Creative Gift Annuity Planning

Planned Giving Council of Greater Philadelphia

Planned Giving Day Conference – October 27, 2021

David J. Toll, J.D.

Senior Associate Vice President Gift Planning
Drexel University

Senior Consultant
Major & Planned Giving Development

Chip Giese

Planned Giving Client - Relationship Manager
PNC Institutional Asset Management

Charitable Gift Annuity Types for Discussion Today

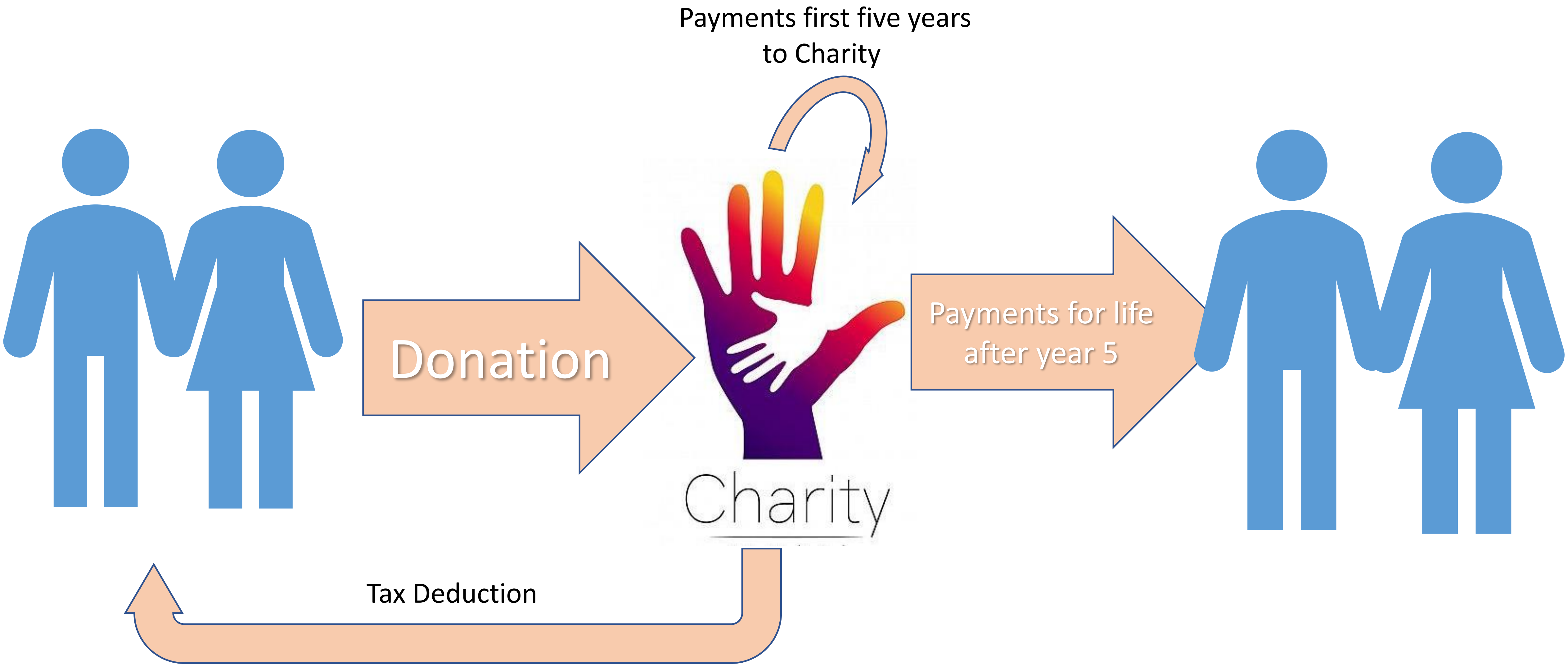
- The Immediate Impact CGA
- The Testamentary Stretch IRA CGA
- CGA for Someone Other Than the Donor
- CGA Funded with Real Estate
- Commuted CGA ("Tuition Assistance Plan")
- Step CGA for Inflation Protection

The Immediate Impact CGA (developed by Greg Johnson MPA, CFP® University Of Pennsylvania)

What is it?

- For the first number of years (“TERM”) (Charity chooses number of years), the income will provide current support for Charity.
- At the end of the TERM, Charity pays donor guaranteed fixed income for life, with the remainder eventually going to Charity.
- Essentially operates as a deferred CGA using a current CGA’s interest rate.

