What to Use and When: CGAs vs. CRUTs and CRATs

Jeff Lydenberg
Vice President, Consulting
jeff@pgcalc.com
617-497-4997

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Agenda

- Characteristics of gift annuity and charitable remainder trust donors
- Features of CGAs, charitable remainder annuity trusts, and charitable remainder unitrusts
- Comparison of a gift annuity and a CRAT
- Charitable remainder unitrusts: variations on themes
- Deferred annuities and CRTs to supplement retirement
- Funding life income gifts with real estate

Gift Annuity Donor Profile

- Concerned about outliving assets
- Relies on income to maintain lifestyle
- Not comfortable with risk
- 79 years old or older
- Frequently establish multiple annuities

Charitable Remainder Trust Donor Profile

- Wealthy
- Younger, 50’s and 60’s (but not always!)
- Financially savvy
- Comfortable with financial risk
- Capable of making six figure or larger gift
- Planning requires a flexible life income gift

CGAs, Annuity Trusts, and Unitrusts

- Estimates suggest that there are hundreds of thousands of gift annuities issued by hundreds of charities.
- In 2012, there were 14,616 annuity trusts in existence
- In 2012, there were 91,250 unitrusts in existence
- Remainder trusts often initiated by donors estate and financial planning professionals
- Most CGAs are initiated by gift planning officers through their charity's marketing efforts.

Features of the Gift Annuity

- Low barrier to entry ($10,000 min. common)
- Easy to establish and understand
- Annuities backed by all of charity's assets
- Subject to heavy regulation in some states
- Can only benefit one charity
- Can only have one or two annuitants

The Prototype CGA

- Leah, 78 years old
  - ✓ $50,000 CD paying 3%
  - ✓ After-tax income $1,140 (24% bracket)
- Contributes $50,000 cash for 6.8% CGA
  - ✓ $3,400 annual payment
  - ✓ $2,475 tax-free for her 10.5 year life expectancy
  - ✓ $925 taxed as ordinary income
  - ✓ $3,178 net spendable for first 10.5 years

The Prototype CGA

- Charitable deduction of $22,400
- CGA is irrevocable
  - ✓ Leah can't get contribution back
  - ✓ She owns an income stream, not principal
- <u>Not</u> equivalent to an investment, it is a gift
- Does not keep pace with inflation
- Not subject to market fluctuation

Rules Applicable to Charitable Remainder Trusts

- Requires trust agreement and separately managed trust account managed by trustee
- Payout may not be lower than 5% or over 50%
- Deduction must be no less than 10% of gift
- Term can be lives, fixed term, or a combination
- Can name multiple charitable beneficiaries
  - ✓ Donor usually retains power to change charities

Rules Applicable to Charitable Remainder Trusts

- Can be created during life or at donor's death
- Unitrusts, in particular, offer flexibility
  - ✓ Trust terms can more easily accomplish multi-generational benefits
  - ✓ Vehicle of choice for illiquid assets
  - ✓ Unitrust can keep pace with inflation if investments appreciate
  - ✓ Can make additions to a unitrust

Charitable Remainder Annuity Trust: The "other" fixed income gift

- Gift minimums much higher than CGAs
  - ✓ $250,000 is common
- Can benefit multiple charities
- Term can be combination of lives and fixed term
- Deduction must be at least 10% of gift amount
- May not be greater than 5% chance trust will exhaust

Charitable Remainder Annuity Trust: The "other" fixed income gift

- Liability for payments limited to assets in the annuity trust
- No risk to charity if named as beneficiary
- Charity acting as trustee fraught with peril
- Not subject to CGA regulations
- Payout negotiated between donor and trustee
  - ✓ No ACGA for trust rates!

