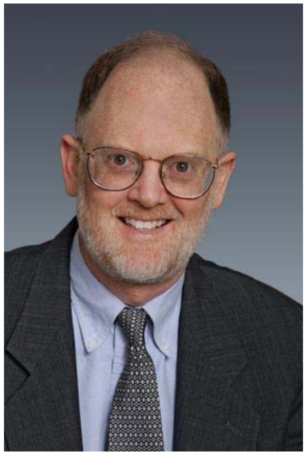
Gift Annuity Challenges and How to Address Them



Date: October 31, 2013

Time: 1:00 – 2:30 Eastern Time

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Vice President and
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Introduction

- Gift annuities generally simple, pose few challenges
- Nevertheless, challenges do exist/can arise:
  - Inherently
  - At gift planning stage
  - At gift administration stage
- Some can be met completely, others merely minimized

Inherent Challenges

- Charity takes on some risk
- Annuitant also faces some risk
- Most states regulate in one way or another

Challenge: Charity Takes on Some Risk

- Contribution exhausted before payment obligation ends
- Contribution not exhausted but charity fares poorly
- Underlying risks:
  - Mortality
  - Investment
  - Expense/accelerated appropriation

Addressing the Challenge

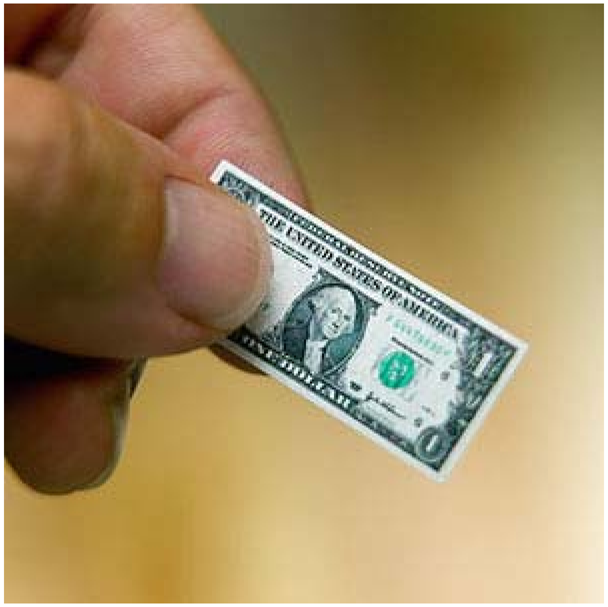
- Spread risk as much as possible
- Reinsurance
- Adopt/adhere to sound policies

Policy Elements

- Rates to be offered
- Minimum/maximum contribution amounts
- Minimum ages
- Acceptable assets
- Expenses/accelerated appropriations
- Investments (substance and implementation)

Challenge: Risks Faced by Annuitants

- Charity will default
- Loss of purchasing power
  - Inflation
  - Change in payment taxation



Addressing the Challenge

- Charity can take steps/provide reassurance
- Annuitant can reduce spending
- "Step annuity" option

Challenge: State Regulation

- 4 states (and DC) are silent
- 19 states require no notice (but may require other things)
- 15 states require notice plus other things
- 12 states require some sort of permit

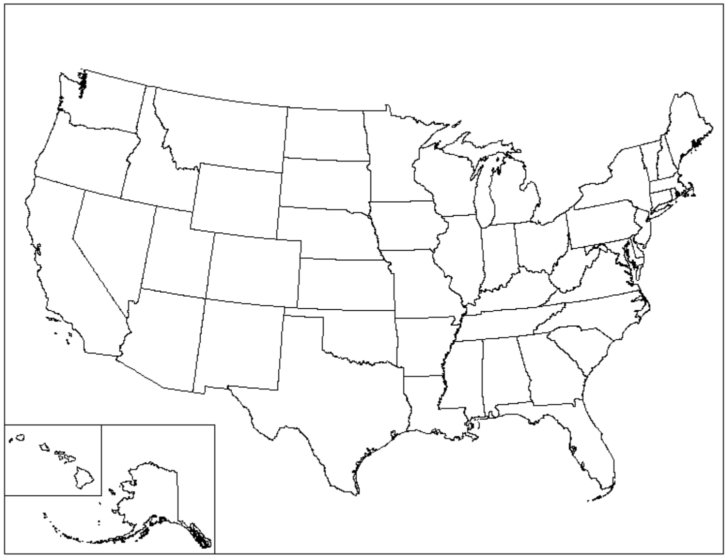
- Versus federal regulation: taxation, disclosure

