

# CHARITABLE GIFT ANNUITIES AND HOW THEY WORK



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Trust and Estate Counsel and a member of its Charitable Planning and Fiduciary Income Tax committees. He was nationally ranked in the 2009 through 2020 editions of Chambers USA for Wealth Management. He appears annually in several ALI CLE estate planning programs and has spoken at many other national tax institutes, including the Notre Dame Tax Institute, the University of Miami Heckerling Estate Planning Institute, and the Southern Federal Tax Institute. Larry has served as an adjunct professor at the Washington University School of Law where he has taught both estate and gift taxation and fiduciary income taxation. Larry is the co-author of the Bloomberg Tax Management Portfolio Charitable Remainder Trusts, Charitable Gift Annuities, and Pooled Income Funds. Larry is also the creator of Tiger Tables actuarial software, which is widely used by tax lawyers and accountants as well as the Internal Revenue Service, and has testified in United States Tax Court on actuarial issues.

Most of us who have attended a university or made a donation to a favorite charity have received an invitation to enter into a charitable gift annuity contract (CGA) to support the organization. But many lawyers who practice in the estate planning field are unfamiliar with the CGAs, despite their popularity with so many charities. Maybe that is because with the CGA there is nothing for the practicing lawyer to draft. Or maybe it is because unlike charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs), you will find no mention of the CGA in the Internal Revenue Code, except for one mention in connection with debt-financed property for unrelated business taxable income purposes. But a CGA can be a valuable tool for clients interested both in maintaining an income stream for themselves or others and helping their favorite charity.

A typical CRAT pays income to one or more non-charitable beneficiaries for a life or lives, with the remainder eventually passing to charity. Similarly, the gift annuity pays a fixed annuity to one or more individuals for life, but there is no trust. Instead, the gift annuity is paid to the annuitant directly by the charity from its general assets and the transaction is

treated for charitable deduction purposes as a bargain sale—a part gift, part sale.

In bargain sales, the donor transfers cash or property to a charity in exchange for consideration worth less than the cash or property transferred. The excess of the fair market value of the transferred property over the consideration received from the charity is deductible as a charitable contribution. If appreciated property is contributed for the annuity, the donor pays tax on the sale portion and can deduct the gift portion. With a gift annuity, the donor transfers cash or property to a charity in exchange for the charity's unsecured promise to pay a fixed annuity to the donor or another individual for life. The excess of the value contributed over the actuarial value of the annuity received in exchange is deductible as a charitable contribution. If appreciated property is used to purchase the gift annuity, gain is also recognized on the sale portion, but the gain is spread out over the lifetime of the annuitant if the donor is the annuitant.

Although CRATs and CRUTs can't be administered economically for less than \$100,000 or \$200,000, CGAs are issued by many charities for as little as \$5,000 or \$10,000 because there is no trust to

administer. CGA donors contemplating a gift annuity should keep in mind that the annuitant is simply an unsecured creditor of the charity, so consideration of the financial health of the charity is important.

Most charities issue gift annuities at age-based maximum rates suggested by the American Council on Gift Annuities (ACGA). This century-old organization sets recommended maximum annuity rates which change from time to time depending on market economic conditions and are structured so that if the charity has a large enough annuity pool to spread the mortality risk, about half of each annuity should on average be left for the charity at the end of the annuitant’s life. Here are the ACGA-suggested one-life maximum rates that became effective on January 1, 2024:

**Single Life Suggested Maximum Gift Annuity Rates**

Age	Rate	Age	Rate
5-11	3.8	69	6.2
12-24	3.9	70	6.3
25-31	4.0	71	6.4
32-37	4.1	72	6.6
38-41	4.2	73	6.7
42-44	4.3	74	6.8
45-47	4.4	75	7.0
48-49	4.5	76	7.2
50-52	4.6	77	7.4
53	4.7	78	7.6
54-55	4.8	79	7.8
56-57	4.9	80	8.1
58	5.0	81	8.3
59	5.1	82	8.5
60	5.2	83	8.7
61	5.3	84	8.9
62-63	5.4	85	9.1
64	5.6	86	9.3
65	5.7	87	9.5
66	5.8	88	9.7
67	5.9	89	9.9
68	6.1	90+	10.1

