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Dear Donor, Please Forgive Me: Avoiding Gift Annuity Mistakes



Date: January 25, 2018
 Time: 1:00 – 2:30 Eastern
 Presenter: Mike Valoris
 Senior Consultant
 PG Calc

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A Gift Annuity Misadventure

Dear Donor, Please Forgive Me. When I solicited your \$100,000 gift, I did not realize that IRA charitable rollover gifts cannot be used 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.


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Points for Discussion

- Why mistakes happen
- The anatomy of a charitable gift annuity
- A review of the process of issuance and administration
- Mistakes involving funding assets
- Mistakes involving donors and/or annuitants
- Challenges in gift annuity administration


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Why Mistakes Happen

- Staff turnover – gaps in program oversight
- Office staff lack an understanding of how CGAs work
- Gift officers lack sufficient training
- Lack of procedures that reduce the chance for error
- Not following best practices in administration


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The Anatomy of a Charitable Gift Annuity

- Funding assets (cash, securities, non-liquid assets)
- Annuity rate (ACGA suggested rates)
- Charitable Midterm Federal Rate (CMFR)/Applicable Federal Rate (AFR)/Section 7520 rate/IRS discount rate
- Income tax charitable deduction
- Investment in the contract
- Gift value minus charitable deduction = Investment in the contract


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Anatomy of a Charitable Gift Annuity

- Date of gift: 1/25/2018
- Gift amount: \$50,000
- Funding asset: Appreciated securities (L-T Cap gain)
- Cost basis: \$10,000
- Capital gain: \$40,000
- DOB of annuitant: 2/1/1938 (Age 80)
- Annuity rate: 6.8%
- Annual annuity amount: \$3,400
- Charitable deduction: \$25,376.50
- Investment in the contract: \$24,623.50
- Reportable gain: \$19,698.80
- Gain reported over: 9.4 years

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Best Practices in Issuance

- Issuance stage is when there's the greatest likelihood for a mistake
- Mistakes jeopardize donor relations (and legal requirements)

The Gift Annuity Application

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Best Practices in Issuance

DONORS AND ANNUITANTS

- Identifies the donors
- Identifies the annuitants
- Relationship of annuitants to the donors (spouse, other)
- Dates of birth of annuitants (not ages)
- Structuring of payments – one life or two, joint or successor?

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Best Practices in Issuance


ASSETS DONATED

- Cash or securities – ownership of the assets
- Securities:
 - ✓ Cost basis, Acquisition date
 - ✓ Assets to be transferred

ANNUITY TYPE

- Immediate payment
- Deferred/Flexible deferred
 - ✓ Date of first payment
 - ✓ Date range for payments


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Best Practices in Issuance

- Social security number of annuitant(s)
- Alternate contact person in CGA application (not the donor or the annuitant – could be a professional advisor)
- Acknowledge receipt of CGA disclosure statement

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Best Practices in Issuance

- Accuracy and attention to detail are key
- Use a comprehensive checklist for all documents connected with the issuance of the gift annuity
- Check the documents against the application
- The originator should not be the only reviewer


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Best Practices in Administration

- Maintain data for the gift arrangement
- Payment issuance
- Reconcile accounts and payment reissuance
- Tax reporting
- Maintain market values & supporting documentation
- General reporting & financial accounting
- State reporting and compliance

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Mistakes with Funding Assets

Dear Donor, I neglected to get the cost basis for your mutual fund shares.

- Gift annuity application issue
- Donor does not know the cost basis
- Ramifications:
 - ✓ Inability to administer the gift
 - ✓ Cannot do tax reporting
 - ✓ Return the gift – but what if liquidated?

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Mistakes with Funding Assets

Dear Donor, I miscalculated the value of your appreciated assets used to fund the annuity.

- Incorrect IRS methodology used
- Publicly traded stock – average of high and low on gift date
- Mutual funds – closing price on gift date
- Mistake:
 - ✓ charity uses net proceeds check as the valuation
 - ✓ charity uses closing price on shares of stock
- If miscalculation: error in deduction, payment amount, tax reporting

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Mistakes with Funding Assets

Remedies for miscalculation of asset value:

- No payments, tax return not filed
 - ✓ Issue corrected calculations and new contract
- Payments made, but caught before end of year
 - ✓ Issue corrected calculations and new contract
 - ✓ Adjust remaining payments to reflect correct annuity amount
- If 1099-R issued and deduction claimed
 - ✓ Issue corrected calculations and new contract
 - ✓ Issue corrected 1099-R and donor corrects tax return

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Mistakes with Funding Assets

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

- Long-term capital gain assets are tax-wise funding assets
- Gain allocated to gift portion forgiven; gain allocated to annuity reported ratably
- Capital loss property - worth less than what donor paid

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Mistakes with Funding Assets

Remedy:

- Advise donor to sell the securities and give cash
- Capital losses can offset capital gains on donor's individual tax return
- This cannot be undone if loss property funds the gift

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Mistakes with Funding Assets

Dear Donor, I did not realize your broker transferred (a) the wrong securities, or (b) more of the securities than you wanted to give.

