



Gift Annuity Essentials



Date: January 28, 2016

Time: 1:00 – 2:30 Eastern Time

Presenter: Bill Laskin
VP, Product Management
PG Calc





Agenda

- Tax Aspects
- Gift Annuity Rates
- State Regulation
- Applications
- Program Operation
- Marketing
- Controlling Risk



Charitable Gift Annuity

- Donor irrevocably transfers cash or property to charity
- Charity pays fixed amount to one or two annuitants for life
- Rate based on age(s) of annuitant(s)
- Unlimited obligation of charity
- What remains at death (“residuum”) goes to the charity



Charitable Gift Annuity





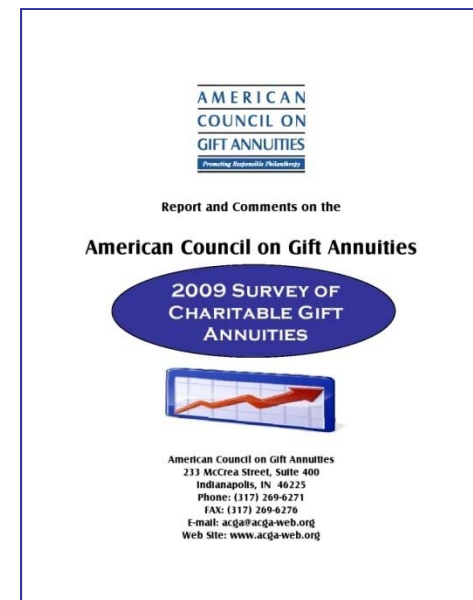
Facts About Gift Annuities

According to 2009 or 2013 ACGA surveys:

- Average gift – \$43,371*
- Average age of annuitants – 79**
- 57% of annuitants are female**
- 12% of annuities are deferred**
– additional 1% are flexible deferred**

* 2009 ACGA Survey

** 2013 ACGA Survey





Profiles of Donors

- Immediate gift annuities:
 - Attractive to those mid-70s and older
 - Retired
 - Fiscally conservative, uncomfortable with debt
 - Not wealthy or don't think they are
 - Annual fund donors, usually very low amounts
 - Worried about outliving their resources
 - Often single (widowed)



Profiles of Donors

- Deferred gift annuities
 - Mid-50s to mid-60s (per ACGA 2013, 73% are 70 or younger)
 - Want supplemental retirement plan
 - Deduction now, income later
- Flexible deferred gift annuities
 - Similar profile to DGAs
 - Not sure when will retire/want income to start
- Annuity for someone else
 - Elderly parent, sibling, child, employee



Gift Annuity Charitable Deduction

- Deduction computed indirectly
- Present value of payments subtracted from gift
- Difference equals charitable deduction
- Present value of payments = purchase price of annuity



Gift Annuity Charitable Deduction

Example: Ms. Palmer, age 74, \$100,000 cash donation,
5.7% annuity, 2.2% discount rate

Present value of annuity	Gift value (deduction)
A \$56,552	B \$43,448



Gift Annuity Charitable Deduction

Present value of annuity payments based on:

- Value of property contributed
- Age of annuitant
- Annuity rate
- Payment frequency
- IRS discount rate
- IRS mortality table (2000CM)



Deduction Comparison: Payment Frequency

- Single annuitant, age 74, annuity rate 5.7%, \$100,000 contribution, discount rate 2.2%.
- Deduction amount when payments are:

Monthly	Quarterly	Semi-Annual	Annual
\$ 43,347	\$ 43,448	\$ 43,599	\$43,908

- The more frequent the payments, the lower the deduction (the higher the present value of the payments); effect is minor



Deduction Comparison: IRS Discount Rate

- Single annuitant, age 74, annuity rate 5.7%, \$100,000 contribution, quarterly payments.

