

Ruby Pediangco's Speaker Notes

*The Sweet Lowdown:
Troubleshooting Tricky Charitable Gift Annuity Situations
and
Remembering Why We Bother*

MPGC Education Program
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WHAT IS A CHARITABLE GIFT ANNUITY (CGA)?

A gift annuity provides a way for a donor to make a contribution to charity, and receive, in turn, fixed payments for life. Although annuitants (payees) are typically donors or donor couples, the annuitant may also be a 3rd party, such as a child or an employee. Most charities follow the American Council on Gift Annuities rate table to set the payments in a gift annuity contract, a table which uses the age of the annuitant. The minimum contribution to establish a gift annuity varies from charity to charity, but many have a \$10,000 minimum requirement. Annuity payments can begin immediately or can be deferred to a specific date. The gift annuity is created through a rather simple contract, which is irrevocable. After the stated payment period in the gift annuity contract, any remaining assets in the contract are released to the charity for its charitable purposes.

Target Audience

Immediate Gift Annuity	Deferred Gift Annuity
<ul style="list-style-type: none">• Typically older individuals (65/70+)• Individuals who are fiscally conservative• Individuals seeking additional income• Individuals who already have a gift annuity• Individuals who wish to give cash or appreciated stock	<ul style="list-style-type: none">• Typically younger individuals (50+) Individuals who want a charitable tax-deduction now but have no need for additional income until retirement age• People who want to establish a supplemental retirement plan• Individuals who wish to give cash or appreciated stock

Tax and Financial Benefits of Creating a Gift Annuity

- Donor receives fixed, guaranteed payments for life (based on the full faith and credit of the charitable organization).
- The donor receives a charitable income tax deduction in the year of the gift.
- For gifts of cash, the annual deduction limit is 50% of the donor's AGI.
- For gifts of long-term appreciated securities, the annual deduction limit is 30% of the donor's AGI.
- Unused charitable deductions may be carried over an additional 5 years.
- The donor bypasses a portion of capital gains on gifts of appreciated securities; any capital gain is recognized over the lifetime of the annuitant.
- A portion of each gift annuity payment is usually tax-free.

The above is a very cursory overview of charitable gift annuities. For more information on these popular gift vehicles, below are a couple of reputable CGA resources:

- *Charitable Gift Annuities: The Complete Resource Manual* sold by PGCalc
 - American Council on Gift Annuities website: www.acga-web.org
- (Note: The ACGA web site serves as a resource to both charities and CGA donors).

Minnesota charities listed on the ACGA web site as sponsors of the ACGA:

Sponsors

Organization: Augsburg College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.augusburg.edu/giving

Organization: Bethel University
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: St. Paul
State: Minnesota
Website: www.bethel.edu/development/planned-giving/

Organization: Carleton College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Northfield
State: Minnesota
Website: www.legacy.vg/137/giving/1.html

Organization: Carthage College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.carthage.edu/give/

Organization: Concordia College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Moorhead
State: Minnesota
Website: www.ccgift.org/plgive_main.jsp?WebID=GL2003-0077

Organization: Crosier Fathers and Brothers
Organization Type: Religious Organization
Office Type: Planned Giving Office
City: Onamia
State: Minnesota
Website: www.crosier.org/

Organization: EFCA Foundation
Organization Type: Religious Organization
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.efca.org/

Organization: Gray Plant Mooty
Organization Type: Law Practice/Firm
Office Type: Business Office

Sponsors

City: Minneapolis
State: Minnesota
Website: www.gpmlaw.com/

Organization: Lutheran Community Foundation
Organization Type: Religious Organization
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.thelcf.org/

Organization: Macalester College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Saint Paul
State: Minnesota
Website: -

Organization: Mayo Clinic
Organization Type: Hospital/Health Care Organization
Office Type: Planned Giving Office
City: Rochester
State: Minnesota
Website: www.mayoclinic.plannedgifts.org/

Organization: Minnesota Orchestra
Organization Type: Arts Organization
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.minnesotaorchestra.org/

Organization: Northwestern Foundation
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Saint Paul
State: Minnesota
Website: www.nwc.edu/web/guest

Organization: OMC Regional Foundation
Organization Type: Hospital/Health Care Organization
Office Type: Planned Giving Office
City: Rochester
State: Minnesota
Website: www.olmmed.org/

Organization: Southwest Initiative Foundation
Organization Type: Community Foundation
Office Type: Planned Giving Office
City: Hutchinson
State: Minnesota
Website: www.swifoundation.org/

Organization: St. Catherine University
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: St. Paul
State: Minnesota
Website: www.stkate.edu/

Organization: St. Mary's University of Minnesota
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Winona

Sponsors

State: Minnesota
Website: www.smumn.edu

Organization: St. Olaf College
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Northfield
State: Minnesota
Website: www.stolaf.edu/giving/

