Life Income Gift Plans

Ways to Give and Receive

Life income gift plans have become a popular way for donors to make major gifts. Typically, the donor makes the irrevocable gift and reserves the right to receive an income for his or her life (or the donor may direct that an income be paid to one or more designated individuals for as long as they may live). The gift property passes to the charity, or becomes available to the charity, but only after all the income rights have terminated.

Life income gifts are made for many reasons. One major reason is personal satisfaction. Donors are able to support major causes in ways that otherwise would be impossible. But the other major reasons involve tax and financial rewards. In many cases, life income gift plans can enhance the investment, retirement, tax, and estate plans of the donor.

The purpose of this booklet is to highlight these life income plans. Technically, they are known as:

- Charitable remainder annuity trust
- Charitable remainder unitrust, and
- Charitable gift annuity.

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These plans are similar in that each provides income payments to the donor or other designated beneficiaries. But they differ in the amount or nature of the income payments, the allowable income tax charitable deduction, the type of property that can be given, and other tax and financial consequences that result from these kinds of planned gifts.

The Charitable Remainder Annuity Trust

You can create a trust that will hold and invest property and pay you and/or other designated beneficiaries a specified dollar amount each year for as long as you or the other beneficiaries may live.

You can select the amount of your annual income payments. It must be at least 5% of the value of your gift but it could be higher provided the trust meets the charitable remainder requirements of federal tax law. Nothing will be paid to our institution until all the income rights have terminated. At that time we receive all the property held by the trustee.

Every Trust is Tailored for the Donor

Every charitable remainder annuity trust is planned and drafted to accomplish the objectives of the donor. For example:

You can name the income beneficiaries. You can name yourself, or anyone you wish, as the income beneficiary of the trust. You can direct that the income benefits be paid to you for your life and then to your spouse for his or her life. Or you can name one or more of your children as beneficiaries. But there must be at least a 10% minimum remainder for the charity.

You can set the exact amount that will be paid each year. You have a right to fix the dollar amount to be paid out every year, within broad limitations. And it will be paid from principal if income is not sufficient. Higher percentage payouts will reduce the charitable deduction and may cause problems with the 10% test.

You can decide how long the income will be paid. Income can be payable for the life of one beneficiary, the lives of two or more beneficiaries, or for a specified period of years (up to 20 years).

You pick the property that will be transferred to the trust. There are advantages to funding your trust with appreciated property, especially if the property is producing little or no income. But there may also be advantages to funding your trust with closely held stock or other properties. We can tell you the tax consequences that will result from the property you select to fund the trust.

You name the trustee. You can name anyone you wish as trustee — your bank, your attorney, a family member, etc.

You name the charitable beneficiary. A qualified charitable institution must be named as remainder beneficiary of the trust. But you can name more than one charity if you wish.

The Charitable Remainder Unitrust

The charitable remainder unitrust differs from the annuity trust in one very important way — rather than a fixed-dollar income, the unitrust arrangement must provide for income payments that vary with the annual value of the trust. Specifically, the unitrust must direct that the trust assets be valued each year and that a specified percentage of the value be paid to the individual beneficiary or beneficiaries. If the value of the trust assets goes up, the annual payments go up. But the reverse is also true — the annual payments will decrease if the value of the trust assets decreases. One other difference: you can make additions to a unitrust, but not to an annuity trust.

Other than that, a unitrust is quite similar to an annuity trust. The donor can select the individual beneficiaries, fix the percentage of value that will be paid to these beneficiaries, and direct the period of time during which income benefits will be paid. The trust can be funded with almost any kind of property, and the donor can name the trustee. The donor can name one or more qualified charities to receive the trust property when the income rights terminate, or direct that the trust be continued for the benefit of the charitable beneficiaries.

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PLANNING POINTERS FOR THE UNITRUST

The charitable remainder unitrust is the preferred option for persons who want an annual income that will increase if the value of trust assets increases. There is the risk, however, that trust assets could decrease.

The income-only and "flip" unitrusts can be advantageous when the trust is to be funded with property that produces low or no income and may be difficult to sell. Payments can be deferred until the property is sold and the reinvested sales proceeds are producing an income.

There are interesting variations possible with a unitrust that are not available with an annuity trust. The unitrust agreement can direct that each annual payment be the lesser of (a) the specified percentage of value in that year, or (b) the income earned by the trust in that year. If option (b) is selected, the trust agreement can (but is not required to) provide that, if less than the specified percentage of value is paid in any year, the deficit will be made up in a subsequent year in which income exceeds the specified percentage of value. This variation makes the unitrust useful as a retirement planning tool.

Further, the unitrust variation just described can be set up so that it "flips" to a conventional unitrust when some triggering event occurs, such as the trust's sale of an asset held in the trust. The various unitrust options offer exceptional planning flexibility.

The Charitable Gift Annuity

A charitable gift annuity is very simple to set up: you transfer money or securities to the charity in exchange for its commitment to pay you a specified annuity for as long as you live. There's no trust agreement or other complexities, just the charity's written obligation to pay a specified dollar amount for life to you and another beneficiary if desired (two recipients maximum).

The amount of the annuity that will be paid is established by each charity that issues gift annuities, and depends on the age of the beneficiary (or beneficiaries).

