


PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS




The Essential Gift Annuity: 7 Things You Need to Know

Date: December 14, 2022
 Time: 1:00 – 2:30 Eastern
 Presenter: Edie Matulka
 Senior Consultant, PG Calc

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PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS **Essential #1**

The amount contributed for the gift annuity is *not* the gift to your organization



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- Donor irrevocably transfers cash or property to charity
- Charity pays fixed amount to one or two annuitants for life
- Payments can start immediately or be deferred to a later date
- Unlimited obligation of charity
- What remains at death ("residuum") goes to the charity

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Donor preference v. charity risk



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- Donor and charity align
 - ✓ Number of beneficiaries
 - ✓ Duration of payments
 - ✓ Taxation of payments
 - ✓ Size of contribution
 - ✓ Ease of gift completion

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PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS **Comparing CGA to CRT**


- Donor and charity diverge
 - ✓ Type of property contributed
 - ✓ Ability to change charitable beneficiary
 - ✓ Nature of payments (fixed v. revalued)
 - Assets backing the payments*

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Individual annuity Program-wide




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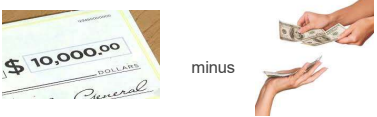
The tax aspects of a gift annuity are important



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PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS **Gift Annuity Charitable Deduction**



$\$10,000.00$ minus cash = Deduction

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Gift Annuity Charitable Deduction

Example: Ms. Palmer, age 74, \$100,000 cash donation, 5.8% annuity, quarterly payments, 2000CM table, 5.2% discount rate

Present value of annuity	Gift value (deduction)
A \$47,164	B \$52,836

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Gift Annuity Charitable Deduction

- What factors are involved in the calculation:
 - ✓ Annuitant age(s) and annuity rate
 - ✓ Payment frequency
The more frequent the payments, the lower the deduction (PV of payments is higher); effect is minor
 - ✓ Charitable Midterm Federal Rate
The lower the discount rate, the lower the deduction (PV of payments is higher); effect can be significant

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Deduction Comparison

- Single annuitant, age 74, annuity rate 5.8%, \$100,000 contribution, discount rate 5.2%.
- Deduction amount when payments are:

Monthly	Quarterly	Semi-Annual	Annual
\$ 52,636	\$ 52,836	\$ 52,137	\$53,729
- Deduction amount when discount rate is:

2.2 %	3.0 %	4.0 %	4.8 %	5.2 %
\$ 42,456	\$ 45,587	\$ 49,108	\$ 51,650	\$ 52,836

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- The charitable deduction and the tax-free portion of payments are inversely related
- The lower the discount rate, the lower the deduction – **but the higher the tax-free portion**
- Deduction amount/tax-free portion when discount rate is:

2.2 %	3.0 %	4.0 %	4.8 %	5.2%	2010CM
\$ 42,456	\$ 45,587	\$49,108	\$ 51,650	\$ 52,836	\$49,692
\$ 4,391	\$ 4,153	\$ 3,886	\$ 3,689	\$3,602	\$3,840

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- 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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PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS **Taxation: Gift of Appreciated Property**


- Portion of stock is gift to charity, portion 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
- If donor is not annuitant, gain attributable to purchase price is taxed upfront, in year of gift (to donor)

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ACGA rates have underlying assumptions



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- 50% residuum, 20% present value
- Mortality (2012 IAR table)
- Total return of 4.5% (1/1/23 increasing to 5.25%)
 - ✓ 55% 10-year Treasury Notes
 - ✓ 40% equities
 - ✓ 5% cash
- Expenses 1.0%
- Full contribution invested

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- Competing for or wooing the donor
- Compliance in some states requires filing rate schedule and adherence
- Increases amount required to maintain reserve in regulated states
- Different schedule: assumptions to support

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Offering a Lower Rate

- Increased deduction for donor
- Risk minimization for charity (large annuities)
- Addendum to agreement

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Essential #5

Federal and State Compliance. . .

Ugh!