Organization: St. Paul Chamber Orchestra
Organization Type: Arts Organization
Office Type: Planned Giving Office
City: St Paul
State: Minnesota
Website: www.thespco.org/

Organization: The Minneapolis Foundation
Organization Type: Community Foundation
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: www.minneapolisfoundation.org/Home.aspx

Organization: University Of Minnesota Foundation
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: Minneapolis
State: Minnesota
Website: -

Organization: University Of St. Thomas
Organization Type: Educational Institution
Office Type: Planned Giving Office
City: St Paul
State: Minnesota
Website: www.ustgiftplanning.org/

RUBY'S DISCLAIMER – MANY OF THE FOLLOWING SCENARIOS INVOLVE GRAY AREAS REGARDING GIFT ANNUITY ADMINISTRATION. THE FOLLOWING INFORMATION IS MEANT TO HIGHLIGHT SOME OF THE DIFFERENT WAYS CHARITIES APPROACH A CERTAIN ISSUE. BEFORE FOLLOWING ANY ONE METHOD BELOW, PLEASE CHECK WITH YOUR NONPROFIT'S LEGAL COUNSEL FOR ADVICE.

FUNDING A GIFT ANNUITY WITH MULTIPLE ASSETS

The date an asset is transferred to the charity to establish a gift annuity controls the gift annuity contract payments. A challenge arises when multiple assets are used to fund a gift annuity (e.g., A donor who wishes to establish a CGA with \$100,000 uses stock as the primary funding asset but will write a check after the fact to make the gift round up to \$100,000). What date does a nonprofit use?

Below are two approaches that exist – charities should always consult with legal counsel to determine which type of approach would best suit its organization:

- 1) A separate CGA contract for each asset donated – this is the most straight forward method, as the gift date within the contract is tied directly to the exact date an asset was transferred. In the above example, the charity would use the gift date of the day the stock was transferred to the charity for CGA contract #1 and the date the cash was given to the charity for CGA #2). Some organizations avoid the hassle of having multiple contracts to sign by summarizing the different gift dates and payment amounts in one document. Care should be taken when modifying CGA agreements to ensure the contract will not run afoul of any state regulations.

*Best practice tip: The multiple-agreement approach should always be used if between the date of the first transfer of assets and the date of the last transfer there is a change in (1) the calendar year, (2) the nearest age of an annuitant, or (3) the CMFR.

- 2) A single CGA contract for all assets donated – two scenarios:
 - a. When a donor has multiple assets to fund a gift annuity – for example three stocks, which will be given on different days – some charities will value each stock as they are transferred to the charity but use the date the final stock was transferred as the date of gift for the contract. Charities will need to consult their planned giving software vendor to learn how to run the appropriate illustration(s) for its donors under this scenario.
 - b. Using the same scenario above – some charities will instead hold the first two stocks in escrow and will wait until the final stock is transferred to the charity and use that final date to determine the fair market value of all three stocks. Extreme care should be undertaken in this scenario should there be a lag between the date the first stock is transferred to when the final stock is transferred.

*Best practice tip: Should a charity engage in such a policy described in 2b, it would serve the charity and donor well to have the donor sign a document indicating his/her understanding that the charity will hold multiple assets in escrow and that during this period they are not to be considered gifts until the final asset has been transferred.

The Wisconsin Donor (a reminder that not all states are created equal when it comes to gift annuities)

In Minnesota it is not uncommon for a charity to have donors in bordering states. One state in particular – Wisconsin – has some state regulations charities should be aware of prior to engaging a Wisconsin donor for a charitable gift annuity.

In order to issue gift annuities in the state, a charity must meet the following regulatory requirements:

Actions Required for Exemption:

A charity must apply to the Wisconsin Office of the Commissioner of Insurance for a certificate of authority prior to issuance of any gift annuity in the state.

There is a \$200 filing fee (\$100 due at the time of application and \$100 due at the time the certificate is granted.)

Disclosure and Agreement Content Requirements:

Although no specific disclosure language is mandated by Wisconsin law or regulations, the Office of the Commissioner of Insurance recommends inclusion of such language. The wording should be placed in a separate paragraph, in type no smaller than that used in the agreement generally.

Suggested Language for State Disclosure: “This qualified charitable Gift Annuity is insurance under the laws of the State of Wisconsin and [Name of Charity], as its issuer, is subject to regulation by Wisconsin's Office of the Commissioner of Insurance with respect to its gift annuity program. However, this qualified charitable gift annuity is not protected by the Wisconsin Insurance Security Fund or any other insurance guaranty association. All of the unrestricted assets of [Name of Charity] stand behind this promise to pay.”