Charitable Remainder Annuity Trust: The "other" fixed income gift

- George and Sally, 85 and 84
- $2M highly appreciated, low yielding stock
- Gift of stock to 5% annuity trust
  - ✓ Payments of $100,000 for life
- Capital gain trapped inside annuity trust
- Income taxed at capital gain rates after reporting interest and dividend income

Unitrust to Diversify and Increase Income

- Sarah and Andrew, both 77
- $1M appreciated stock to 5% unitrust
- No immediate capital gain tax
- $445,080 income tax charitable deduction
- $50,000 income in year one
  - ✓ Income taxed at capital gain rates after first reporting interest and dividend income

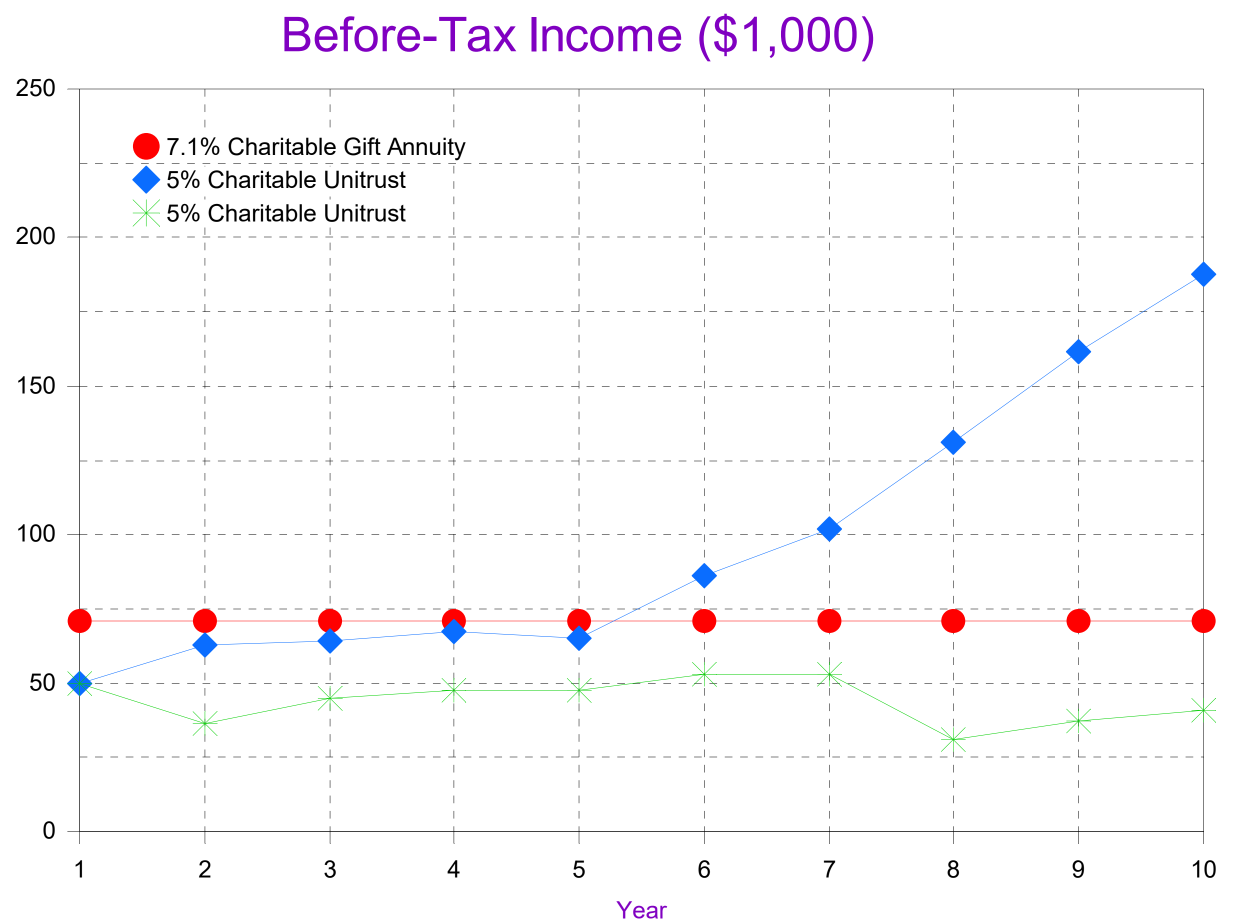
Unitrust to Diversify and Increase Income

- Trustee sells stock and diversifies investments without triggering immediate capital gain tax
- Assume constant net return of 6%
  - ✓ 2% income, 4% capital appreciation
  - ✓ $1M principal has grown to $1,104,622 in year 10
  - ✓ Before-tax income has increased to $54,684

