Charitable Gift Annuities: Planning Considerations

A charitable gift annuity is a simple contract in which a donor transfers cash or securities to The First Church of Christ, Scientist, and we promise to pay an annuity (fixed income) for life to one or two individuals selected by the donor. The Church follows payout rates recommended by the American Council on Gift Annuities, which range from 4.4% at age 60 to 9.0% (ages 90 and over) for one-life immediate payment arrangements.

Sample One-Life Gift Annuity Rates

Age of Recipient	Payout Rate	Age of Recipient	Payout Rate
60	4.4%	76	6.0%
62	4.5%	78	6.4%
64	4.6%	80	6.8%
66	4.8%	82	7.2%
68	4.9%	84	7.6%
70	5.1%	86	8.0%
72	5.4%	88	8.4%
74	5.7%	90 or over	9.0%

Charitable gift annuities also can be arranged to make payments for the lifetimes of two people, such as a husband and wife, brothers and sisters, parents and children or close friends. We would be pleased to provide you with information on two-life payout rates and a complete tax and financial illustration for the particular ages. The minimum amount to fund a charitable gift annuity is $10,000.

By law, gift annuity payments are backed by the full resources of the Church. Charitable gift annuities offer an income you cannot outlive. For example, an individual, age 82, who establishes a gift annuity with $10,000 will receive $720 a year (7.2%) for the rest of his or her life. Additional considerations include:

- Donors will receive an income tax charitable deduction that is typically 25% to 50% of the amount transferred for the gift annuity.

- A portion of each annuity payment is a tax-free return of the donor's principal. The tax-free portion of the recipient's payment is generally 50% to 75%, depending on ages and interest rates.

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- Unlike commercial annuities, gift annuities may be funded with appreciated securities. Part of any long-term capital gain in the securities must be reported, but any reportable capital gain generally can be reported annually over the recipient's life expectancy if the donor is a recipient.

- Deferred payment gift annuities are arrangements in which payments begin more than one year from the date of the annuity contract. Both the annuity payments and the charitable contribution deductions are larger for deferred annuities.

Special Gift Annuity Opportunities

- **Relief from Low-interest CDs.** Do you have certificates of deposit that are nearing maturity? Consider converting CD funds to a gift annuity. Mrs. K, age 76, has a $10,000 CD that is maturing soon. She expects to get 2% interest on a new CD. Mrs. K also has long considered making an important gift to the Church. She decides to transfer the $10,000, at maturity, to a gift annuity that will pay her $600 a year (6.0%) for the rest of her life. About $442 of her payments will be tax free, and she will also receive a charitable deduction of about $4,700.

- **Awaken Sleeping Savings Bonds.** Many people own United States savings bonds that have stopped earning interest (an estimated $8 billion now fall in the expired category). These bonds should be cashed immediately. Proceeds could be used to fund a gift annuity that provides lifetime income and a charitable deduction that may offset taxes on any interest reported when the bonds are cashed (see the case study presented later in this article).

- **Switch from Stocks to Fixed Income.** Gift annuities offer a means for donors to rebalance portfolios with reduced exposure to capital gains taxes. Investors should consider using their securities to establish both immediate payment and deferred payment charitable gift annuities. In general, up to half of a donor's capital gain escapes capital gains tax completely. The remaining gain can be reported in small annual installments as part of the donor's annuity payments – if the donor is also a recipient. The reportable gain may be tax free, if the recipient is in the 15% tax bracket.

- **Roth IRA Conversion Tax Relief.** All individuals are eligible to convert traditional IRAs into Roth IRAs, but amounts transferred will be taxed. Donors who do Roth conversions should consider charitable remainder trusts, gift annuities – especially deferred payment gift annuities – or other contributions in the same year to help offset the tax.