- Brokers can make mistakes in what is transferred to the charity
- Assets not intended for the gift or exceeding what is intended
- Most charities liquidate the shares upon receipt

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Mistakes with Funding Assets

Remedy:

- Compare the assets received with the gift annuity application *prior* to liquidation
- Procedure for GP office to authorize sale of securities when they arrive

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Challenges with Funding Assets

Dear Donor, the funding assets arrived on different days.

- Typical when various assets used to fund the annuity (i.e securities and cash)
- Some donors like to “even-up” the gift amount

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Challenges with Funding Assets

Remedies:

- Option #1 – separate gift annuity agreements
- Option #2 – value assets on date of receipt; obligation to pay on date of last transfer
- Charitable deduction – date of last transfer, using total contribution amounts valued on respective gift dates
- Donor should agree with methodology
- Check with your counsel

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Mistakes with Donors and/or Annuitants

Dear Donor, I didn't realize you will not be the annuitant.
(Transfer Tax issue)

- The donor does not need to be the annuitant
- Transfer tax issues arise when donor is not the annuitant
- The investment in the contract may cause transfer taxes
- Gift and estate tax exemption:
 - ✓ Spouses - unlimited exemption
 - ✓ Non-spouses - \$15,000 per donee annual gift tax exclusion in 2018
- \$11.2 M/\$22.4M lifetime gift/estate tax exclusion (increased under new tax law)

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Mistakes with Donors and/or Annuitants

(Transfer Tax issue)

Remedy:

- Only income interest subject to taxation, not entire gift
- Donor retains right to revoke the payments - incomplete gift
- Completed gift to extent of payments made
- If within annual exclusion amount, no tax filing required

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Mistakes with Donors and/or Annuitants

Dear Donor, I didn't realize you will not be the annuitant.
(Capital Gain Taxes)

- Funding with appreciated long-term capital gain assets
- Capital gain tax issue if donor is not the annuitant
- Capital gain allocated to charitable gift - forgiven
- Capital gain allocated to the annuity - tax due in year of gift

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Mistakes with Donors and/or Annuitants

Remedy:

- Fund the gift annuity with cash
- Since only some gain is taxed, may be acceptable to the donor

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Mistakes with Donors and/or Annuitants

- Date of gift: 1/25/2018
- Gift amount: \$50,000
- Funding asset: Appreciated securities (L-T Cap gain)
- Cost basis: \$10,000
- Capital gain: \$40,000
- **DOB of annuitant (not the donor):** 2/1/1938 (Age 80)
- Annuity rate: 6.8%

- Annual annuity amount: \$3,400
- Charitable deduction: \$25,376.50
- Investment in the contract: \$24,623.50
- **Reportable gain: \$19,698.80**
- **Gain reported: in the year of the gift**

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Mistakes with Donors and/or Annuitants

Dear Donor, I didn't realize that the spouse who owned the stock would not be the annuitant.

- Spouses may not be clear who owns the assets
- If donors and annuitants are not the same, capital gain taxes can be triggered
- Some spouses will have only one spouse as the annuitant to increase the annuity rate
- Spouse A owns the securities, Spouse B to be the sole annuitant
- Spouses A&B own the securities, Spouse A to be the sole annuitant

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Mistakes with Donors and/or Annuitants

(Spouses using appreciated assets for funding)

Remedy:

- Retitling assets prior to the gift in the name of the annuitant/spouse is the solution
- If a donor spouse will not be an annuitant, inform her/him about risk of payments stopping
- Donors told to consult their financial advisor
- Document your file!

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Mistakes with Donors and/or Annuitants

Dear Donor, I put an incorrect payment frequency in your annuity agreement.

- The frequency in the annuity agreement may have been wrong from the outset
- Frequency of payments can be changed (i.e. more frequent to less frequent)
- Present value of the payments will increase if payments will be made more frequently
- If PV of payments would increase, the amount of payments must be adjusted downward to keep PV the same

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Mistakes with Donors and/or Annuitants

(Changing the frequency of payments)

Remedy:

- Calculate Present Value (PV) of current payment frequency and new payment frequency
- If PV increases, reduce annuity payments
- Document any changes, with donor and charity to sign

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Mistakes with Donors and/or Annuitants

Dear Donor, By giving you a higher rate than ACGA suggested rates, I may have violated state laws and increased the risk that our organization will not realize funds from your gift.

- The phone call with the donor who is “shopping rates”
- Issues when offering higher than ACGA suggested rates:
 - ✓ State regulatory violations
 - ✓ Increasing the risk of exhausting the residuum
 - ✓ Increases amount required to maintain annuity reserves in regulated states

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Mistakes with Donors and/or Annuitants

(Offering higher than ACGA rates)

Remedy:

- Follow ACGA rates consistently
- Track contracts that are exhausting
- Ask annuitant to assign income to charity

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Mistakes with Donors and/or Annuitants

Dear Donor, this is not my mistake. How was I to know that you would get a divorce after funding the gift annuity?

