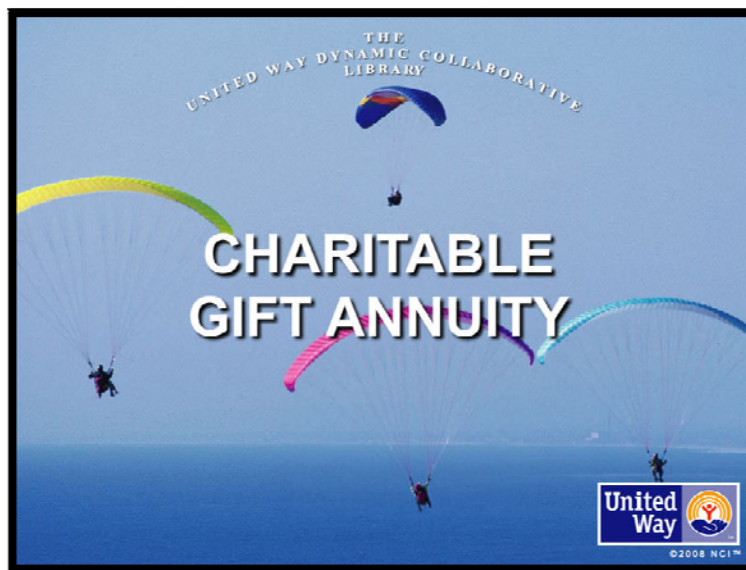


UNITED WAY DYNAMIC COLLABORATIVE™  
DONOR-STUDY SERIES



# CHARITABLE GIFT ANNUITY

QUESTIONS & ANSWERS



United Way of Central New Mexico



# CHARITABLE GIFT ANNUITIES

## Questions and Answers

### **What is a charitable gift annuity (CGA)?**

- A CGA is a contract between a donor and a charitable institution. A CGA is not a trust; thus, there are no trustees and no trust documents. CGA contracts are simple to understand and to explain.
- A donor transfers assets to a charitable institution, partly in exchange for an annuity and partly as an outright gift. Thus, the terms “gift” and “annuity” precisely describe this type of transaction.
- The charitable institution agrees to provide a fixed annuity for one or two lives. The annuity rate is fixed at the creation of the contract and will never increase or decrease in future years.
- A charitable contribution deduction is available in the year the CGA is created. The amount is determined by subtracting the present value of the annuity stream from the total amount transferred to fund the CGA.

### **How is the annuity rate determined?**

- CGA rates are based upon actuarial assumptions and assumed future investment returns. The younger the annuitant(s), the lower the rate. The older the annuitant(s), the higher the rate. A majority of charitable institutions follow the recommended rates of the American Council on Gift Annuities (ACGA). Those recommended rates can be found at [www.acga-web.org/](http://www.acga-web.org/). However, unless state regulations mandate otherwise, CGA rates are negotiable.

### **Who guarantees the annuity payments?**

- Future annuity payments are backed by the financial integrity of the charitable organization that signed the CGA contract. Unlike charitable remainder trusts, which can look only to the assets of that trust for making future distributions, CGAs are a general obligation of the issuing charitable organization. Of importance is the value of an organization’s “unrestricted” assets. Before a CGA is created, the issuing charitable organization is required to disclose to the donor(s) specific financial information regarding the organization.

### **Can CGAs be for more than two lives or for a term of years?**

- No, CGAs can only provide an annuity for one or for two lives. In the case of a two-life CGA, the annuity can be payable to one person for life, and then to a successor beneficiary. Alternatively, a two-life CGA can be paid jointly to two individuals, and then 100% to the survivor.

### **What is the minimum amount to fund a CGA?**

- There is no stated minimum. However, many charitable organizations have adopted a policy which sets the minimum CGA at \$10,000. While this may seem like a small amount in light of the related administrative costs (and, in fact, it is), many charitable institutions view CGAs as a way to open the door to more meaningful, future philanthropic relationships. Many first-time CGA donors will establish subsequent CGAs and provide gifts through their estates as well.

### **What is the minimum age for a CGA beneficiary?**

- There is no minimum age. However, most charitable organizations set the minimum age at or near age 60.

### **What assets can be used to fund a CGA?**

- Cash and marketable securities are the most common assets used to create a CGA. Because the charitable organization has an obligation to make the annuity payments, CGAs are not typically funded with illiquid assets. However, depending on the circumstances, it is quite possible that non-income-producing real property, personal property and closely-held stock could be used to fund a CGA.

### **How can charitable organizations set CGA rates so much higher than current yields on money market funds or bonds?**

- The underlying CGA rate assumptions provide that when a CGA terminates, the charitable organization will realize a gift that is less than the initial amount transferred. In fact, charitable organizations with a full portfolio of CGAs at different rates and at different ages can expect to ultimately receive approximately 50% of the original amount transferred.
- Charitable organizations do not pay income tax on the interest, dividends, and capital gains generated by their investments. Thus, they have a tremendous advantage in their investment return yields as taxes are irrelevant. This leverage also compounds year after year and can be substantial.