Common Requirements

- Things applicable to charities generally
- Years in existence/operation
- Minimum asset level
- Disclosure language in agreements
- Maintenance of reserve account
- Fees/reports

Addressing the Challenge

- Comply with law of state of domicile
- Other states: comply or don't issue
- Make use of vendors



Gift Planning Challenges

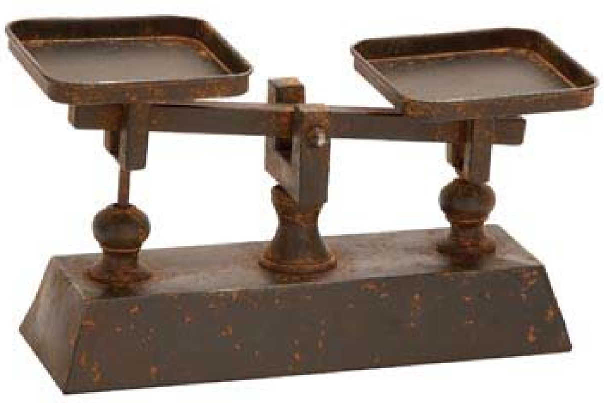
- Another charity offers higher rates
- Donor and annuitant are different persons
- Donor or annuitant lives outside U.S.
- Two or more different funding assets
- Revocable living trust involvement

Challenge: Another Charity Offers Higher Rates

- Not all that common
- Increases risk, decreases benefit
- May violate state laws

Addressing the Challenge

- Confirm availability of higher rate!
- Match – and accept consequences
- Decline to match – and risk losing gift

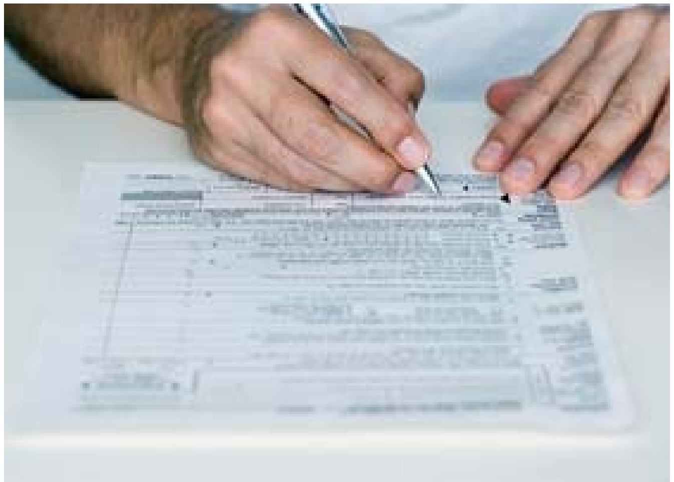


Challenge: Donor and Annuitant Are Different Persons

- Donor = owner
- Gift/estate tax issues now of less concern, but …
- Capital gains tax issues

Addressing Gift Tax Challenge

- Right of revocation retained but not used
- Allow (potentially) taxable gift to be made
- Gift tax return(s) may need to be filed



Addressing Capital Gains Tax Challenge

- Spouses have better choices
- Option if donor is one of two annuitants
- Rely on deduction to reduce/eliminate tax

Challenge: Donor or Annuitant Lives Outside U.S.

- Not really a problem if person is U.S. citizen
- Generally, foreign law determines benefit (if any) received by donor
- Annuitant affected by U.S. and foreign tax law
- Be alert for successor annuitants living outside U.S.