The Immediate Impact CGA



The Immediate Impact CGA
(developed by Greg Johnson MPA, CFP®
University Of Pennsylvania)

How to Illustrate:

- Run an immediate CGA illustration and **note the annuity payout rate**
- Run a deferred CGA illustration
  - Enter dollar amount
  - Date of first payment: 5 years in the future (or number of years charity receives payments)
  - Replace the automatically calculated payout rate with the rate from the immediate CGA
  - When prompted to recalculate rate, **click NO**
- Customize in Word:
  - Change the "label" from "Deferred Gift Annuity" to "Immediate Impact Gift Annuity"
  - Add text (optional):
- ***CHARITY Immediate Impact Annuity***: The first five (5) years of annuity payments are gifts to CHARITY to support an area or areas designated by the donor; the charitable deduction for the five (5) years of gift payments is available immediately at the time the gift is made. After ______ * years from the year the payments begin, the entire annuity becomes ordinary income. *(* use the life expectancy from the illustration)*
- **DO NOT** include the software's "How it Works" numbers illustration

The Immediate Impact CGA
(developed by Greg Johnson MPA, CFP®
University Of Pennsylvania)

Run Immediate CGA

ASSUMPTIONS:

Annuitant Age	75
Cash Donated	$100,000
Payout Rate from ACGA2020A Table	5.4%
Payment Schedule	quarterly at end
IRS Discount Rate	1.2%
Charitable Deduction	$45,084.00

Annuity	$5,400.00
Tax-free Portion	$4,428.00
Ordinary Income	$972.00

After 12.4 years, the entire annuity becomes ordinary income.

PG Calc © https://pgm.pgcalc.com/PGMAnywhere Software

The Immediate Impact CGA
(developed by Greg Johnson MPA, CFP®
University Of Pennsylvania)

Run Deferred CGA

ASSUMPTIONS:

Annuitant Age	75
Age at Date of First Payment	80
Cash Donated	$100,000
Payout Rate from ACGA2020A Table	7.4%
Payment Schedule	quarterly at end
IRS Discount Rate	1.2%
Charitable Deduction	$56,981.00

Annuity	$7,400.00
Tax-free Portion	$4,573.20
Ordinary Income	$2,826.80

After 9.4 years, the entire annuity becomes ordinary income.

PG Calc © https://pgm.pgcalc.com/PGMAnywhere Software

The Immediate Impact CGA
(developed by Greg Johnson MPA, CFP®
University Of Pennsylvania)

Run Deferred CGA with Immediate CGA Interest Rate

ASSUMPTIONS:

Annuitant Age	75
Age at Date of First Payment	80
Cash Donated	$100,000
Payout Rate from ACGA2020A Table	5.4%
Payment Schedule	quarterly at end
IRS Discount Rate	1.2%
Charitable Deduction	$68,608.00

Annuity		$5,400.00
	Tax-free Portion	$3,337.20
	Ordinary Income	$2,062.80

After 9.4 years, the entire annuity becomes ordinary income.

PG Calc © https://pgm.pgcalc.com/PGMAnywhere Software

The Immediate Impact CGA
(developed by Greg Johnson MPA, CFP® University Of Pennsylvania)

Comparison

	Immediate	Deferred	Immediate Impact
Annuitant Age Age at Date of First Payment	75	75 80	75 80
Cash Donated	$100,000	$100,000	$100,000
Payout Rate from ACGA2020A Table	5.4%	7.4%	5.4%
Payment Schedule	quarterly at end	quarterly at end	quarterly at end
IRS Discount Rate	1.2%	1.2%	1.2%
Charitable Deduction	$45,084.00	$56,981.00	$68,608.00
Annuity	$5,400.00	$7,400.00	$5,400.00
Tax-free Portion	$4,428.00	$4,573.20	$3,337.20
Ordinary Income	$972.00	$2,826.80	$2,062.80