### **Are the recommended rates subject to change?**

- Yes, the recommended ACGA rates for immediate and for deferred CGAs are subject to change. Each year, the ACGA evaluates actuarial and projected investment return assumptions to determine if rates should be increased or decreased.

### **Do states uniformly regulate how CGAs are structured and offered to its residents?**

- CGAs are similar to commercial annuities in many respects. Every state regulates commercial annuities, but not all states regulate CGAs.

During the past 10-15 years, several states have shown a much greater interest in this area. The level of involvement can be summarized into four categories:

- States with no regulation.
- States that require charitable organizations to meet certain criteria (Example: number of years in existence; total assets) in order to offer CGAs, but no registration is required.
- States that require initial registration and periodic notification of CGA-related activities.
- States that require stringent initial registration criteria and retain oversight of CGA practices and offerings. These states often find the ACGA-recommended rates acceptable, because the ACGA is well respected and continuously analyzes all aspects of CGAs.

### **Can a CGA be created by a donor(s), but the annuity paid to another person(s)?**

- Yes, absolutely. CGAs are a great way to create a current charitable contribution deduction and provide an annuity for a loved one, such as a parent. When the annuity is paid to someone other than the creator of the CGA, capital gain (not an issue if funded with cash) and gift tax consequences will need to be considered.

### **How are annuity payments reported for income tax purposes?**

- Annuity payments are reported on a 1099-R which the annuitants receive by January 31 each year.
- The annual annuity amount is reported as ordinary income and tax-free return of principal. The amount of each category is determined by the age of the beneficiaries and the annuity rate.

- If a CGA is funded with appreciated assets (for example, publicly-traded stock that has increased in value), there is no immediate capital-gain consequences to the donor. However, the annual annuity amount will then be reported in three categories: ordinary income, capital gain, and tax-free return of principal.
- When the CGA is created, the actuarial life expectancy of the beneficiary is known. Should the beneficiary live beyond his or her life expectancy, the annuity will continue, but will become 100% taxable as ordinary income.

**If donors have provided for a charitable organization through their estate plans, why is a CGA even more attractive?**

- Donors who already plan to provide a charitable gift through their estate plans are prime CGA prospects. Why? If the gift is made using a CGA during their lifetimes, rather than through their estates, the Internal Revenue Service becomes a partner in philanthropy. By establishing the CGA now, a current individual income-tax contribution is available. This income-tax savings would not occur with an estate gift of the same assets.

**Can a CGA be used in retirement planning?**

- Yes. Rather than receiving the annuity payments immediately, donors can elect to start the payments at a selected time in the future. This opportunity is known as a deferred CGA. And the longer the deferral period, the higher the annuity rate and the greater the charitable contribution deduction. Establishing a deferred CGA while in a higher tax bracket and receiving annuity payments while in a lower tax bracket can be a great planning opportunity.

**What is a deferred CGA, and how does it differ from an immediate CGA?**

- Rather than beginning the annuity payments now, a donor can elect to have the payments start at a specific date in the future.
- The annuity rate will be higher with a deferred CGA because the charitable organization can invest the amount transferred during the deferral period.
- Typically, the charitable contribution deduction will also be greater.
- Example:
  - ❖ A \$100,000 two-life CGA (funded with cash) with immediate payments for a couple both age 72 will yield:
    - A 6% CGA rate.

- A charitable contribution deduction of \$28,662.
- Taxation of annuity:
  - Tax free                   \$2,205
  - Ordinary Income         3,795
  - Total                    \$6,000
  
- ❖ A \$100,000 two-life CGA (funded with cash) with a three-year deferral for a couple both age 72 will yield:
  - A 7.3% CGA rate.
  - A charitable contribution deduction of \$33,695.
  - Taxation of annuity:
    - Tax free                   \$4,044
    - Ordinary Income         3,256
    - Total                    \$7,300

*\* This example does not reflect current interest rates and is for illustration purposes only.*

**How would a CGA funded with appreciated assets differ?**

- The charitable contribution deduction would not change. The assets used to fund the annuity do not affect the amount of the deduction.
- The taxability of the payments would include an element of capital gain.
- Example:\*

- ❖ A \$100,000 two-life CGA (funded with marketable securities having a \$40,000 tax basis) with immediate payments for a couple both age 72 will yield:
  - A charitable contribution deduction of \$28,662.
  - Taxation of annuity:
    - Tax free                   \$1,517
    - Capital Gain             2,275
    - Ordinary Income         2,208
    - Total                    \$6,000

*\* This example may not reflect current income tax or interest rates and is for illustration purposes only.*



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