- Deduction amount when discount rate is:

1.2 %	2.2 %	3.2 %	4.2 %	5.2%
\$ 39,149	\$ 43,488	\$ 47,252	\$ 50,632	\$ 53,649

- The lower the discount rate, the lower the deduction (the higher the present value of the payments); effect is significant



Taxation of Payments: Gift of Cash

- Bargain sale
 - Part sale (purchase), part donation
- Purchase price returned pro-rata over life expectancy
- Tax-free portion of payment = return of purchase price
- Balance of payments is ordinary income



Taxation of Payments: Gift of Cash

Example: Ms. Palmer, age 74, \$100,000 cash donation,
5.7% annuity, 2.2% discount rate

- Present value of annuity payments = \$56,552
- Returned over life expectancy of 13.1 years
- Taxation of payments:

Tax-free is $\$56,552 \div 13.1 = \$4,315$

Ordinary income is $\$5,700 - \$4,315 = \$1,385$



Taxation: Gift of Appreciated Property

- Portion of stock is gift to charity
- Portion of stock used to “purchase” annuity
- Cost basis and capital gain allocated to both portions
- If donor is annuitant, gain attributable to purchase price returned pro-rata over life expectancy



Taxation: Gift of Appreciated Property

Example: Ms. Palmer, age 74, \$100,000 stock donation, \$40,000 cost basis, 5.7% annuity, 2.2% discount rate

Present Value of Annuity \$56,552		Gift value (deduction) \$43,448	
A \$22,621	B \$33,931	C \$17,379	D \$26,069

A and C reflect cost basis; B and D reflect gain



Taxation: Gift of Appreciated Property

- Present value of annuity payments = \$56,552
Cost basis: \$22,621; Gain: \$33,931
- Returned over life expectancy of 13.1 years
- Taxation of \$5,700 annual payment:
Tax-free is $\$22,621 \div 13.1 = \$1,726$
Capital gain is $\$33,931 \div 13.1 = \$2,589$
Ordinary income is $\$5,700 - \$4,315 = \$1,385$



Tax-free Portion of Payment: IRS Discount Rate

- Single annuitant, age 74, annuity rate 5.7%, \$100,000 contribution, quarterly payments
- Deduction amount/tax-free portion when discount rate is:

1.2 %	2.2 %	3.2 %	4.2 %	5.2%
\$ 39,149	\$ 43,488	\$ 47,252	\$ 50,632	\$ 53,649
\$4,646	\$4,315	\$4,024	\$3,768	\$3,540

- The lower the discount rate, the lower the deduction – **but the higher the tax-free portion**