PLANNING POINTERS FOR THE GIFT ANNUITY

The simplicity of the gift annuity makes it attractive to many donors. In most cases, a gift annuity can be set up for only $5,000 or $10,000, depending on the specific charity's minimum.

Donors like the fixed payments for life, the fact that part of the payments may be tax free, and that the effective yield is extremely attractive.

The deferred gift annuity can be especially attractive to mid-career professionals (ages 50–65). It can be an excellent way to supplement retirement savings.

Persons making a contribution to a gift annuity fund may arrange to defer annuity payments for a period of years. For example, a 55-year-old donor may wish to defer annuity payments until he is 65 years of age and retired. A deferred start date increases the payout amount as compared to a regular gift annuity that starts payments right away. Plus, the donor receives a larger charitable deduction compared with a regular gift annuity as well.

Tax Consequences of Life Income Gifts

The deferred gift methods we have discussed each provide at least three basic tax benefits:

First, the present value of the deferred gift to the charity can be deducted as a charitable contribution on the donor's income tax return in the year the gift is established.

Second, the gift generally does not give rise to an immediate capital gains tax even if the gift property has substantially appreciated in value. Also, the gift property can be sold by the charity or the trust without incurring a capital gains tax.

Third, the income payments to the donor or other beneficiary may be favorably taxed.

The Allowable Charitable Deduction

The charitable deduction allowable for a deferred gift depends on several different factors. The value of the gift and the nature of the gift property are obviously important factors. So is the amount of income payable to individual beneficiaries, the period of time during which payments will be made, and the form in which the deferred gift is made.

Avoiding Capital Gains Taxes

A life income plan can avoid, reduce or spread out the capital gains tax liability to the donor. And the trust or charity can sell the property without incurring any capital gains tax. This means that the full value of the property will be available to provide an income for the beneficiary and the property passing to the charity will not be depleted by capital gains taxes. Part of the payout from a life income plan may be taxed as capital gain.

Favorably Taxed Income

A life income gift may provide a tax-free or favorably taxed income to the beneficiary in certain cases.

For instance, the payments made from a charitable gift annuity will be partially income tax-free until the annuitant reaches the age of his or her life expectancy as measured at the time the gift is made.

A Life Income Gift to Accomplish Your Objectives

A life income gift to our institution can be — and should be — carefully planned to accomplish the individual investment, retirement, or estate objectives of the donor. Here are some examples.

Build an Immediate Retirement Fund

Frank W. is 75 years of age and expects to retire within the next few months. He has accumulated stock in his employer's corporation that is now worth $400,000. His cost basis is only $60,000. The stock pays a very small dividend and is a rather risky investment. Frank wants to sell it and invest the proceeds for a high income.

A sale of the stock would, of course, result in a federal and (possibly) a state capital gains tax liability and selling expense.

Frank could transfer the stock to a charitable remainder annuity trust that would pay him $20,000 a year for as long as he might live. The gift in trust would result in an immediate income tax charitable deduction to shelter Frank's income from taxes.

Build a Future Retirement Fund

The simple and practical gift annuity can be an excellent method of making a life income gift and building a future retirement income.

Richard C. is 55 years of age. For the next five years, he intends to transfer $15,000 each year to a charity to set up a charitable gift annuity. He defers the payment start date on each annuity until he reaches age 65. He can deduct a substantial portion of each annual

$15,000 gift to the charitable institution. And he can supplement his retirement income with his many annuity payments that begin at age 65.

Minimizing Taxes and Other Costs.

Each of the life income plans can be very effective in minimizing estate taxes and settlement costs.

Nancy J. included a testamentary charitable trust in the provisions of her will. The charitable remainder trust will name her daughter as the beneficiary who receives an annual income. Then, when the trust ends, charity will receive the remaining trust assets. Nancy likes the idea that the trust will provide for her daughter then provide for her favorite charity — a way to take care of the people she loves and causes she believes in that continues on.

Providing Favorably Taxed Payments.

A charitable gift annuity is a very popular way to gain a favorably taxed payment. For example, Helen R. (age 70) gives $10,000 in cash to a charity and receives a fixed annuity of $580 a year for her life. Of that $10,000 transfer, $3,289 would be deductible as a charitable contribution. And $422 of each annuity payout would be tax-free until Helen reaches the age of her life expectancy (based on an AFR of 2.4% and a quarterly payout).

Establishing an Educational Fund.

A charitable remainder trust can be created to pay an income to one or more children for a specified period of years. For example, a grandfather could create a trust that would pay 15.0% of the value of the trust assets to a grandchild each year for five years.

Because trusts can be created for a specified number of years (up to 20) they are an ideal way to build an educational fund or a career-starting fund for a minor child. A deferred gift annuity can also be used to build an educational fund for a minor child. The charity can pay the child the commuted value of the lifetime annuity at a time when the child needs educational funds (only available in some states).

We Can Provide More Information

Life income gifts are important for our future, and can be richly rewarding to donors who make them. We would welcome an opportunity to discuss how a life income gift can work for both you and us.

Figures in our examples are based on average interest rates, and may be different at the time of a gift. Tax information provided herein is not intended as tax or legal advice and cannot be relied on to avoid statutory penalties. Always check with your tax and financial advisors before implementing any gift.

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