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Compliance - What

- Disclosure statement
 - ✓ Federal v. state
 - ✓ Create standard practice for providing
- Tax reporting: 1099-R
- State CGA compliance differs from charitable solicitation (or doing business)

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Compliance - Where

State regulatory matters

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Essential #6

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Outcomes - Control v. No Control

	Gift Date	Contribution	Annuitant age	Rate offered	ACGA rate	Residuum
#1	Nov 1995	\$1.022M	76	8.0%	7.9%	\$(4,873)
#2	May 2005	\$1.15M	77	7.9%	7.4%	\$530,738
#3	July 2007	\$1.014M	84	9.9%	9.2%	\$41,184

- The slight increase in the annuity rate resulted in approximately \$24,000 in "extra" payments - above what would have been paid if the ACGA rate had been used. That amount would have turned the negative residua into a positive one (albeit very small, particularly considering the gift size.) Beyond the charity's control was the market (which over the life of the annuity repeated a good, bad cycle) and the annuitant's lifespan (approximately 12 years longer than expected at the time of the gift).
- The choice to offer a higher rate result in approximately \$78,000 in "extra" payments; money the charity thus did not receive, although the ultimate residuum came pretty close to the ACGA assumption. This annuitant lived approximately 12 years longer than expected, with the market doing good, bad, and then great over the life of the annuity.
- The rate difference here resulted in almost \$84,000 in "extra" payments; that amount added to the actual residuum would have made the gift result more palatable, though obviously well below what had been hoped for. This annuitant lived only about 2 years longer than expected. The biggest factor in the low performance was a significant drop in value shortly after the gift was received.

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Policies – Minimum Age

- Average age = 79
- Most common minimum = 65
 - ✓ younger = 43%
 - ✓ no minimum = 21%
- Deferred = 10 years younger than immediate
- Two life = both meet minimum

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Policies – Too Young

- Lower present value
 - ✓ \$15k residuum = \$6,180 w/ 30-year life exp.
 - ✓ \$10k residuum = \$7,441 w/ 10-year life exp.
- Worsen an underperforming annuity
 - ✓ Increase likelihood of going underwater
 - ✓ More out-of-pocket payments/admin costs


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Policies – Contribution Amount

- \$10,000 or higher = 77%
 - ✓ 14% are \$25k or higher
- Consider present value
 - ✓ \$2,500 residuum in 10 years = pv \$1,860
 - ✓ \$5,000 residuum in 10 years = pv \$3,720



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Maximum Contribution?

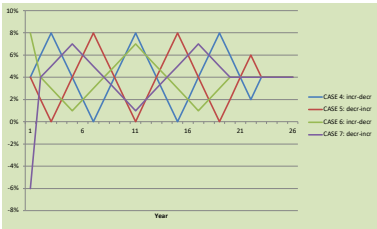


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Investment Returns



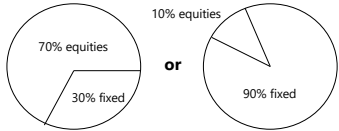
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Allocation Considerations

- Fixed nature and length of obligations
- *Different from your endowment!*
- State investment limitations
- Risk tolerance
- Imprudent?




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- Consistency is key
 - ✓ Have an overall strategy
 - ✓ Look for what works with your donors
- Can't predict the right time to issue
- Pulling back can "lock in" losses
- Post-recession: rates lower, market rebound



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- Payment obligation fixed, why track?
 - ✓ Restricted purpose
 - ✓ Accurate withdrawal at termination
 - ✓ Monitoring profitability of program




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Gift annuities are simple. . .
until they're not



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Unusual Situations

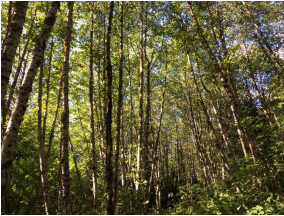
- Posthumous deduction
- Changing frequency of payments
- Assigning annuity interest
- Cash-out
- Divorcing annuitants
- Contributions of illiquid assets

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Conclusion



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Still Have a Question?

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