- **Retirement Planning with a Deferred or Flexible Deferred Gift Annuity.** Deferred payment charitable gift annuities provide a way for younger donors planning for retirement to make a major charitable gift that takes advantages of tax benefits and adds a fixed, secure source of income for their retirement. But what if the baby boomer says she doesn't really know the year she wants payments to start? She may decide to work until age 70 or 75 and won't need the money earlier than that. Or unforeseen circumstances may force her to look for other options, such as the ability to tap annuity payments early. An IRS ruling permitted a donor to postpone choosing the exact starting date for the annuity until years into the future. The donor could elect to have payments start in any year, upon giving charity three months' notice. The donor's deduction would be fixed at a possible starting date (age 65, for example), but he or she could qualify for larger payouts by delaying the start of payments according to a schedule incorporated in the annuity contract. The donor could start payments earlier than the assumed start date by taking lower annual payments.

For example, an individual, age 55, decides to give the Church $10,000 in appreciated stocks for a deferred payment gift annuity. The individual believes that he or she might retire at age 67, and selects that possible age when her payments should begin. The individual deducts about $4,500 this year as a charitable gift, and at age 67 could start receiving annuity payments of $730 (7.3%) a year. But suppose the individual wants to keep working past age 67, or for any reason wants to postpone the start of annuity payments. He or she could elect to initiate benefits at age 70 and be paid at a rate of 8.5%, or defer even longer and receive a payout rate of 9.7% by starting at age 72, as shown in the following sample table:

Starting Age	**Payout Rate**	**Annual Payments**
67	7.3%	$730
68	7.7	770
69	8.1	810
70	8.5	850
71	9.2	920
72	9.7	970

This technique may appeal to persons of any age who need tax deductions and the ability to receive life income payments at some indeterminate time in the future. Anyone with a large influx of income (from the sale of a business, for example) might be an ideal candidate.

Deferred annuities when converting to a Roth IRA. Judith, age 55, is making a Roth IRA conversion and needs to increase her itemized deductions. She decides to transfer $100,000 in securities to the Church, in exchange for a charitable gift annuity that will initiate payments when she turns 67. Age 67, however, is merely an estimate of when she might retire, and Judith would have the option to start payments later or earlier, depending on circumstances. Judith can deduct roughly $45,000 this year as a charitable gift and will receive payments of $7,300 (7.3%) at age 67. But if she decides to continue working past age 67, or for any reason wishes to postpone the start of annuity payments, her payout will increase. She could elect to get her first check at age 70 and be paid 8.5%, or receive 9.7% by starting at age 72. If Judith found it desirable to start her annuity before age 67, she could do so, at a reduced payout rate. Her charitable deduction, which smoothes the path to her Roth IRA conversion, is unaffected by her choice of when she initiates payments.

Purchasing Gift Annuities for Others

A charitable gift annuity can be arranged to fit most financial and philanthropic needs, including helping friends and family members:

Q: *Is there some way I could use an annuity to help support my mother and have the payments come to me after her death?*
A: You can establish a two-life "survivorship" annuity that would provide a lifetime income to your mother and a charitable contribution deduction for you this year. When your mother passes on, the payments would continue to you for the rest of your life.

Q: *Can I arrange a gift annuity for a family friend? She is actually our part-time caregiver and is getting ready to retire. I would like to do something for her but still benefit The Mother Church as well.*
A: Gift annuities can be an important supplement to anyone's retirement income, including friends and family members. The friend will receive annual payments for life, but you will receive the charitable deduction. It's best to fund such annuities with cash, for tax purposes.

Q: *We want to provide for a family member who has not been able to save for retirement. Could a gift annuity be helpful?*
A: You could provide your loved one with a fixed retirement income through a deferred payment gift annuity that would start paying him or her at age 65, or some other age you might select. You would be entitled to a significant charitable deduction for making the gift.