PG Calc © https://pgm.pgcalc.com/PGMAnywhere Software

The Testamentary Stretch IRA CGA

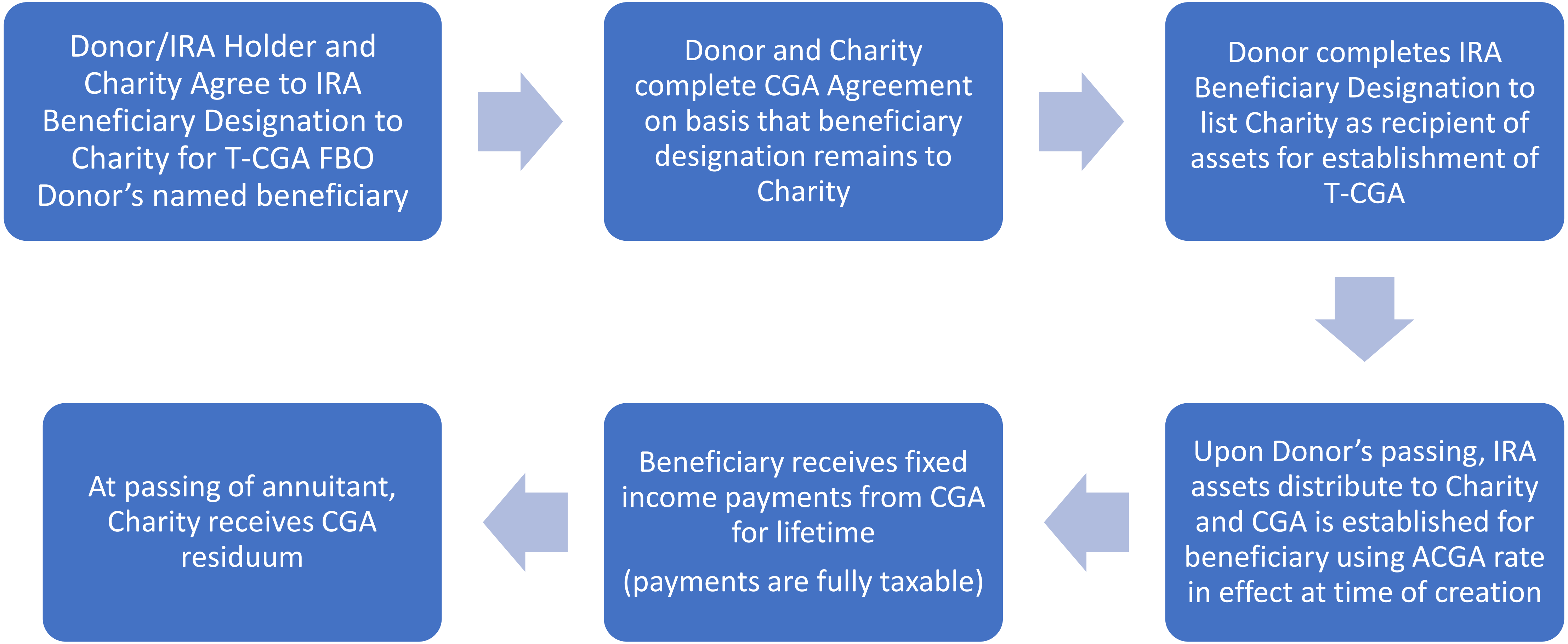
- SECURE Act
  - Three items relative to giving:
    - Repealed 70 ½ age limit for contributions
    - Age for Required Minimum Distributions (RMD)
      - IRA RMDs – Raised to Age 72
      - IRA QCDs – Age 70 ½
    - Stretch Benefits after IRA Donor's Death Greatly Limited
      - Non-Spousal Beneficiaries
      - IRA required to be paid out by December 31 of 10th year following death
      - Exceptions – minor child or disabled

The Testamentary Stretch IRA CGA

Creation

- Charity named as IRA beneficiary - as recipient of contribution for a CGA
- Detail specifics of the CGA - ACGA rate at the time of death
- Designate single, joint or concurrent annuitants (up to 2 only)
- Upon CGA's maturity – Charity benefits
- Provide language to your donors for their custodian to place within the IRA beneficiary designation
  - Should refer to annuity based on ACGA rates in effect at death

