity subsequently located a missing annuitant and a payment is made to cover all prior amounts that were not received by the annuitant, no further tax filing is required as prior 1099-Rs have shown the income to the annuitant. However, if the charity subsequently learns that an annuitant deemed to be missing has died, the charity may need to amend Form 1099-R for one or more years depending on when the annuitant died.

All of the above is a reason that the Gift Annuity Application should contain an alternate contact person in the event the donor/annuitant cannot be located.

D. Dear Donor's Executor, Please forgive me. You might think me insensitive, but you need to return the last annuity payment that was made after the annuitant's death. Charities have been known to make an annuity payment after the death of the last annuitant because the charity was unaware of the annuitant's death. Most charitable gift annuity agreements state:

Charity's obligation under this Agreement shall terminate with the regular payment preceding the Donor's death.

Requesting the return of an annuity payment can become awkward, especially if the annuitant died only days before the payment due date in the annuity agreement. If there is no executor or attorney involved, the awkward situation can be compounded by having to request the return of the payment from family members.

Apology accepted, but…The charity should take steps to recover from the estate the amount overpaid. Usually, this will entail little more than providing the annuitant's personal representative with an explanation of why a refund needs to be made, possibly sending a copy of the annuity agreement so the executor can see the language that governs the charity's obligation to make payments. If the personal representative does not return the payment, the charity may be required to file a claim against the estate, depending on state law. Once the amount of the overpayment has been recovered, the charity may need to file a revised Form 1099-R. Conversely, if the payment has not been returned then the amount of the payment should be included in the Form 1099-R for the tax year in which the payment was made.

A charity may be tempted not to seek a refund, either out of a sense of goodwill toward the family of the deceased or simply out of a desire to avoid the hassle if the amount to be returned is small. However, the overpayment arguably constitutes impermissible private inurement, prohibited by IRS. To stay in the good graces of IRS, the charity should make a reasonable effort to collect the amount due.

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SUMMARY

Mistakes happen. The key is to minimize the possibility for mistakes. That can most often be accomplished by having a good infrastructure and sound policies for administering a gift annuity program. It is crucial to get the donor to provide all the information needed to establish and administer the gift annuity. Ideally, the staff person handling the administration should be knowledgeable about how gift annuities work. There should be systems to check the accuracy of the information input in the software to establish and administer the annuities. And when a mistake does happen, there should be a review of why the mistake happened and how the procedures can be revised to avoid a recurrence of the mistake.

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SCHEDULE A

1. Donor name(s) ______________________________

2. Donor address ______________________________

3. Donor phone number ______________ Email ______________

4. Amount of gift ($10,000 minimum) ______________________________

5. (a) Payment start date ________ immediate *or* ________ defer payments to start on ______________ (Specific month/day/year)

   Payments may begin on ________ (month/day) in any year starting ________ (1st possible year) and ending ________ (last possible year)

   (b) Payment frequency ________ Monthly ________ Quarterly ________ Semi-annually ________ Annually

6. Type of asset ________ cash ________ appreciated securities

Note: If gift of cash, the date of the gift is the postmark date on the envelope in which the check is mailed or the date the check is physically delivered to the Fenway School of Psychology (if not sent via USPS). If this gift is of securities, the date of gift will be the date the securities arrive in the Fenway School of Psychology's account. Be sure that the securities have appreciated in value. Contact the Office of Gift Planning by calling 666-395-3327, or send an email to giftplanning@fenway.org for specific transfer instructions.

7. If giving appreciated securities, please provide the required information in the chart below:

Name of Security	Number of Shares	Approx. Aquisition Date	Cost Basis

8. If there is more than one donor, please note whether the asset being given is owned by both donors or note the name of the sole owner. This answer may impact the taxation of payments. If you have questions please call us.

   Asset owned by: ________ both donors *or* ________ one donor ______________ (donor's name)

9. My gift shall be used: ________ where the need is greatest or for the following charity program:

____

10. Beneficiary #1 information *(Note: This is usually the donor.)*

   Name: ______________ Relationship to donor(s): ______________

   Address: ______________________________

   Date of birth: ______________ Social security number: ______________

11. Beneficiary #2 information *(If there is a second beneficiary)*

   If two beneficiaries, income payments are to be made (check one):

   ________ jointly, then to survivor *or* ________ to beneficiary #1, then, if living, to beneficiary #2

   Name: ______________ Relationship to donor(s): ______________

   Address: ______________________________

   Date of birth: ______________ Social security number: ______________

12. Alternate Contact: Please provide the name, address, phone number and email address of a relative, professional advisor, or close friend whom Fenway may contact if we are unable to locate each annuitant. ______________

I/We acknowledge that I/we have received the Fenway School of Psychology's Gift Annuity Disclosure Statement.

Date: ________ Donor signature(s): ______________________________

____

Checks should be made payable to the Fenway School of Psychology and sent to the Fenway School of Psychology, Office of Gift Planning, 225 Boylston Street, Boston, MA 02467. For more information call, 666-395-3327, or send an email to giftplanning@fenway.org.

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SCHEDULE B

GIFT ANNUITY CHECKLIST

Donor #1 ____________________Donor #2 _______________________ Date ___________

Summary of Benefits

1. Donor Name at top ________
2. Date of birth ________
3. Date of gift ________
4. Principal donated ________
5. Cost basis ________
6. Payment Schedule ________
7. IRS Discount Rate ________

Taxation Schedule – Calculations

1. Number of Payments in first year ________
2. Days in First Period (dates) ________
3. Days of Payment Credit (dates) ________

Gift Annuity Agreement

1. Donor Name ________
2. Donor Address ________
3. Donor gender (Paragraph 1) ________
4. Date of gift ________
5. Fair market value ________
6. Payment frequency ________
7. Date of first payment ________
8. Donor Date of Birth ________
9. Use of gift (i.e. general purposes) ________
10. Governing law ________
11. Schedule A – Description of Property ________

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