- Divorcing annuitants - awkward for the charity
- Payments on the contract may be affected

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Mistakes with Donors and/or Annuitants

Remedy:

- ✓ Communicate in writing with both spouses
- ✓ Has the annuity been addressed in any divorce agreement?
- ✓ Get a copy of relevant documents
- ✓ Joint and survivor annuitants – split payments
- ✓ Tax reporting issues

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Mistakes with Donors and/or Annuitants

Dear Donor, I was not aware you were contemplating filing for Medicaid after funding this charitable gift annuity.

- A gift annuity can affect Medicaid benefits
- Annuities funded to assist a loved one on government benefits - maybe not be a good idea
- Medicaid is a federal program administered at state level
- Assets must be spent down - there is a five-year look-back to qualify

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Mistakes with Donors and/or Annuitants

(Medicaid benefits)

Remedy:

- Advise donors to consult counsel if Medicaid benefits might be an issue
- Suggest donors inquire about having payments made to a special needs trust

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Mistakes with Donors and/or Annuitants

Dear Donor, I apologize that I did not make you aware of other opportunities with your charitable gift annuity. (Assigning an income interest to charity)

- An annuitant may no longer need the annuity payments
- The annuity contract may be “under water”

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Mistakes with Donors and/or Annuitants

Remedy:

- ✓ Track the value of each contract
- ✓ The annuitant can assign her right to payments to the charity
- ✓ Gift credit – PV of remaining income interest
- ✓ Charitable deduction – undistributed investment in the contract or PV of income interest, whichever is less
- ✓ Qualified appraisal needed if deduction > \$5,000
- ✓ Annuitant should consult their tax advisor

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Mistakes with Donors and/or Annuitants

Dear Donor, I apologize that I did not make you aware of other opportunities with your charitable gift annuity. (Allowing the charity to keep the payments)

- An annuitant may decide they do not need the payments now
- The annuitant may want to do more to support the charity

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Mistakes with Donors and/or Annuitants

Remedy:

- ✓ The annuitant allows the charity to keep the payments
- ✓ Each payment is a gift to charity and charity should send a receipt
- ✓ All annuity payments are reported on 1099-R issued to donor

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Mistakes with Donors and/or Annuitants

Dear Donor, I should have been more proactive in reminding you annually that you can start to receive payments on your flexible deferred gift annuity.

- The flexible deferred gift annuity - a range of dates for payments to begin
- Annuitant to contact charity to begin payments (except for final date in the contract)
- Annuitants age or get ill and may forget about the gift

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Mistakes with Donors and/or Annuitants

Remedy:

- ✓ An annual letter is good stewardship; no less than every few years
- ✓ Ensures current contact information for the annuitant

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Challenges in CGA Administration

Dear Donor, our charity does not track the market value of each CGA contract and we're not sure if there will be anything left from your gift annuity.

- Best practice to track the market value of each contract
- Restricted residuum – need to know the amount at termination
- Potential exhaustion of residuum – better management of the program

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Challenges in CGA Administration

Remedy:

- ✓ Explore tracking the market value of each contract
- ✓ Possible to estimate market values if not already tracked

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Challenges in CGA Administration

Dear Donor's Executor, I neglected to inform you that because the annuitant died before the end of her life expectancy she is entitled to an additional income tax deduction on her final income tax return.

- Annuitants who die before life expectancy get an additional income tax deduction
- Deduction is for the unrecovered investment in the contract
- If funded with appreciated assets - deduction for unrecovered basis allocated to PV of annuity payments
- Not a charitable deduction – an itemized tax deduction
- Consult estate tax advisor

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Challenges in CGA Administration

Donor dies before life expectancy – additional income tax deduction
 (Example of funding with appreciated assets - \$50,000 funding)

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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Challenges in CGA Administration

Dear Donor, your annuity checks are no longer being cashed, your 1099-R has been returned, and we cannot locate you.

- Annuitants periodically disappear
- Death or a change in the annuitant's living situation
- Challenging for the charity – how to proceed?
- CGA regulations, also state financial, accounting, and unclaimed property laws
- Obligation to continue sending payments can usually stop
- Tax reporting – income reportable in the year payable, even if not received
- CGA application – should contain a name for alternate contact

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Challenges in CGA Administration

Dear Donor's executor, you might think me insensitive, but you need to return the last annuity payment that was made after the death of the annuitant.

- Consult the annuity agreement for dealing with annuity payments at death
- Most agreements state last regular payment during life is the final payment
- Charities often make payments after death due to lack of notice
- Best practice is to request the return of the payment
- If an estate and payment is not being returned, can file a claim with the estate

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Summary

- The Gift Annuity Application is the key document to avoiding mistakes
- Take the extra time when establishing the annuity to double-check processing
- Have a detailed procedures manual
- Be careful with appreciated assets
- Follow best practices for administration
 - ✓ Tracking market values of the contracts
 - ✓ Following ACGA rates
- When a mistake happens, determine why and alter procedures to avoid a repeat occurrence


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Questions?



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Still Have a Question?

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