The Testamentary Stretch IRA CGA



The Testamentary Stretch IRA CGA

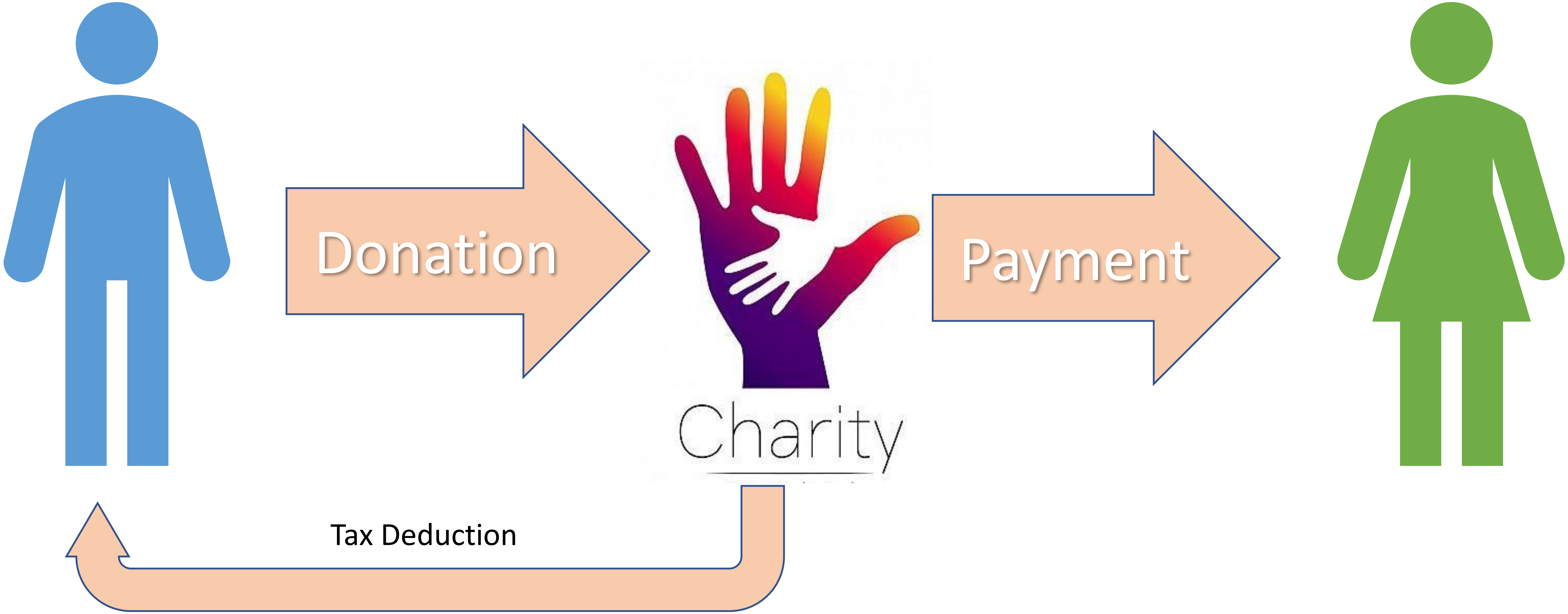
- Benefits
  - IRA assets pass to Charity without being subjected to estate tax
  - IRA Holder is able to provide guaranteed, fixed payments for the lifetime of their named annuitant(s)
  - Annuitant is relieved of the market risk of assets remaining in IRA and distributions are paid directly to them
  - The T-CGA is a contractual obligation of the Charity
  - It is generally a less expensive and more easily administered gift type
  - A gift to Charity is assured

CGA for Someone Other than the Donor

- Why
  - Desire to provide a gift to Charity and guaranteed income for someone other than themselves
  - Way for your organization to show younger donors how to use a CGA to provide for an older individual
- Scenarios
  - Sibling supplementing retirement income for sibling
  - Child supplementing retirement income for a parent

https://www.acga-web.org/donor-guide-to-gift-annuities

Gift Annuity for Someone Other than the Donor



CGA for Someone Other than the Donor

- Example
  - Son establishes a $50,000 CGA for his mother

7.2% Charitable Gift Annuity

ASSUMPTIONS:

[1]	Annuitant Date of Gift	83 10/27/2021
[2]	Cash Donated	$50,000.00
[3]	Payout Rate from ACGA2020A Table	7.2%
[4]	Payment Schedule	quarterly at end
[5]	Discount Rate under IRC Section 7520(a) for 10/2021	1%

https://www.acga-web.org/donor-guide-to-gift-annuities PG Calc © https://pgm.pgcalc.com/PGMAnywhere Software

CGA for Someone Other than the Donor

- Results
  - Annuity $3,600 (Quarterly Payments of $900)
  - Taxation of payments during life expectancy:
    - Tax-Free $3,085
    - Ordinary $515
  - Charitable Deduction $25,948
  - Investment in contract = Present value of life interest = $24,052
  - Son has made two gifts:
    - A present interest gift to Charity of the full gift value
    - A present interest gift to Mom of the present value of the CGA

CGA for Someone Other than the Donor

- Reminders
  - Electing for a lower AFR will lower the charitable deduction, but maximize the amount of tax-free annuity ($3,085 of $3,600)
  - Present value of life interest $24,052 (Gift to Mom)
  - > annual exclusion of $15,000
  - Gift Tax
  - Retain the power to revoke the annuitant’s payments in life or at death

Charitable Gift Annuities: The Complete Resource Manual-Minton/Matulka https://www.irs.gov/instructions/i709#idm140535812766672

CGA Funded with Real Estate

- WHY?
  - The amount of the payments is fixed and guaranteed by the Charity.
  - The value of the property is too low to justify establishing a trust (“flip” charitable remainder unitrust)
  - If the property is subject to a mortgage for which the donor is personally liable

CGA Funded with Real Estate

Issues to Consider

- All states except New York permit the funding of a CGA with real estate
- Considerable risk
- Charity commits itself to fixed payments without knowing when the property will sell or for how much
- Prior to the sale, Charity must advance its own funds to make the annuity payments, service any debt, and cover various expenses.
- The net amount remaining for investment after absorbing these expenses and paying selling costs may be insufficient to sustain the payments for the life of the annuitant, in which case the Charity will lose money.

