

Who Should Establish a Charitable Gift Annuity and When?

Someone who is charitably inclined, frustrated with historically low interest rates on CDs and similar investments, and seeking to increase their income without assuming additional risk may be an ideal candidate for a Charitable Gift Annuity, or CGA. A CGA can generate an attractive lifetime income, produce significant tax advantages, and simultaneously support a meaningful organization. One can contribute cash, marketable securities, and/or other property to a charitable organization in exchange for a lifetime annual fixed payment and an immediate tax deduction equal to the present value of the charitable remainder interest. The lifetime payment can be made to the donor and, if they choose, a second beneficiary with income payments made jointly or successively. Payments can begin immediately or be deferred to a future date. The charity is contractually obligated to make the payments, even if it must tap into its general funds to do so. Payments are fixed from the outset, and will remain constant regardless of what may happen to interest rates or the stock market.

The amount of the income payment depends primarily upon the age of the income beneficiary, also known as the “annuitant.” Unlike interest from a CD which is fully taxable as ordinary income, a fixed amount of each CGA payment is tax-free. When appreciated property or securities are donated to fund the annuity, a portion of the income payment will also be taxed at more favorable capital gains rates. Only the remaining amount of the income payment is considered interest and taxed at ordinary income rates.

Although it is contractually obligated to make the payments and incurs the related investment risk and longevity risk given the uncertainty of the lifetime payment duration, the benefit to the charity is that it receives the remaining value when the donor dies and the payout period terminates. The payout rate of a charitable gift annuity is typically lower than a comparable commercial annuity, which is beneficial to the charity since it increases the likelihood of a larger remainder benefit compared to the remainder benefit that a commercial insurer would expect to receive. Given the investment risk and the risk that a donor may live beyond their life expectancy, it’s possible that no remainder value may exist at all and that a charity could lose money on a particular individual annuity contract. However, based upon the law of large numbers, life expectancies and related payment durations can be estimated with greater accuracy and precision when a large pool of annuitants is involved. Some donors will die prematurely prior to reaching life expectancy, whereas others will live beyond it. On average, however, the overall pool of annuitants if sufficiently large will entail a payment duration close to the life expectancy that is actuarially assumed. As a general rule, nonprofit organizations should not offer charitable gift annuities unless they have sufficient scale and have an annuity donor pool that is sufficiently large so that the expected remainder amounts reverting to the charity are actuarially sound.

Although anyone can establish a Charitable Gift Annuity, most donors tend to be older retirees who want to increase their cash flow, would like to save taxes, and seek the security of guaranteed payments. The older the annuitants are at the date of gift, the greater the income payment. According to a recent survey by the American Council on Gift Annuities, the average

age of annuitants is 79 and nearly 82% of annuitants are 75 years of age or older. Annuity rates are generally determined annually by the American Council on Gift Annuities, and are as high as 9.0% for 2017. Those considering a Charitable Gift Annuity should contact their favorite charity and their personal financial advisor to discuss the merits of incorporating a CGA into their overall financial plan.

Kevin J. Smith has been named “One of America’s Best Financial Planners” by Consumers’ Research Council of America. He is Executive Vice President-Wealth Management with “Smith, Mayer & Liddle”, a wealth advisory group with Janney Montgomery Scott, LLC, a full service financial services firm in York, PA.