Reserve Requirements:

The segregated fund must maintain assets at least equal to the sum of a charity's reserves on its outstanding gift annuity agreements plus a surplus of the greater of: (i) \$100,000; or (ii) 10% of its reserves. The reserves are to be calculated in accordance with prescribed mortality tables and discount rates. A deduction in reserves may be made for any portion of the annuity risk that is reinsured by an authorized insurer.

Assets in the reserve fund are to be invested in accordance with the prudent investor standard, under Chapter 881 (Trust Fund Investments). **Note:** Prior to the passage of 2009 Wisconsin Act 33, which was effective August 4, 2009, Wisconsin imposed specific restrictions on the investment of gift annuity reserves.

Annual Reporting:

An annual report on the segregated reserve fund is due by March 1 each year after a certificate of authority is obtained. While generally a verification by an actuary of the reserve calculation had to accompany the report, the 2013 annual statement form was modified to eliminate the need for an actuary's signature.

There is a \$50 annual renewal fee.

Compliance/Enforcement:

Enforcement may be made through summary order, resulting in a revocation of the permit.

Wisconsin is a state to watch. Last year legislation was introduced that would have significantly lessened the requirements in order for charities to issue gift annuities. The law did not pass, but it is anticipated that it could this year. If so, this would open the door for charities which have shied away from issuing CGAs to WI residents due to prohibitive requirements.

The donor who wants to maintain the gift annuity contract but tells the charity to keep the payments because the donor does not need them

In conducting my survey of common gift annuity administration issues – a planned giving consultant said that quite a few clients (charities) will run into the issue of donor-annuitants who wish to keep the gift annuity contract in place (because of the future gift) – but ask if the charity would simply keep the payments because the donor no longer needs them.

Some charities will accommodate such donors and forgo paying the annuity to the donor. In this situation the 1099R is still issued to the donor for he or she is under the gift annuity contract. The taxation of such payments is unavoidable. In addition, a gift receipt is issued to the donor for the payments the donors gives to the charity. If the donor really does not want to be taxed on the annuity payments, then a discussion of terminating the contract and assigning the future payments to the charity should be explored.

The consultant went on to further state that she has seen charities issue the annuity payment to a 3rd party (e.g., the annuitant-donor's parent or child) – again – the donor just needs to understand that they will still need to be issued the 1099R. It becomes “riskier” when the payment starts going to another individual instead of the charity – as always – it is advisable to get the blessing from the charity's counsel if administration will veer into something outside the standard practice.

Complying with various state specific disclosures when you market your gift annuity program nationally.

The state regulations of certain states do affect the marketing of a charitable gift annuity program that is meant to reach donors who reside all over the country. A good resource

to consult on state regulations is the ACGA web site. Below is a summary of the various state regulations of which to be aware when it comes to marketing materials:

- California requires that all promotional materials advise donors to seek the advice of competent counsel and that the state guaranty association does not guarantee or insure gift annuities. (Note: CA even requires a nonprofit to sign a statement to this effect)
- Oklahoma and South Dakota require that the disclosure language, which must be included in the annuity agreements, also appear in any promotional materials.
- Alabama has prohibited the use of “testimonials” – both donor quotes and generic fact patterns used for illustrations that would describe a hypothetical donor’s charitable deduction and payments.

*Best practice tip: To avoid any tangles with the state regulators of the above states – it would be best to adhere to the above state specific disclosure requirements in any blanket marketing materials. Note that CA does specifically state the disclosure language must appear in bold 12 pt font.

The donor who wants to donate stock to fund a gift annuity but has no idea what the cost basis of the stock is

When working with a donor who wishes to fund his or her charitable gift annuity with securities, obtaining the cost basis of the securities is important in calculating payments. Every effort should be made by the donor to determine his or her cost basis by working with a broker or consulting historical prices. Ultimately it is the donor’s responsibility to provide the cost basis to the charity in good faith. If a donor cannot come up with the basis, a conservative approach is to attribute zero for cost basis.

The 3.8% Medicare surtax & the 1099R

Beginning in 2013, the Affordable Care Act imposes a 3.8% surtax on the lesser of: 1) a taxpayer’s net investment income (interest, dividends, capital gains, rental and royalty income, non-qualified annuities, and net passive business activity income) or 2) the excess (if any) of the taxpayer’s modified adjusted gross income over certain thresholds (\$250,000 for married individuals filing jointly, \$200,000 for single taxpayers, and \$125,000 for married individuals filing separately). Bottom line is that this surtax affects the payments from a charitable gift annuity.

The interesting question from a gift administration perspective is how much “hand holding” do nonprofits do in alerting its donors of such a change?

There seems to be varying thoughts on how “helpful” a nonprofit should be. Some pundits would err on the side of caution and would suggest generally referring to the new law and advise donors to seek the advice of counsel. While others would feel it would be good donor stewardship to be more specific on the new legislation affecting gift annuity payments with a caveat for the donor to seek the advice of counsel.