Addressing the Challenge

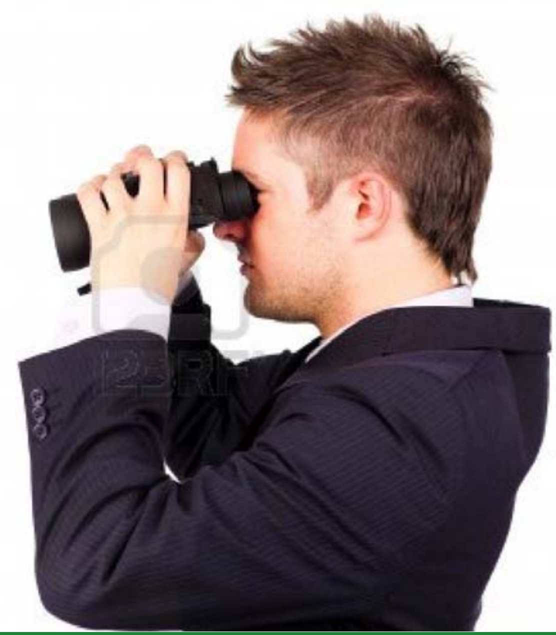
- Basics of issuing annuity unaffected, so long as currency clarified
- Ditto for complying with state regulation
- Understand limits of U.S. illustrations
- Refer donor/annuitant to knowledgeable tax counsel
- Handle U.S. tax withholding as necessary

Challenge: Two or More Different Funding Assets

- Consequences of differences:
  - Transfer process/date
  - Contribution value
  - Tax status (measure of deduction, nature of any gain)
- Reduce rate when illiquid assets contributed?

Addressing the Challenge

- Spot/discuss issues ahead of time!
- Perhaps establish separate gift annuities



Challenge: Revocable Living Trust Involvement

- Revocable living trust (RLT) basics
- Contribution made from RLT (yet trust is ***not*** donor)
- Payments made to RLT

Addressing the Challenge

- Transfer assets from RLT to donor before contribution
- Clearly document that person – not RLT – is donor

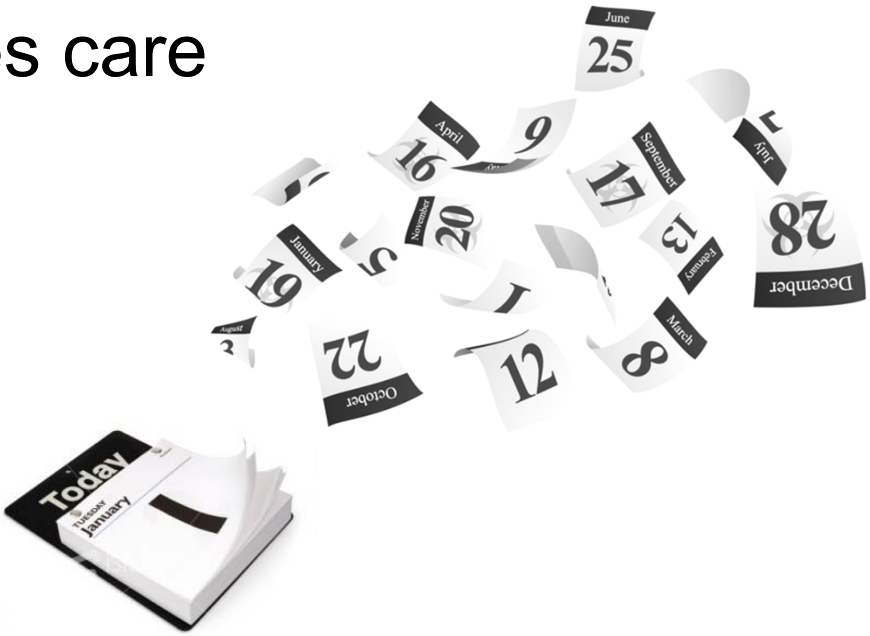
- Clearly document that person – not RLT – is annuitant
- Allow annuitant to elect later to receive payments directly
- Annuitant remains taxable on payments