Gift Annuities in an Estate Plan

Gift annuities can be established in a will, living trust or most financial arrangements that permit beneficiary designations. Donors who set up gift annuities by will or trust should include contingency clauses covering the possibility that the beneficiary of the annuity may predecease them – either naming an alternative beneficiary or leaving an amount outright to the Church. Here is an example of gift annuities in estate planning:

> Miss Smith knew the value of having a charitable gift annuity: generous lifetime payments for as long as she lived, favorable tax benefits and the profound satisfaction of supporting our core activities. That understanding caused her to establish a plan that would provide for her family and for a remainder benefit to the Church. Miss Smith decided to establish, through her will, nine separate charitable gift annuities for her brothers, sisters and other family members. The gift annuities will provide lifetime payments to her family, along with significant tax savings for Miss Smith's estate. Through a special arrangement, each family member will receive quarterly checks following Miss Smith's passing, with an important portion of the payments being tax free.

The IRS has approved a plan by which a donor would name charity as death beneficiary of her IRA. The balance left in her IRA would fund a charitable gift annuity for a family member. The value of the IRA would be included in the donor's gross estate, but there will be an estate tax charitable deduction equal to the value of the IRA, less the value of the annuity. Neither the donor's estate nor the charity would owe income tax (IRD) on the IRA, but the IRS declined to rule on how the annuity payments would be taxed to the heir. While there are no cases or rulings on the subject, it would seem any financial arrangement with a beneficiary designation could be adapted to establish a testamentary charitable gift annuity along the lines of the IRA plan set out above. Thus, life insurance, P.O.D. accounts and T.O.D. accounts could name charitable beneficiaries on the condition that the Church pay an annuity to one or two individuals. Note: Churches and charities cannot be named as beneficiaries on United States savings bonds.

Gift and Estate Tax Considerations

Gift tax consequences. Donors who establish annuities for other persons make two gifts for federal tax purposes: a charitable gift that qualifies for an income tax charitable deduction and the unlimited gift tax charitable deduction, and a noncharitable gift that may be subject to gift tax. Donors may render gifts incomplete by retaining the right to revoke the annuity; during life and/or at death. Gifts also qualify for the $14,000 annual gift tax exclusion (except for deferred payment annuities) and the gift tax marital deduction. Retaining the right to revoke an immediate or deferred payment annuity means that completed gifts will occur only as payments are actually received by the annuitant during the donor's life. These payments are gifts of present interests that can be offset with the $14,000 annual gift tax exclusion.

Estate tax consequences. If a donor obtains a gift annuity for his or her own life, the only amount that is correct in the gross estate would be a payment that is due but not received before death. If the donor arranges a gift annuity for another, the date-of-gift value of the annuity is includible in his or her adjusted taxable gifts, assuming the donor did not retain the power to revoke the annuitant's interest. If the donor did retain such power, the date-of-death value of the recipient's annuity is included in the donor's gross estate. If the annuity recipient is the donor's spouse and the value of his or her annuity is includible in the donor's gross estate, it qualifies for the estate tax marital deduction.

Planning strategies. From purely a transfer tax standpoint, donors who establish gift annuities that make payments to someone else should generally include a right to revoke in the annuity contract. A sister who arranges an annuity for her brother with $50,000 to $100,000 could completely avoid gift taxes via the $14,000 annual exclusion. If she outlives the brother, there would be no estate tax due, either. Even if she passes on before the brother, the value of the annuity taxable for estate tax purposes could be much smaller than the original income interest.

Selecting Assets to Fund Charitable Gift Annuities

The First Church of Christ, Scientist accepts, at present, only gifts of cash and marketable securities for the funding of charitable gift annuities. Cash gifts provide donors with the largest potential tax-free payments during their life expectancy, and deductions are subject to the highest ceiling: 50% of adjusted gross income, with a five-year carryover for excess deductions.

Gifts of securities with long-term capital gain enable donors to escape capital gains tax on a portion of their paper profit. The remaining gain generally can be reported in pro-rated amounts over the donor's life expectancy – if the donor is also a recipient of payments. Note: If a person funds an annuity with appreciated securities and names someone else to receive the payments, pro-rating of gain is not an option; it all must be reported by the donor in the year of the gift. Deductions are subject to a 30%-of-AGI ceiling, with a five-year carryover.