CGA Funded with Real Estate

Reduce Risk

- Make sure the property is marketable before accepting it to fund a CGA.
- Do advance marketing and possibly identify a buyer prior to the date the property is transferred.
  - A sale of real estate will not be considered prearranged, and the donor will not be taxed on the capital gain, if the Charity is under no binding obligation to sell the property.

CGA Funded with Real Estate

Reduce Risk (Cont.)

- Adjust the CGA rate to take into consideration the fact that net proceeds might be less than appraised value.

  The CGA payment can be any amount mutually agreed upon by the donor and the Charity, subject to two conditions:

  a) The payment must result in the present value of the CGA being less than 90 percent of the value of the property transferred. Otherwise, the CGA may result in unrelated business taxable income. (See IRC Secs. 501(m) and 514(c)(5)); *and*

  b) If the CGA is issued in a regulated State to which the Charity has submitted a schedule of rates, it cannot vary from those rates (except to offer a lower rate with the donor's knowledge and consent).

CGA Funded with Real Estate

Reduce Risk (Cont.)

- Offer to create a CGA based on Net Proceeds and delay entering into CGA Agreement
  - IF you anticipate that net sales proceeds may be substantially less than the appraised value, offer to pay an annuity equal to the calculated rate for a person of the annuitant’s age, multiplied by the net sales proceeds. They may therefore delay executing the CGA agreement until the property is sold, and indicate on Schedule A of the CGA agreement that the value of the property contributed will equal the net sales proceeds.

Gift Annuity Funded with Real Estate

Reduce Risk (Cont.)

- If the Charity does not want to delay the creation of the CGA agreement, the safest way to proceed is to make a conservative estimate of the net proceeds and offer a gift annuity rate equal to **estimated net proceeds x normal gift annuity rate/appraised value.**
- This calculation results in discounting the CGA rate. The donor, of course, should document their consent to the rate in writing.
- It is the rate, not the property value, that should be discounted; the value of the property reported on Schedule A of the CGA agreement should be the same as the value determined by the appraisal of the real estate and that which is entered on IRS Form 8283.
- The financial consequences to the Charity are the same whether the property value or the CGA rate is discounted 10 percent.

CGA Funded with Real Estate

Reduce Risk (Cont.)

- In the event this is a “hot” property and a sale is expected soon after the transfer, the CGA payment might be determined (and the CGA agreement executed) *after* the sale. This would enable the rate reduction, if any, to be based on the known proceeds, rather than on an estimate. The effective date of the CGA agreement, which is the date of the gift, would be the date the deed to the property is transferred by the donor to the Charity.
- Keep in mind: the charitable deduction is based on the appraised fair market value of the property, and using the nearest age of the annuitant and the applicable IRS discount rate as of the date the deed is delivered (or the rate for either of the two preceding months). The date of sale is not the contribution date, nor are the *net* sales proceeds the contribution amount.

CGA Funded with Real Estate

Reduce Risk (Cont.)

- Ask the donor to agree to defer payments for two years or more to avoid advancing money for annuity payments prior to the anticipated sale.
- Concurrent Simultaneous Close (aka Winston F. C. Guest decision)

Step CGA for Inflation Protection

The Laddered Deferred CGA

- A donor can use deferred CGAs to achieve predictable and secure payments that also provide inflation protection.

How it works:

- Rather than give a single deferred CGA that starts payments when the donor anticipates retiring, the donor gives a deferred CGA each year, up to her year of retirement. Each CGA is set up with the same number of years of deferral, so once payments start they increase each year as each subsequent CGA commences payments.
- If you expect interest rates to rise over time, a CGA ladder allows you to capture the rate increases, again increasing retirement income.
- Laddering allows you to take more investment risk in the early years of retirement and earn higher returns that are not available from an immediate CGA.
- Use a Flexible CGA to increase flexibility.