Security v. Growth Potential

- Charitable remainder unitrust payments subject to market performance
- Compare two 5% CRUTs invested as follows
  - ✓ Historical returns for 10 year period beginning 1/1/1990
  - ✓ Historical returns for 10 year period beginning 1/1/2000
- Compare to 7.1% annuity paying to 80 year-old

Security v. Growth Potential



Security v. Growth Potential

- 5% CRUT invested for 10 years beginning 1/1/1990
  - ✓ Before-tax income of $979,229
- 5% CRUT invested for 10 years beginning 1/1/2000
  - ✓ Before-tax income of $442,410
- 7.1% Charitable Gift Annuity
  - ✓ Before-tax income of $710,000

The Flip Charitable Remainder Unitrust

- Operates as net-income trust until trigger event
  - ✓ Operates as straight payout after trigger
- Flip trigger may not be in discretion of donor, trustee, or any other person
- As a retirement vehicle
  - ✓ Invest for low income in pre-flip years
  - ✓ Invest for total return post-flip
- Flip occurs in year <u>following</u> flip trigger

Life Income to Supplement Retirement

- Dr. and Mrs. Mahoney, both 55
- Retiring at age 70
- Gift of $250,000 to flip CRUT in 2018
  - $40,000 annual additions for 10 years
  - Flips at age 70

$250,000 in year one, $40,000 additions for 10 years	$650,000
Trust fair market value at age 70	$764,082
Trust income at age 70 (5% x $764,082) (Income in subsequent years will vary.)	$37,826
Total income tax charitable deductions, approximately	$169,360

Deferred Payment Gift Annuity

- Annuity payments begin at least one year from date of gift
- ACGA rate compounded at 3.75% a year
  - ✓ Deferred offers higher annuity rate and larger deduction than immediate payment annuity
- Two flavors of deferred annuities
  - ✓ Donor picks a future payment date at time of gift
  - ✓ Donor chooses a range of payment start dates (flexible)

Deferred Payment Gift Annuity

- Linda Sommers, 50
  - ✓ 4% if an immediate CGA in 2018
- Gift of $50,000 in 2018
- Defers payments to age 65
- Deferred annuity rate 8.9%
  - ✓ Annual annuity of $4,450 for life
- Income tax deduction of $20,125 in year of gift

Flexible Deferred Annuity

- Richard Runcey, 59
- Unsure when he might want CGA payment
- Funds flexible deferred annuity with $100,000
- Retains right to begin payments between age 65 and 75
- Lowest deduction of all possible start dates

Flexible Deferred Annuity

Elective Start Date	Age at Start Date	Annuity Rate	Annuity Amount
9/30/2024	65	6.3%	$6,300.00
9/30/2025	66	6.7%	$6,700.00
9/30/2026	67	7.1%	$7,100.00
9/30/2027	68	7.3%	$7,300.00
9/30/2028	69	7.8%	$7,800.00
9/30/2029	70	8.4%	$8,400.00
9/30/2030	71	8.8%	$8,800.00
9/30/2031	72	9.3%	$9,300.00
9/30/2032	73	9.8%	$9,800.00
9/30/2033	74	10.5%	$10,500.00
9/30/2034	75	11.1%	$11,100.00

Deferred Annuity with Inflation Protection

- Matthew Kennedy, 64
- Wants secure fixed payments of a CGA
- Wants 3.5% annual inflation protection
- Creates immediate annuity funded with $100,000
- At same time, creates smaller deferred annuities to increase income by 3.5% per year

Deferred Annuity with Inflation Protection

Type of Annuity	Payment Beginning Date	Funding Amount	Payment Increment	Total Annuity
Immediate	9/30/2018	$100,000		$5,000
Deferred	9/30/2019	$3,302	$175	$5,175
Deferred	9/30/2020	$3,234	$181	$5,356
Deferred	9/30/2021	$3,177	$187	$5,544
Deferred	9/30/2022	$3,181	$194	$5,738
Deferred	9/30/2023	$3,089	$201	$5,938
Deferred	9/30/2024	$3,012	$208	$6,146
Deferred	9/30/2025	$2,947	$215	$6,361
Deferred	9/30/2026	$2,892	$223	$6,584
Deferred	9/30/2027	$2,810	$230	$6,814

Stacking Flexible Deferred Annuities

- Richard Runcey, 59
- Previous case showed 3.5% inflation protection
- In this case, Richard creates 10 flexible deferred annuities each funded with $10,000
- Richard can choose when and how many annuities to begin payments to meet his income needs