Stocks for Gift Annuities: A Case Study. Ralph has long invested in the stock market. Recently, however, he has determined that it may be time to diversify further, or possible exit the market altogether, in favor of more stable assets that provide a more predictable return.

Some individuals who share Ralph's approach decide to sell off their stocks and reinvest the proceeds in commercial annuities that pay a fixed income for life. In doing so, however, they typically lose 15% of any stock profits to capital gains taxes. An alternative for people who wish to benefit the Church and reduce their exposure to stock market risks is a charitable gift annuity, funded with stocks that have gone up in value.

Investors with large capital gains can use gift annuities to lock in investment profits now, in case their stock drops in value, and receive annual payments from the Church that range from 4.4% to 9.0%, depending on the age or ages of the persons receiving the payments. In general, 30% to 50% of a donor's capital gain escapes capital gains tax completely. The remaining gain can be reported in small annual installments as part of the donor's annuity payments – and taxed at only 15% or even less.

In Ralph's case, if he transfers $10,000 in stock to the Church, we will pay him $510 a year (5.1%) for as long as he lives, based on his current age (70). He has a $4,000 capital gain (paper profit) in the stock, but with the gift annuity he will escape tax on about $1,561 and be taxed on only $153 annually of the remaining capital gain. Furthermore, a large part of his $510 annual payments will be tax free during his life expectancy – and he receives a charitable deduction of about $3,900. Ralph thinks that's a good combination of benefits, both for himself and the Church.

Zero Capital Gains Rates and Gift Annuities. The capital gains tax rate is zero percent in 2014 for taxpayers in the 15% tax bracket, which could make funding charitable gift annuities with appreciated securities especially appealing. For 2014, single taxpayers remain in the 15% bracket until taxable income exceeds $39,600. Married couples filing jointly will pay at a 15% rate on 2014 taxable income up to $73,800.

> Tom and Mary are a retired couple, both in their late 70s, whose taxable income is about $55,000 a year (15% tax bracket). They already have three charitable gift annuities with the Church, all funded with highly appreciated utilities stocks, and are delighted to learn that in 2014 the capital gains portion of their annuity payments will be free of tax. They have also been considering establishing additional gift annuities, with a unique tax strategy. They decide to transfer $10,000 in stock to the Church in 2013 for a new gift annuity. Assuming a $2,000 cost basis, their reportable capital gain from the annuity would be about $4,000 (the remaining $4,000 of gain would be avoided as a charitable contribution). Rather than prorate the $4,000 gain over their life expectancies, they plan to report the entire $4,000 in the year of the gift – but will owe no tax because they are in the 15% tax bracket. They will be safe from capital gains taxes in the future, even if the tax laws change, or they move into a higher tax bracket.

United States Savings Bonds: A Case Study. Whenever the economy takes a downturn, many people search for ways to augment their incomes. One hidden source of additional revenue may be United States savings bonds that lie forgotten in a desk drawer or safe deposit box. Cashing these bonds generally results in taxation on the buildup of interest, but what if there was a way to convert savings bonds to a stream of income with little or no tax? Charitable gift annuities offer such an opportunity. Take the case of Don:

> "The other day I was organizing some old files and found a packet of United States savings bonds that had been accumulating since the 1950s," Don commented. "It was quite a stack, too – war bonds, Series E and EE bonds. Some were so old they had stopped paying interest. I showed the bonds to my sister, Helen, and we agreed that something should be done with them. I checked with the bank, and here's the situation: The bonds are worth $23,400, and if I cash them in I will be taxed on about $11,000 of interest."

Don's question was simple: "Is there some way I can give these bonds to the Church, take advantage of tax benefits, get a charitable deduction, and obtain income, too?" The answers: (1) United States savings bonds can't be transferred to any organization during life. So to use them in a gift arrangement, Don would have to cash the bonds and give us the proceeds. That means he must report all the bond interest on his tax return. However . . . (2) We can enable Don, who is age 80, to reduce or eliminate taxes if he transfers the $23,400 of proceeds in exchange for a charitable gift annuity that pays him 6.8% ($1,591) a year for the rest of his life. He will be entitled to a charitable deduction that will wipe out any tax on the $11,000 of built-up interest. Furthermore, most of his annual payments will be tax free.