Step CGA for Inflation Protection

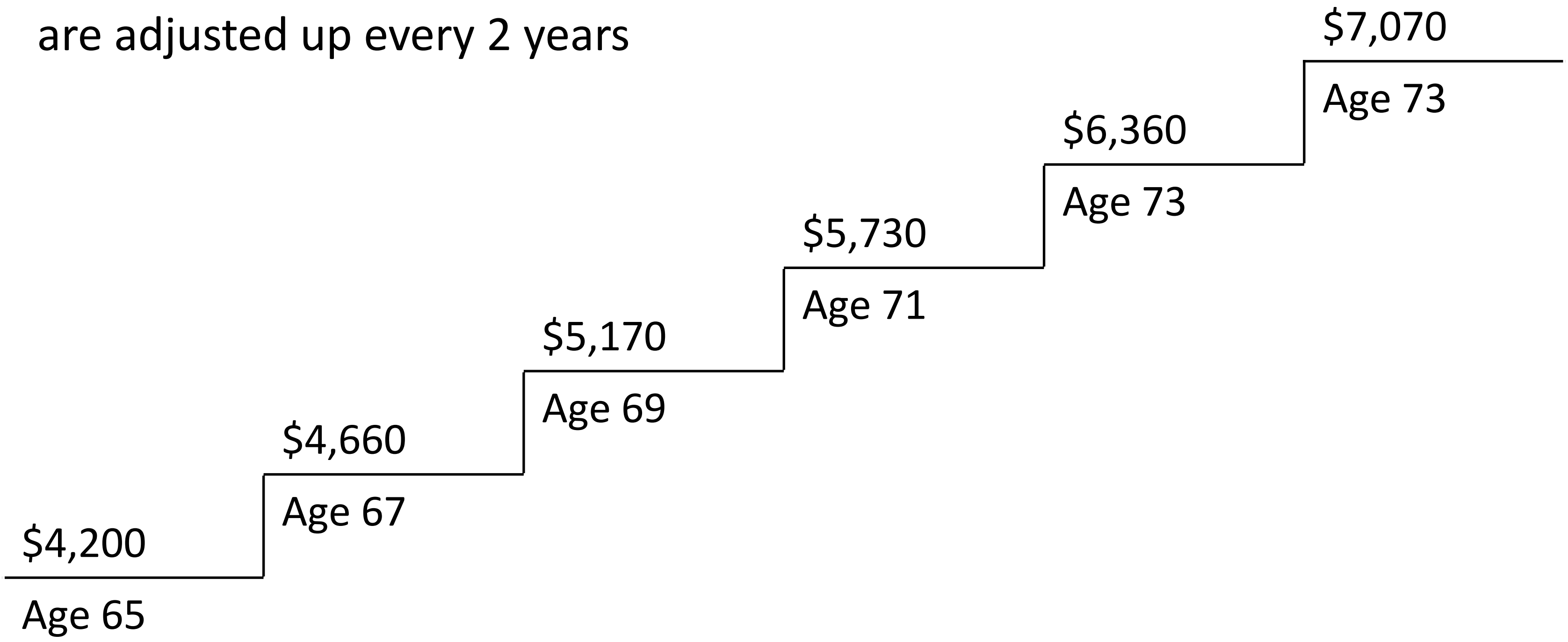
Example:

- Donor is 65. Wants to do a $150,000 CGA
- Immediate CGA Rate: 4.2%, Charitable Deduction: $51,628.50, Annuity Payment: $6,300 per year.
- Donor simultaneously establishes six CGAs on October 19, 2021. One is an immediate CGA funded with $100,000 cash. The other five are deferred CGAs, each funded with $10,000.
- The payment-beginning dates of the deferred CGAs are on October 1 of 2023, 2025, 2027, 2029, and 2031.
- Donor’s total income tax deduction for the six Step Annuity gifts totaling $150,000 is $55,998.50.

Step CGA for Inflation Protection

Example:

Donor’s annuity payments
are adjusted up every 2 years



$10,000 Flex Annuity - 65 year-old

Elective Start Date	Age at StartDate	Annuity Rate	Tax-free Income	Ordinary Income	Total Annuity
12/31/2022	66	4.4%	$337.04	$102.96	$440.00
12/31/2023	67	4.6%	$351.90	$108.10	$460.00
12/31/2024	68	4.9%	$367.99	$122.01	$490.00
12/31/2025	69	5.1%	$385.56	$124.44	$510.00
12/31/2026	70	5.4%	$405.00	$135.00	$540.00
12/31/2027	71	5.6%	$423.36	$136.64	$560.00
12/31/2028	72	5.9%	$443.68	$146.32	$590.00
12/31/2029	73	6.3%	$466.20	$163.80	$630.00
12/31/2030	74	6.6%	$491.70	$168.30	$660.00
12/31/2031	75	7.1%	$519.01	$190.99	$710.00
12/31/2032	76	7.5%	$545.25	$204.75	$750.00
12/31/2033	77	8.0%	$580.00	$220.00	$800.00
12/31/2034	78	8.5%	$612.85	$237.15	$850.00
12/31/2035	79	9.1%	$650.65	$259.35	$910.00
12/31/2036	80	9.8%	$685.02	$294.98	$980.00
12/31/2037	81	10.3%	$731.30	$298.70	$1,030.00
12/31/2038	82	11.1%	$775.89	$334.11	$1,110.00
12/31/2039	83	11.7%	$824.85	$345.15	$1,170.00
12/31/2040	84	12.4%	$881.64	$358.36	$1,240.00
12/31/2041	85	13.1%	$947.13	$362.87	$1,310.00

Commuted Payment CGA: (“Tuition Assistance Plan”)

What is it?