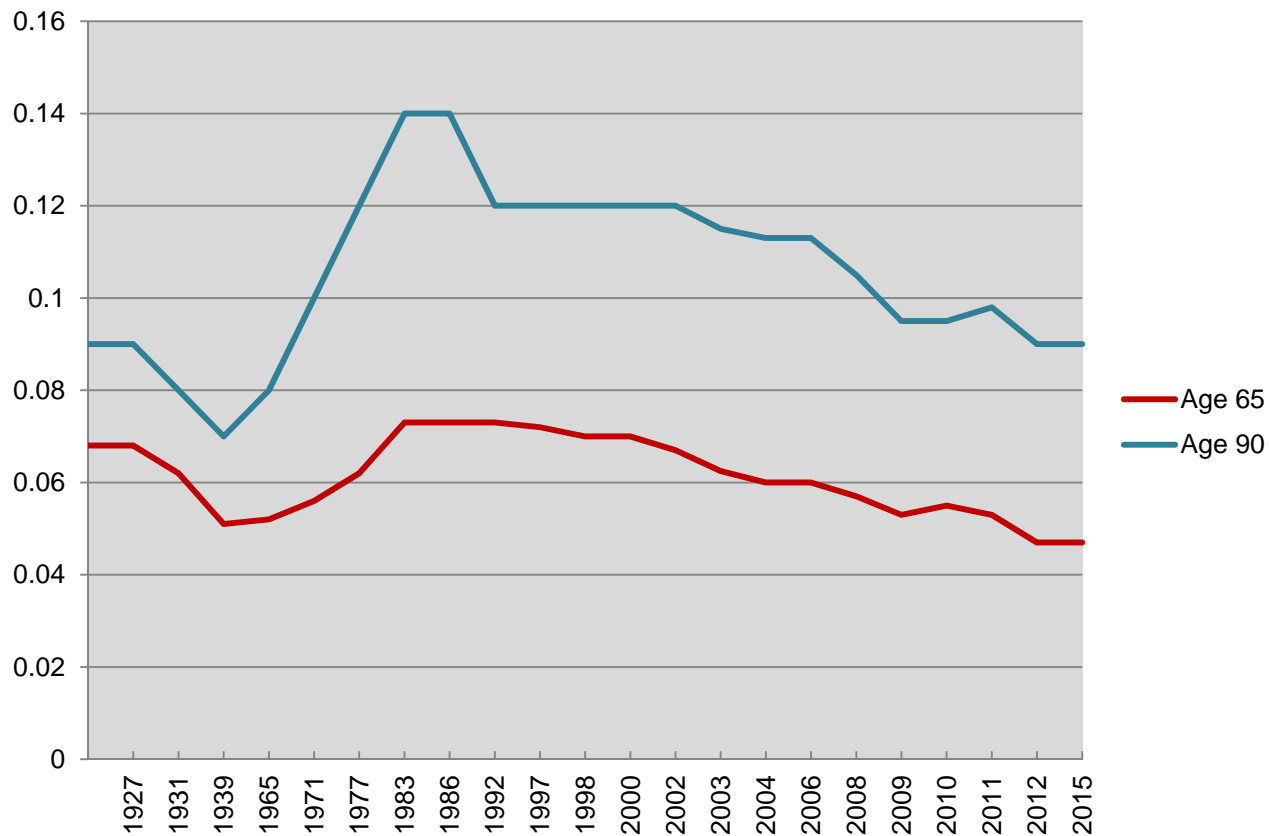


Gift Annuity Rates

- Suggested by the American Council on Gift Annuities (ACGA) since 1927
- Rates reviewed annually
- Emergency rate changes
- Current rates became effective January 1, 2012



Historical Gift Annuity Rates