Stacking Flexible Deferred Annuities

Elective Start Date	Age at Start Date	Annuity Rate	Payment from Each Annuity	Potential Total Annuity if All Elected in One Year
9/30/2019	60	4.8%	$480	$4,800
9/30/2020	61	5.0%	$500	$5,000
9/30/2021	62	5.3%	$530	$5,300
9/30/2022	63	5.6%	$560	$5,600
9/30/2023	64	6.0%	$600	$6,000
9/30/2024	65	6.3%	$630	$6,300
9/30/2025	66	6.7%	$670	$6,700
9/30/2026	67	7.1%	$710	$7,100
9/30/2027	68	7.3%	$730	$7,300
9/30/2028	69	7.8%	$780	$7,800
9/30/2029	70	8.3%	$830	$8,300

Life Income with Gifts of Illiquid Assets

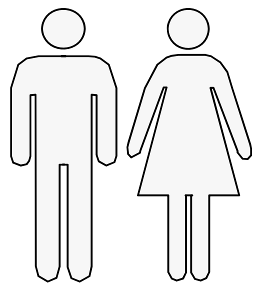
Illiquid Assets Funding a Flip CRUT

- A Flip CRUT pays its net income prior to the trigger event
  - ✓ Non-income producing asset, no income prior to flip
  - ✓ Donors continue to receive net income until flip
- Sale of an “unmarketable asset” is a permissible trigger event
- Unmarketable means not easily converted to cash
  - ✓ Real estate, tangible personal property, business interests

Illiquid Assets Funding a Flip CRUT

- Timing of trigger event matters!!
- Flip to straight payout occurs year <u>following</u> trigger event
- Sale on January 1 v. December 31?
  - ✓ If income producing asset sold early, net income could drop precipitously
  - ✓ Circumstances of income and sale require special attention

Flip CRUT Funded with an Apartment Building



James and Linda, 71 and 70

$1.6M FMV
$400,000 basis

Deduction
$668,843

"Flip"
NIMCRUT

Net income until sale
5% of trust value after sale

James and Linda

Flip CRUT Funded with an Apartment Building

Year	Year-End Principal	Capital Appreciation	Income	Before-Tax Payments
		(0%)	(4%)	
Year of gift 1	$1,600,000	$0	$64,000	$64,000
Sale in year 2	$1,600,000	0	$64,000	$64,000
		(4%)	(2%)	
Flip in year 3	$1,616,000	$64,000	$32,000	$80,000
4	$1,632,160	$64,640	$32,320	$80,800
5	$1,648,482	$65,286	$32,643	$81,608
6	$1,664,966	$65,939	$32,970	$82,424
7	$1,681,616	$66,599	$33,299	$83,248
8	$1,698,432	$67,265	$33,632	$84,081
9	$1,715,417	$67,937	$33,969	$84,922
10	$1,732,571	$68,617	$34,308	$85,771

Gift Annuity Funded with Real Estate

- CGA funded with real estate fraught with peril!
- Opportunity if charity wants real estate
- Deferred annuity highly recommended
  - ✓ Allows time to liquidate property
- Same due diligence as with any gift of real estate
- Must plan how to liquidate quickly
  - ✓ Danger of pre-arranged sale

Gift Annuity Funded with Real Estate

- Value of real estate must match donor's appraisal
- Net proceeds of sale may be far less than appraised value
- Use appraised value as gift amount, but adjust annuity rate

Gift Annuity Funded with Real Estate

Adjust annuity rate on CGA funded with real estate

1. Appraised value = $750,000
2. ACGA rate = 7.1% ($53,250)
3. Anticipated net proceeds = $650,000 (minus expenses and attractive sale price)
4. Annuity rate is 7.1% of $650,000 = $46,150

Summary

- One life income gift does not suit all
- Consider donor's profile and risk tolerance
- Consider donor's objective with life income
- Select the vehicle that suits donor <u>and</u> charity
- Use familiar vehicles in new ways
- Take advantage of flexibility of some life income gifts

Conclusion

Questions and Answers

Still Have a Question?

Contact: Jeff Lydenberg
Vice President, Consulting
PG Calc Incorporated

E-mail: jeff@pgcalc.com