

Doing Well by Doing Good

Help clients help their communities – and themselves – with charitable gift annuity

The Edgars* respond generously to annual appeals, supporting a number of charities dear to their hearts. They also use highly appreciated securities to set up multiple charitable gift annuities, each dedicated to a specific charity. As Charlene Pryor of the San Diego Foundation puts it, giving through gift annuities “turns into a win for them for the rest of their lives while creating a great charitable gift and a legacy when they’re gone.”

Your clients may also be generous donors but be reluctant to entirely give up income-producing assets. When this is the case, advisors can help clients fulfill their charitable intent by using vehicles that support the donors’ favorite causes and maintain an ongoing income stream. An increasingly popular arrangement is to use a charitable gift annuity.

More advisors are recommending gift annuities to donors for several reasons. The first is that affluent individuals are increasingly interested in supporting local causes. Research shows that the majority of wealthy people report a strong obligation to give back to their communities. In fact, the wealthy view their ability to make charitable gifts as one of the major benefits of their good fortune.

The second reason is the aging of the population. As Frank Minton of the American Council on Gift Annuities notes, “A guaranteed income stream is very attractive to older people.” As the baby boom generation moves into retirement, more people are seeking income-producing assets while finding ways to make meaningful contributions to their communities.

Finally, the low interest rate environment of recent years has made charitable gift annuities more attractive. Instead of rolling over certificates of deposit earning 2 to 3 percent or relying on assets paying 2 percent in dividends, advisors can guide donors to put their money into a gift annuity and potentially triple their cash flow. Many put appreciated assets, such as securities or real estate, into gift annuities. Some donors, Ms. Pryor notes, use gift annuities “to create more income out of an asset not currently producing much income.”

How Gift Annuities Work

Charitable gift annuities are available through a wide range of charitable, educational and religious organizations. In exchange for a charitable gift to the sponsoring organization, the donor is promised an income stream for life and an immediate tax deduction.

That annuity – the lifetime income stream– is based on the donor’s age (and the age of the donor’s spouse if payouts are to continue over the lives of both spouses) and the “gift annuity rate” in effect at the time of the gift. The gift annuity rate is not purely an interest rate, since payments represent both interest and a return of capital. Most charities, but not all, use the gift annuity rates set by the American Council on Gift Annuities (ACGA).

In 2004, for example, a 60-year-old donor could receive an annuity at 5.7 percent (see table.) An annuity for a couple, both age 60, would be set at 5.4 percent; the lower rate is because the joint life expectancy is longer. The older the donor is, the larger the stream of income. At age 80, the gift annuity rate for an individual is currently 8 percent; for a couple who are both age 80, it is 6.9 percent.

| Suggested Gift Annuity Rates at Age | Single Life | Two Lives, Joint and Survivor, at Same Age |
|-------------------------------------|-------------|--|
| 60 | 5.7% | 5.4% |
| 70 | 6.5% | 5.9% |
| 80 | 8.0% | 6.9% |

Annuity payments may begin immediately or may be deferred. Most gift annuities are immediate, according to Frank Minton, chairman of ACGA. Deferred annuities tend to be taken by younger donors who are planning ahead for supplemental income at retirement. Deferred annuities, with gift annuity rates based on the donor’s current age plus a compounding factor of 5 percent, are a good way to lock in a future stream of income, and result in a larger charitable income tax deduction. Immediate or deferred, annuity payments are usually made quarterly, but they may be made—at the donor’s option—on a monthly, semi-annual or annual basis.

Tax Advantages

Donors receive an immediate tax deduction, based on their age, the annuity rate and a rate set by the IRS. Based on today’s rates, a 65-year-old donor contributing \$10,000 would receive an immediate tax deduction of approximately \$3,000. An 80-year-old contributing the same amount might receive a deduction of \$4,000 or more.

In addition to removing the donated amount from their potentially taxable estates, donors also benefit from the tax treatment of annuity income. A portion of each payment check is treated as a tax-free return of principal. However, if donors outlive IRS life expectancy tables – approximately 16 years at age 70 – remaining annuity payments are fully taxable. There is an additional benefit if appreciated property is donated, because a portion of the annual income may be taxed at favorable capital gains rates.

Before Establishing a Gift Annuity

The first rule for any donor, says Frank Minton of ACGA, is to know the charity well. "The safety of the gift annuity depends on the strength of the charity." There have been a few rare instances where the promise of a stream of income was not fulfilled. Minton notes that the good news is that "gift annuities are backed by the general assets of the charity, not just by the property contributed."

Most charities required a minimum contribution of at least \$10,000 to establish a gift annuity. A few charities will take less, but some require more. The Greater Kansas City Community Foundation, for example, will accept donations of \$25,000 or more in exchange for a charitable gift annuity. While donors can choose a specific charity to accept their contributions, the advantage of giving through a community foundation is that donations may support the variety of causes supported by the foundation.

Advisors who can help implement planned giving strategies using instruments such as a charitable gift annuity can bring myriad benefits to charities and clients alike. The charity can receive a larger gift than they might otherwise receive with an outright donation, which can bolster support for the programs. Donors will achieve fixed predictable payments plus the satisfaction of making a charitable gift. And advisors can benefit, too; creating a smart giving strategy can give advisors the satisfaction of helping their clients and their communities.

* Not their real name

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To learn how the Petoskey-Harbor Springs Area Community Foundation can assist you with your clients' needs, contact Maureen Nicholson mnicholson@phsacf.org