Gift Administration Challenges

- Changing frequency/timing of payments
- Divorcing annuitants
- Missing annuitants
- Terminating a gift annuity

Challenge: Changing Frequency/Timing of Payments

- Less frequent – no problem!
- More frequent requires care
- Same frequency but new timing involves similar issues



Addressing the Challenge

- Document any change
- Increased frequency entails present value analysis
- Example:
  - End-of-quarter to end-of-month
  - $1,950 per quarter becomes $648.71 (not $650) per month
  - No choice of federal discount rate

Challenge: Divorcing Annuitants

- How are payments structured?
- What does divorce paperwork say?
- Is further clarification/documentation necessary?
- Using this information, determine how future payments will be made

Addressing the Challenge

- Adjust future payments (and 1099-Rs) per determination
- Perhaps make further adjustment when one annuitant dies
- Stay in touch with both annuitants!

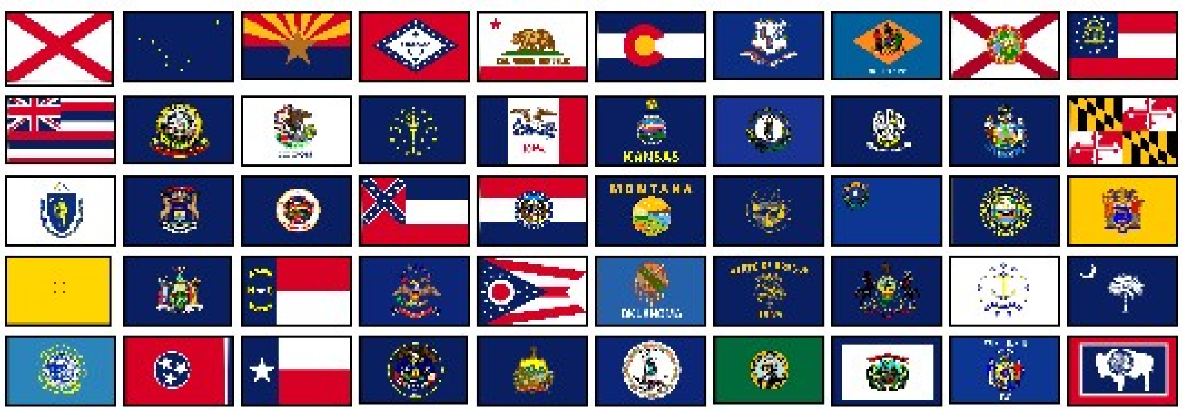
- Even if annuitants stay married, one's death during deferral period of a DCGA will require recalculating taxation of payments

Challenge: Missing Annuitants

- Monitor disposition of payments
- Has annuitant died?
- Do any payments need to be returned?
- If annuitant not dead/can’t be found, follow law

Legal Requirements Regarding Missing Annuitants

- Which state(s) will have a say?
- IRS: Keep reporting income, even if annuitant not receiving it



Addressing the Challenge

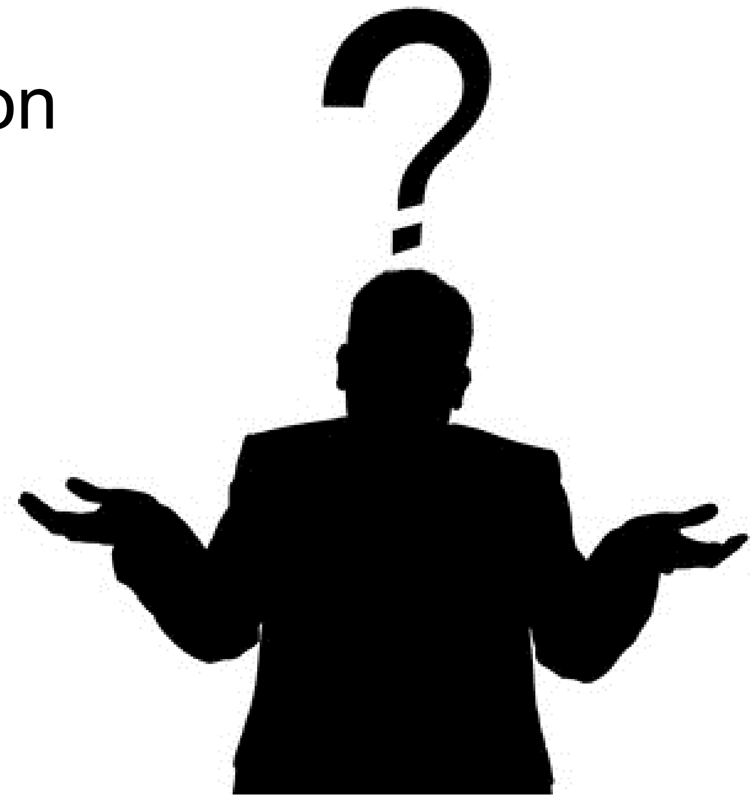
- Be prepared to stop payments, yet treat obligation as ongoing
- Probably consult state authorities/involve legal counsel
- Document developments
- Practice great stewardship (even if annuitant not a donor)