- For donors who need payments for a set period of years, rather than for a lifetime.
- Commuted Payment CGA makes fixed payments to the donor and/or another beneficiary for a set period of years starting in the future.
- The Commuted Payment CGA is a modified deferred CGA.

Commuted Payment CGA ("Tuition Assistance Plan")

When it is used:

- To provide income if you retire early
- To pay for college for children or grandchildren

Commuted Payment CGA (“Tuition Assistance Plan”)

How it works:

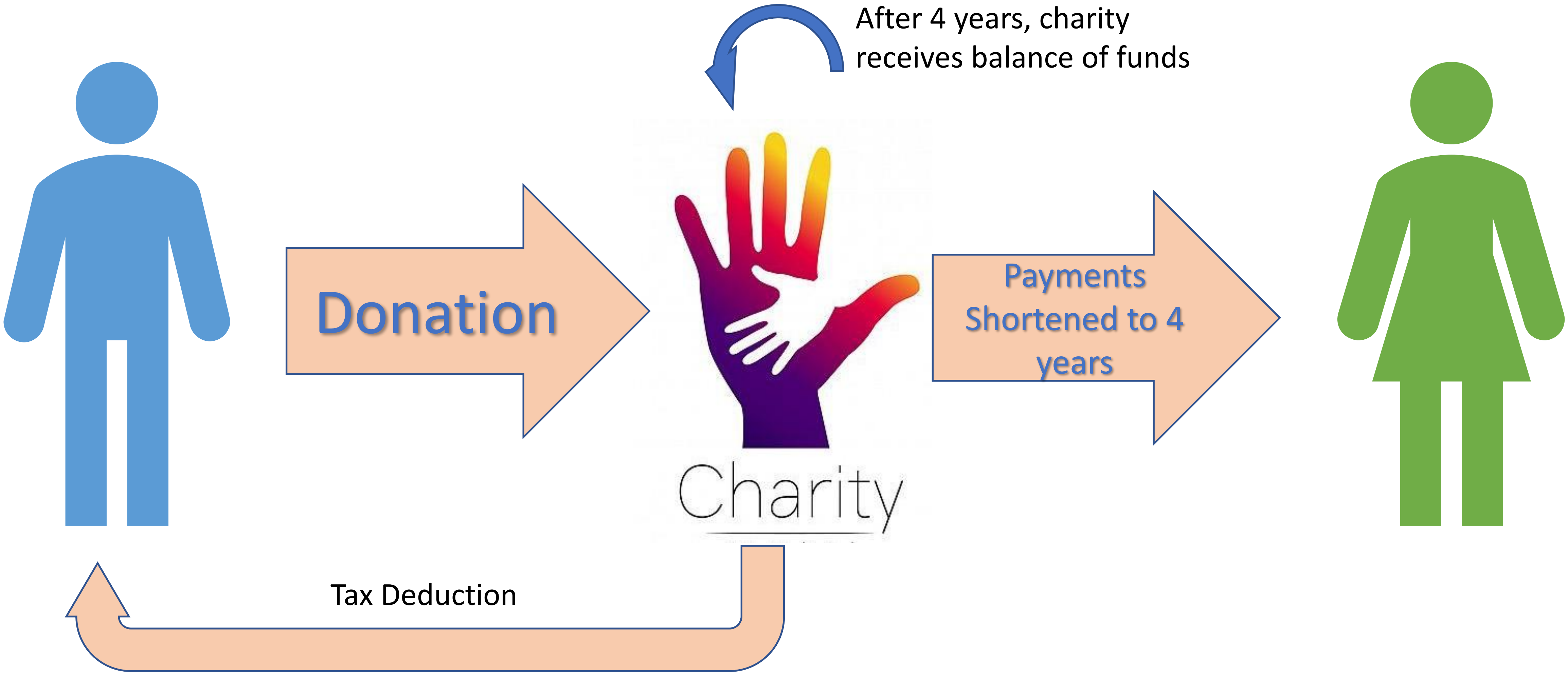
- Donor establishes a deferred CGA and names the future student as the beneficiary, with life payments to begin at age 18.
- Before the payments start date — at least one payment period prior to the first payment date — the CGA payment schedule can be reduced to four or more installments to mirror the student’s years in college.
- The annuitant (or annuitant’s legal guardian in the case of a minor), has the option of either accepting the annuity payments for life or electing the “commuted value” for the term detailed in the CGA agreement.
- By commuting the payments, instead of receiving fairly small payments for life beginning at age 18, the annuitant receives larger installments during the college years.