Don likes the idea of supporting the Church, increasing his income and eliminating the tax from cashing in the savings bonds. The charitable deduction means that he actually has more money left from the bonds to produce income than if he had cashed them in and reinvested the proceeds. Note: All Series E bonds and Series H bonds have now stopped paying interest.

Required minimum distributions from IRAs and retirement plans. Don is past the age of 70 1/2 and this year must take a minimum distribution of $12,000 from his IRA. Don, age 76, would like to reduce the taxes on this payment and decides to transfer the $12,000 to The First Church of Christ, Scientist, which will pay him $720 a year (6.0%) for the rest of his life. Don's charitable deduction is roughly $5,400, which reduces his taxes. Furthermore, 78% of his payments will be tax free during his life expectancy. He can repeat this gift in future years and receive additional deductions.

Commercial Annuity or Gift Annuity?

Consumers are flooded these days with marketing messages urging them to purchase commercial annuities. The Church has been offering charitable gift annuities for many years, and we are sometimes asked about the relative advantages of each arrangement.

Similarities: Both commercial annuities and gift annuities provide lifetime payments to recipients, a portion of which is tax-free return of principal during their life expectancies. Benefits can start immediately or can be deferred for several years, resulting in higher payments.

Differences: Commercial annuities offer higher payout rates than gift annuities, plus additional planning options, such as variable annuities, payments over a certain number of years and various refunding features. Only cash may be used to fund commercial annuities, and agents who sell annuities realize generous commissions.

Charitable gift annuities result in gifts to the Church that average about 50% of the amounts transferred by donors. These gifts are tax deductible for donors who itemize. Gift annuities also can be funded with appreciated securities, which results in additional capital gains tax savings. These tax rewards can boost the effective payout rates of gift annuities significantly (see the following chart). But the most important reason why friends arrange gift annuities is quite simple: their care and concern for the Church and the ability to magnify their support through a gift that provides them with lifetime income. Please call our office if you would like a personal illustration of the benefits of a gift annuity.

Benefits of a Charitable Gift Annuity for $10,000*

Age	Recipient's Annual Payment	Tax-Free Portion	Taxable Income	Charitable Deduction	Effective Payout Rate**
60	$440	$276	$164	$3,356	5.8%
65	$470	$309	$161	$3,848	6.3%
70	$510	$353	$157	$4,377	7.0%
75	$580	$420	$160	$4,791	8.2%
80	$680	$513	$167	$5,181	9.8%
85	$780	$622	$158	$5,772	11.5%
90	$900	$741	$159	$6,369	13.6%

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* The $10,000 figure is merely a convenient multiple. We will be glad to provide you with tax and financial results for any size gift.

** The effective return takes into account the donor's charitable deduction tax savings and the benefits of tax-free income in a 28% top federal income tax bracket during the donor's actuarial life expectancy. Deductions and tax-free amounts vary according to current interest rates (the examples employed a 3.0% applicable federal rate).

How to Proceed

If you are interested in arranging a charitable gift annuity, please e-mail, call or write our office.

We are pleased to advise you:

1. The amount of your annual payments
2. The portion that will be tax free
3. The amount of your income tax charitable deduction
4. The amount of any reportable capital gain, if appreciated securities are being transferred

You will need to share with us:

1. The amount of cash and/or the market value of securities you might contribute
2. Your date of birth and/or that of a second income beneficiary
3. Your Social Security number and that of the second recipient, if any

If you intend to use securities or other assets for your charitable gift annuity, we would also need to know:

1. The date you purchased the assets and how much they cost
2. A description of the securities or other property
3. An estimate of the current value of the asset, other than marketable securities

You can contact our office at philanthropy@csps.com, by phone at 1-800-288-7155, extension 3288, or write to us at the address below. We look forward to hearing from you.

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