ACGA Rate Assumptions

- 50% residuum, 20% present value
- Mortality (Annuity 2000 table)
- Net return of 3.25%
- Adjustments for younger and older ages



Deferred Gift Annuity Rates

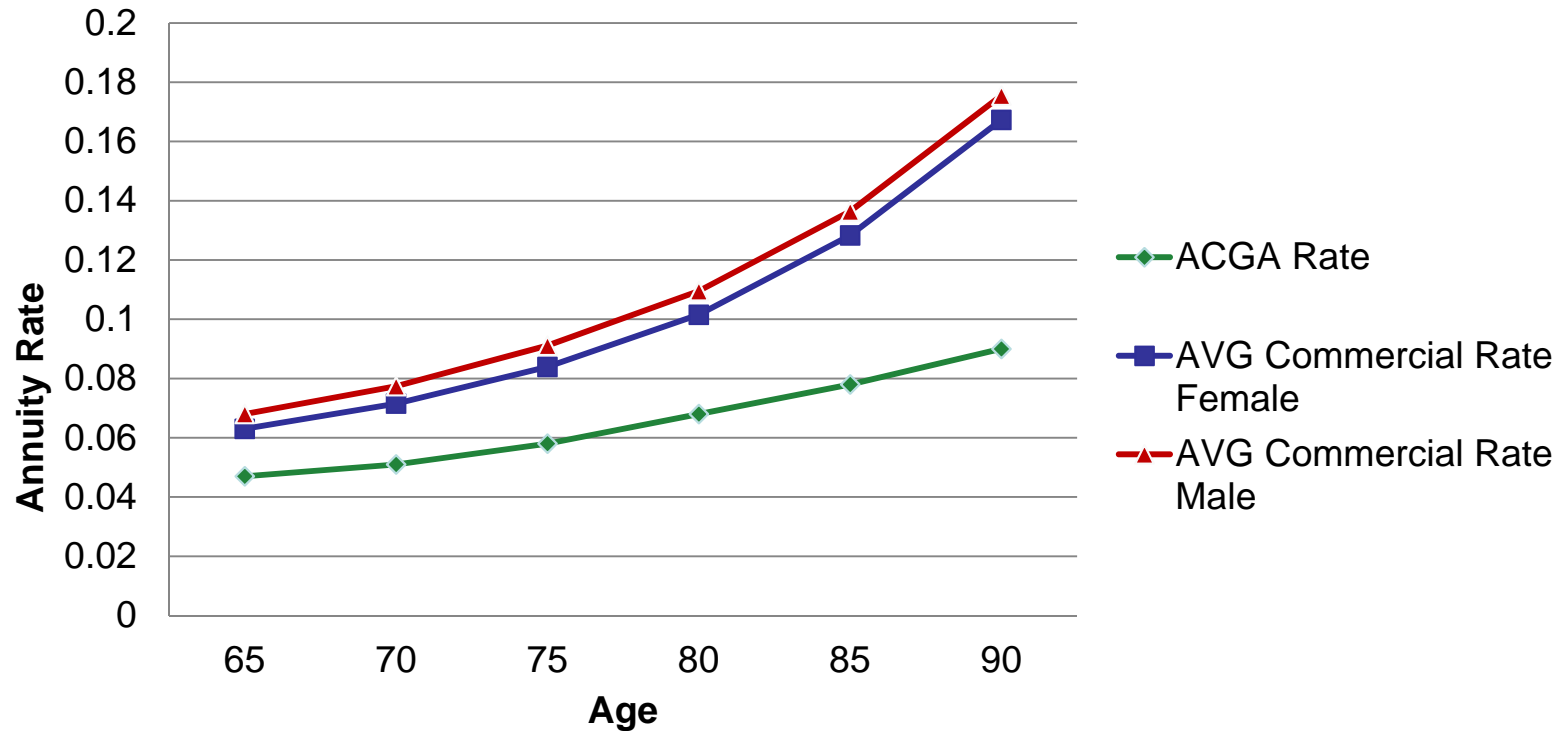
Calculation:

- Immediate annuity rate at date of first payment
- 3.25% annual compounding for length of deferral period (gift date to annuity start date)
- Interest factor x immediate gift annuity rate = deferred annuity rate



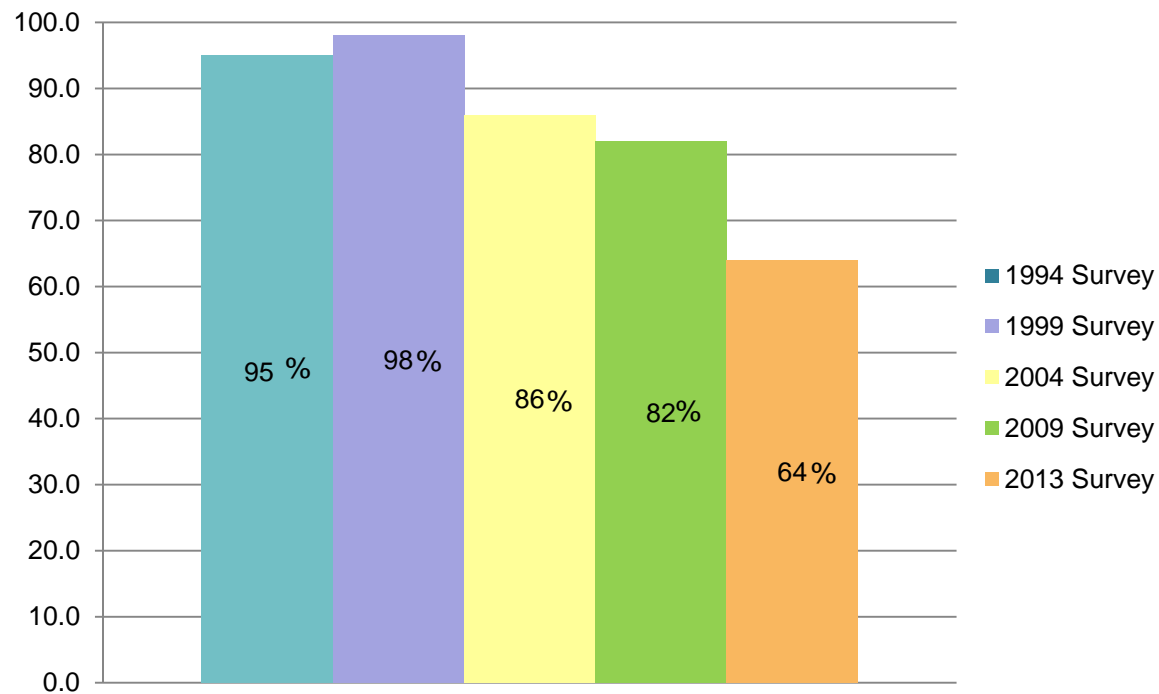
Rates Comparison ACGA vs. Commercial (One-life)