Challenge: Terminating Gift Annuity

- Who wants to terminate and why?
- Payments have value, charity has obligation
- Termination vs. modification
- Consult gift annuity agreement

Addressing the Challenge

- Charitable termination
- Non-charitable termination
- Partial termination
- Rare: replace one gift annuity with another



Termination Options

- Charitable:
  - Deduction = lesser of annuity's present value or unreturned investment in contract
- Non-charitable:
  - No deduction
  - Annuitant taxed on some/all of lump sum

Termination Options (continued)

Example:

- 2008: $10,000 cash annuity pays annuitant age 84 $740/year
- $2,696.21 of $5,139.60 investment in contract returned tax free
- Unreturned investment in contract = $2,443.39
  PV of annuity = $4,360
- Charitable termination: $2,443.39 deduction
- Non-charitable termination: $4,360 lump sum, of which $1,916.61 will be taxable

Addressing the Challenge: Modification

- Charity "reinsures"
  - Cost may be prohibitive
  - Comply with state law
  - Technically, not a "sure thing"
- Another charity assumes payment obligation
  - Other charity usually related or acquiring
  - Cost, state law issues likely relevant
- Either way, notify annuitant

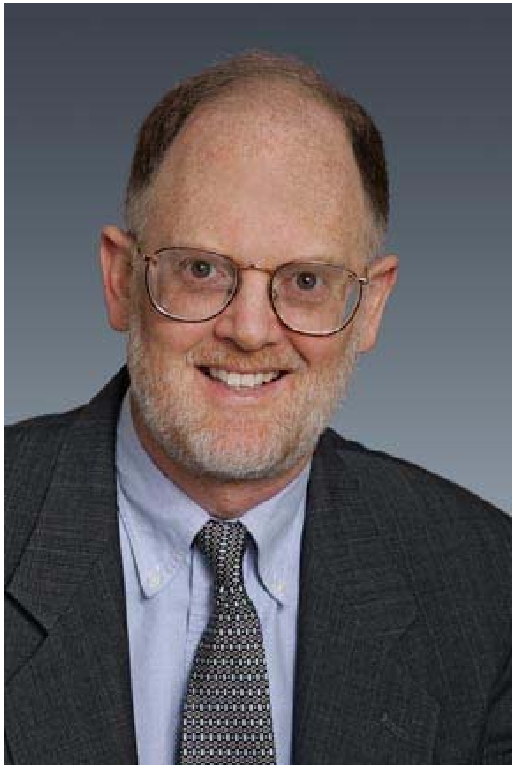
Closing Thoughts

- Understand how gift annuities work
- This can take time, so consult:
  – Planned giving organizations & their members
  – Vendors
  – Professional advisors

ACGA 2013 Survey Information

- To participate in the American Council on Gift Annuity's 2013 Charitable Gift Annuity survey:
  - Email acga@acga-web.org
  - Phone 770-874-3355
- Deadline for participation is November 15.

Questions and Answers



Still Have a Question?

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