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## Gift Annuity Essentials



**Date:** January 28, 2016  
**Time:** 1:00 – 2:30 Eastern Time  
**Presenter:** Bill Laskin  
 VP, Product Management  
 PG Calc




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## Agenda

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

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## 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

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## Charitable Gift Annuity

1. Give assets

2. Income tax deduction  
Reduced tax on capital gain  
Fixed payments

3. Remainder to The Fenway Fund

Donor

Charitable gift annuity

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## 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

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## 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)

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## 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

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## 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

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## 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

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### 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)

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### 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

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### 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

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### 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

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### 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  $\$5,700 - \$4,315 = \$1,385$

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### 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

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### 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	B	C	D
\$22,621	\$33,931	\$17,379	\$26,069

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

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### 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  $\$5,700 - \$4,315 = \$1,385$

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### 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**

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## 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

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## Historical Gift Annuity Rates

Year	Age 65 Rate	Age 90 Rate
1927	0.07	0.09
1931	0.06	0.08
1939	0.05	0.07
1945	0.05	0.08
1951	0.06	0.10
1957	0.07	0.12
1963	0.07	0.14
1968	0.07	0.14
1973	0.07	0.12
1978	0.07	0.12
1983	0.07	0.12
1988	0.07	0.12
1993	0.07	0.11
1998	0.07	0.11
2003	0.06	0.11
2008	0.06	0.10
2013	0.05	0.09
2015	0.05	0.09

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## ACGA Rate Assumptions

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

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### 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

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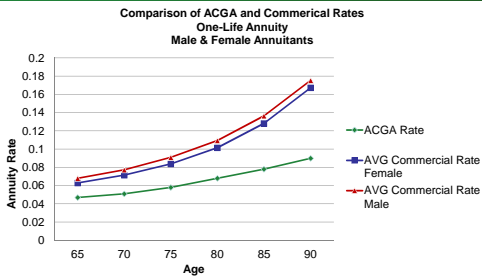
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### Rates Comparison ACGA vs. Commercial (One-life)




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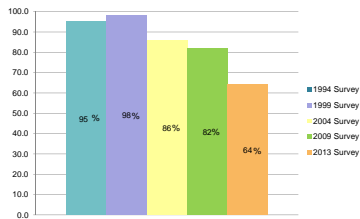
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### Comparison of Median Residuum (based on ACGA Survey results)




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## 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

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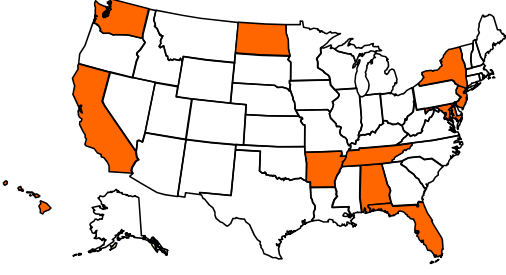
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## States With Significant Regulation

 = Reserves, Annual Reporting, or Detailed Application



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## 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

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### 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**

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### Comparison of Cash Flow from \$50,000 Cash

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

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### 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**



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### Comparison of Cash Flow from \$50,000 Stock

<b>Prior to the Gift:</b>	
Dividends	\$1,500
Income tax on dividends (15% rate)	(\$225)
Net spendable	<b>\$1,275</b>
<b>After the Gift:</b>	
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	<b>\$2,264</b>

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### 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

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### 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)

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### 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)

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### Conclusion

Gift Annuities:

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

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### Questions and Answers



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## Still Have a Question?

**Contact:** Bill Laskin  
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