Comparison of ACGA and Commercial Rates
One-Life Annuity
Male & Female Annuitants





Comparison of Median Residuum (based on ACGA Survey results)





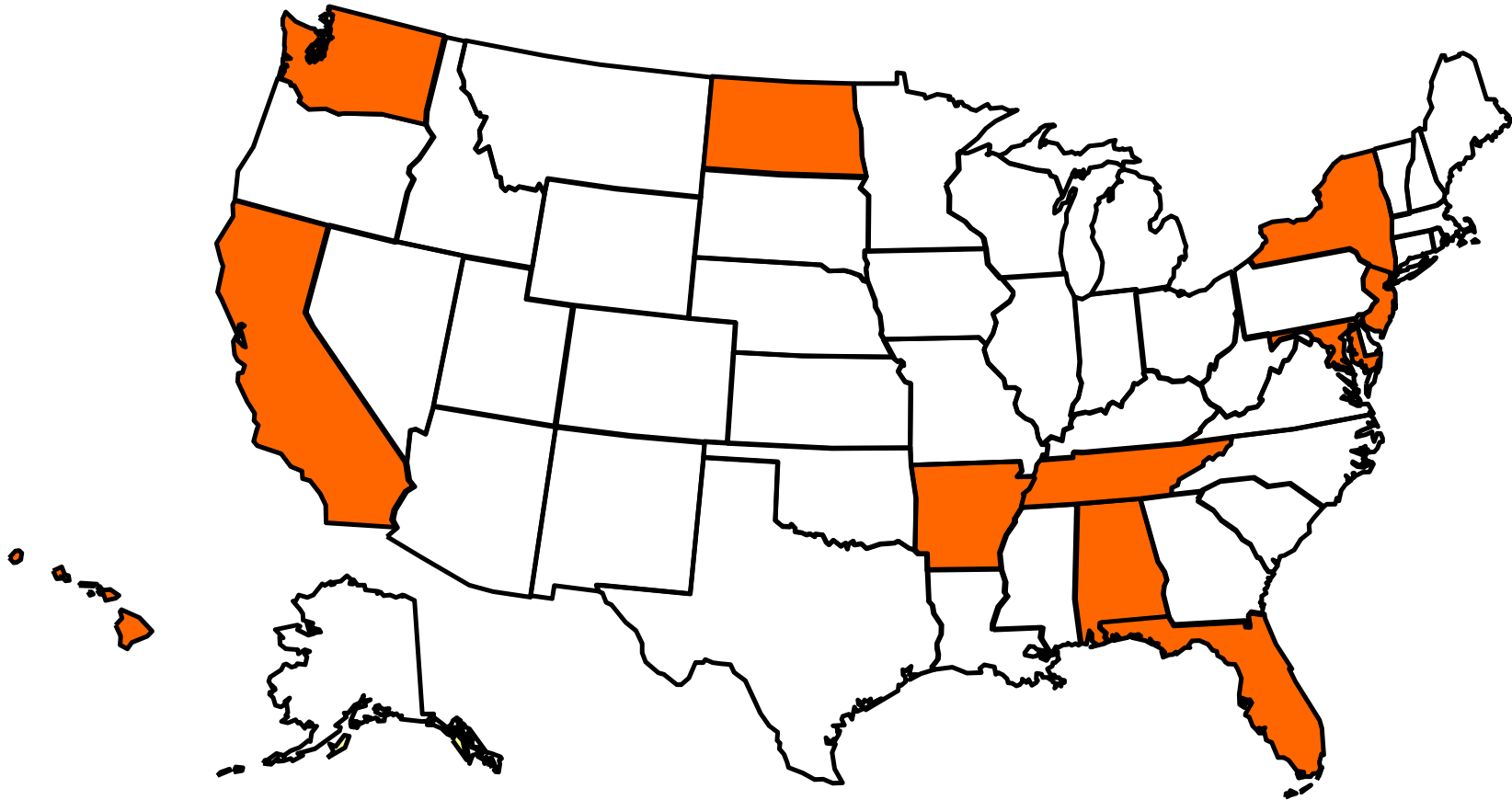
Federal and State Regulations

- Federal
 - Disclosure statement (Philanthropy Protection Act)
 - Forms 1099-R and 1096
- State
 - Charity subject to laws of states where it markets and issues gift annuities
 - If donor moves, does not subject charity to new state's laws



States With Significant Regulation

 = Reserves, Annual Reporting, or Detailed Application





Common Gift Annuity Scenarios

- Funded with cash or publicly-traded securities
- One donor, who is also the annuitant
- Couple, who contribute jointly-owned or community property for a joint-and-survivor annuity



Gift Annuity Funded with Cash

- Ms Sylvester, age 75
 - \$50,000 invested in CDs
 - 2 percent interest
 - **\$720 after-tax income**

- \$50,000 gift annuity
 - \$2,900 before-tax income
 - **\$2,708 after-tax income**



Comparison of Cash Flow from \$50,000 Cash

Prior to the Gift:	
Interest (2%)	\$1,000
Income tax on interest (28% rate)	(\$280)
Net spendable	\$720
After the Gift:	
Annual payment	\$2,900
Ordinary income	\$684
Tax-free	\$2,216
Income tax (28% x \$684)	(\$192)
Net spendable	\$2,708



Gift Annuity Funded with Stock

- Mr. and Mrs. Gregory, 79 and 76
 - Stock, value of \$50,000 and cost of \$20,000
 - 3 percent dividend
 - **\$1,275 after-tax income**
- \$50,000 two life gift annuity
 - \$2,650 before-tax income
 - **\$2,264 after-tax income**





Comparison of Cash Flow from \$50,000 Stock

Prior to the Gift:	
Dividends	\$1,500
Income tax on dividends (15% rate)	(\$225)
Net spendable	\$1,275
After the Gift:	
Annual payment	\$2,650
Ordinary Income	\$615
Long-term capital gain	\$1,221
Tax-free	\$814
Income tax (33% x \$525, plus 15% x \$1,880)	(\$386)
Net spendable	\$2,264



Deferred Annuity as Supplemental Pension

Dr. Hecht, age 50

- \$50,000 deferred annuity
- Payments to begin at 65
 - Immediate rate for age 65 = 4.7%
 - Deferred rate = 7.6% (compounded for 15 years)
- \$3,800 annuity payment beginning in 2031
 - Tax-free = \$1,710
 - Ordinary income = \$2,090
- Charitable deduction = \$15,986



Flexible Deferred Annuity as Supplemental Pension

What if Dr. Hecht is unsure when he wants to start receiving payments?

- \$50,000 flexible deferred annuity
- Payments may begin early as 60 or late as 75
 - Annuity if payments start at 60: \$3,050 (6.1%), \$1,571 tax-free
 - Annuity if payments start at 75: \$6,450 (12.9%), \$3,051 tax-free
- Charitable deduction = \$12,156 (compare to \$15,986 if deferred to 65 with no flexibility)



Controlling Gift Annuity Risk

- Offer gift annuities only if charity financially sound
- Do not exceed ACGA rates
- Do not offer annuities to young annuitants
(Under age 60 for immediate annuities)
- Do not accept gifts below prudent minimums
(Under \$10,000)



Conclusion

Gift Annuities:

- Popular with donors
- Can be beneficial to a charity
- Require sound policies and good administration
- Should be marketed actively



Questions and Answers





Still Have a Question?

Contact: Bill Laskin
VP, Product Management
PG Calc

E-mail: bill@pgcalc.com