*Best practice tip: In the end, charities would be best served by accompanying any references to legislative changes with a disclaimer that the charity is not qualified to provide legal advice and that the donor is strongly encouraged to seek the advice of his or her attorney or tax advisor.

*Helpful article: In preparing for this presentation, I found very little articles post 2014 that discussed CGAs and the 3.8% Medicare surtax. The one I found worth mentioning is by Conrad Teitell of Taxwise Giving:
<http://wealthmanagement.com/blog/final-regulations-38-percent-medicare-tax-crts-cgas-pifs-and-clts>

How do you know when an annuitant has passed away?

Ideally, a nonprofit will be in regular contact with all of its annuitants to avoid having one pass away unnoticed. Yet, for non profits with a large number of gift annuity contracts or whose annuitants shy away from personal visits, it is very possible for the nonprofit to miss when an annuitant has died.

While there are paid services a nonprofit can engage to search for death records, the following are some free web sites to check that might turn up the actual obituary or clues as to whether someone might have passed:

- <http://www.legacy.com/ns/> (search obituaries)
- <http://www.myrelatives.com/search.aspx> (you can search most death records with the donor’s name and birthday)
- Planned giving consultant Greg Lassonde shared the Social Security Admin. has a death record index that is helpful

Discovering your annuitant has passed away after you have mailed the annuity payment(s) (and the gift annuity contract states that the annuity payments terminate with the last regular payment immediately preceding death)

Although it makes a planned giving officer’s heart sink to know that an annuity payment was improperly sent, it happens. From a legal perspective, the charity is within its right to request the family to return the improperly mailed payment back to the charity. While it’s an awkward prospect, charities do it all the time and usually with positive results when done with respect and in the spirit of honoring the donor’s ultimate wishes.

Should a charity find that it cannot retrieve an improperly paid annuity payment, the 1099R issued to the personal representative should include the extra payment. Ideally, calling and writing the donor's surviving family, regarding the issue should be undertaken before forgoing the payment. The issue of private inurement should be carefully weighed with the advice of legal counsel as to whether even greater steps should be undertaken with the estate to seek repayment.

What if several payments have been improperly issued and the surviving family, unaware the payments were impermissible, is willing to return them all? Again, the charity is placed in a gray area – some charities might feel the hassle of issuing corrected 1099Rs and having the family amend tax returns might not be worth the effort, knowing that the IRS has received its money when the 1099Rs were issued with the payments. While other nonprofits may wish to avoid winding up on the IRS's bad side and will take the steps to undo the improperly paid annuity payments.

What is best for each charity should be arrived at with the aid of legal counsel.

What is the best practice for a charity when the sole/surviving annuitant has died?

- Obtain a death certificate of the deceased annuitant for the charity's records
- Furnish a copy of the gift annuity agreement to the personal representative
- For annuity payments that started after 1986, if the annuitant died before his or her life expectancy, then a posthumous income tax deduction should be provided to the personal representative
- For annuity payments that started before 1986 and the annuitant died before his or her life expectancy, no posthumous deduction is available
- The charity will need to revise its annuity records

The donor who wants to terminate the gift annuity contract

There may be an occasion where a charity encounters a donor who no longer needs the payments from a CGA and wishes to assign his or her interest in the contract to the charity. Another scenario where this might occur is when a charity broaches the topic of terminating payments to donors and a donor takes the charity up on the idea.

The following is a general outline of the steps a charity would engage in to terminate a donor's interest in a gift annuity contract. (Note: this scenario envisions the straight forward donor-annuitant single life contract).

- Review the gift annuity agreement to ensure there is language that would allow the interest to be assigned to charity. Should the contract say the interest is unassignable, engage legal counsel. Could an argument be made by legal counsel that to prohibit assignment of the interest to charity would frustrate the intent of the overall contract?

- Software programs have the capability to generate the present value interest in the remaining payments under the gift annuity contract. Note: when running such an illustration, the IRS has noted that using the IRS discount rate in the month of the assignment is always ok but has been silent as to whether using an IRS discount rate from one of the previous two months. As a result, a conservative approach is to always use the IRS discount rate of the month of assignment.
- Should the present interest value exceed \$500 – the donor will need to file a Form 8283 part A – even if the CGA was originally funded with cash. This is because the gift to charity is the present value of the future interest in the payments.
- Should the present value exceed \$5,000 – the donor will need to complete part B on the Form 8283 and receive an independent appraisal. This should not be done by the charity. A charity could consult with its planned giving software vendor or administrator for recommendations on appropriate appraisers.
- A statement by the donor assigning his or her annuity interest to the charity should be entered into by the donor, which confirms the charity is no longer obligated to make payments to the donor.