Commuted Payment CGA ("Tuition Assistance Plan")

How it works:

- To commute the payments, the annuitant or the annuitant's legal guardian must elect by written notice to exchange the right to receive an annuity for life for an annuity payable over a set term of years.
- The amount of the payments will equal the present value of the lifetime payments that the annuitant would have received, based on the starting date of the payments and on the Charitable Midterm Federal Rate (CMFR) and mortality tables in effect at the time of the assignment.
- Upon making the gift, the donor receives a charitable tax deduction.
- The payments are taxable to the annuitant as ordinary income, and are partially tax-free at the student's lower tax rate.
- If the election is made after the annuity starting date, the payments are immediately taxable in full to the annuitant.

Commuted Payment CGA
(“Tuition Assistance Plan”)



Commuted Payment CGA ("Tuition Assistance Plan")

Example:

- On July 5, 2006, donor contributed stock with a fair market value of $100,000 and a cost basis of $30,000 to fund a CGA for their granddaughter, who was 3 years old.
- The CGA agreement stated that granddaughter would receive semi-annual payments for life, beginning September 1, 2021.
- The agreement also contained a provision allowing the commutation of life payments. On July 13, 2006,the granddaughter's guardian assigned her annuity interest to the Charity in exchange for eight semi-annual installments.

Commuted Payment CGA ("Tuition Assistance Plan")

Example: (Cont.)

Donor:

- Donor received a charitable deduction of $63,587
- Donor's realized capital gain is $25,489.10
- The taxable gift is $36,413. (CGA agreement included language that allowed donor to revoke the annuity payments during his lifetime, or by will or testamentary instrument could postpone any taxable gift — IRC Reg.25.2511-2(c).)

Commuted Payment CGA ("Tuition Assistance Plan")

Example (Cont.)

Granddaughter:

- receives $25,000 during each college year to be taxed as follows:
  - Ordinary income: $15,896.75
  - Tax-free portion: $9,103.25

Commuted Payment CGA ("Tuition Assistance Plan")

The Fine Print

- Commuted payment CGAs have only been approved by the IRS through Private Letter Rulings.
- The State of New York does not permit this type of annuity per State law.
- The annuitant does not have to use the money for college tuition or education costs.
- The donor will not avoid capital gains if the CGA is funded with appreciated securities.
- Annuitants under the age of 59 1/2 are subject to the 10 percent excise tax per IRC Sec. 72 (q). This tax would be in addition to the ordinary income tax the student would pay on the installments.
- It is important that the annuitant (or the annuitant's legal guardian) is aware of the gift in order to elect that payments commute prior to the payment start date.
- Usually the annuitant or guardian exercises the commutation option soon after the CGA is funded. Exercising the commutation is what fixes the installments that will be paid when the annuitant enters college.
- Delaying the commutation could cause the payments to be higher or lower depending on the CFMR and mortality tables at the time.
- Given the longevity of the gift, there are more market variables that may ultimately impact the charitable residuum, positively or negatively.
- Due to reduced ACGA rates for young annuitants, the commuted installments may not be as large as desired.

Impact of Proposed Tax Legislation

- Eliminating the benefits of split-interest gifts for taxpayers.
  - Transfers of appreciated assets – including donations to a split-interest trust – as “realization events.”
  - Tax the difference between the asset’s fair market value on the date of the transfer and the asset’s adjusted basis (its “basis”). Exclusion allowed for the charity’s share of the gain.
  - Impact on charitable remainder trusts and pooled income funds.
- Reduction in the estate and gift tax exemption. to $6,000,0000
- Any distribution to a beneficiary other than to the grantor or the grantor’s spouse, or to discharge a debt of the grantor, to be treated as a taxable gift. Similarly, assets held by a trust that ceases to be treated as a grantor trust for tax purposes (for example, due to the grantor’s renunciation of certain powers over the trust) would also be treated as a taxable gift of the grantor.

Creative Gift Annuity Planning

Planned Giving Council of Greater Philadelphia

Planned Giving Day Conference – October 27, 2021

QUESTIONS

Chip Giese

Planned Giving Client - Relationship Manager
PNC Institutional Asset Management

David J. Toll, J.D.

Senior Associate Vice President Gift Planning
Drexel University

Senior Consultant
Major & Planned Giving Development