**Benefits of CGAs**

What benefits besides the fixed annuity does the CGA donor receive? First, the donor receives an income tax charitable deduction for the excess of the fair market value of the annuity over the amount of cash or property transferred to the charity in exchange for the annuity. The value of the retained annuity is determined by IRS actuarial tables which assume an interest rate (the so-called 7520 rate or Charitable Monthly Federal Rate) which varies from month to month. The second benefit the donor receives is that a portion of the gift is generally income-tax free, just as it would be with a commercial annuity. The portion of each annuity payment which is a nontaxable return of basis is larger when the gift is made with cash than when the gift is made with appreciated property.

Let’s consider a gift annuity purchased by a 75-year-old donor. Assume that the gift is made in January 2024, using the IRS January interest rate of 5.2 percent, and further assume that the payments are made quarterly at the end of each quarter.

In the first example, we have a donor who contributes \$100,000 in cash for a gift annuity with her favorite charity. The current ACGA maximum suggested annuity rate for a donor aged 75 is seven percent, so the donor’s annual annuity would be \$7,000 per year. According to IRS tables, the annuity is worth \$60,737. Subtracting that from \$100,000 gives us the charitable deduction of \$39,263.

**How is the annuity taxed for income tax purposes when received by the annuitant?**

IRS life expectancies under Internal Revenue Code section 72 are used to determine the income taxability of annuity payments, both commercial annuities and charitable gift annuities. Under that table, a 75-year-old person has a life expectancy of 12.4 years. 12.4 times the annual annuity of \$7,000 gives us an expected return of \$86,800. Because the purchase price of the annuity—the donor’s basis in the annuity—is deemed to be \$58,484, the amount of each payment excluded from income is \$58,484 divided by \$86,800 or 67.4 percent. So, 67.4

percent of each annuity payment of \$7,000 (\$4,718) is excluded from income until complete recovery of basis in 12.4 years, after which the entire annuity is taxable. The following is the result:

Contribution	\$100,000
Annual Annuity	\$7,000
Charitable Deduction	\$41,516
Nontaxable Amount of Each Payment	\$4,718
Taxable Amount of Each Payment	\$2,282

Now, let us assume that the donor and donor's spouse contribute \$100,000.00 to the gift annuity. Assume further that both donors are 75. At those ages, the ACGA recommended annuity rate is 6.2 percent, so the annual annuity would be \$6,200.

Contribution	\$100,000
Annual Annuity	\$6,200
Charitable Deduction	\$35,173
Nontaxable Amount of Each Payment	\$3,956
Taxable Amount of Each Payment	\$2,244

Now, let us look at an example where the contribution consists of appreciated property held for more than one year worth \$100,000, with a cost basis of \$50,000. The charitable deduction will be the same, but in that case, in my two-life example, only \$1,979 of each payment would be nontaxable, and \$1,976 would be capital gain, reducing what would otherwise have been nontaxable return of investment in the contract.

Contribution	\$100,000
Charitable Deduction	\$32,325
Nontaxable Amount of Each Payment	\$1,979
Ordinary Income Portion of Each Payment	\$2,244
Capital Gain Portion of Each Payment	\$1,976

### What things can I do with a CGA annuity that I cannot do with a CRAT?

Unlike a CRAT annuity, a CGA annuity can be immediate or deferred. ACGA-suggested rates for deferred annuities are higher than the rates for immediate annuities because if the annuitant dies before the annuity starting date, the annuitant will receive nothing.

Also, a CGA may be better from an income-tax standpoint than a CRAT because of the tax-free portion of each payment. CGAs can be purchased with appreciated tangible personal property, and if the charity will be able to use the tangible personal property in a way that is related to its tax-exempt purpose, the charitable deduction will be based on fair market value rather than basis as would be the case if the tangible personal property were given to a CRAT.

Additionally, the self-dealing rules that apply to CRATs do not apply to gift annuities. This opens up a number of transaction possibilities:

A donor could contribute an office building to a charity in exchange for a gift annuity and lease all or part of the building back at fair market value rent;

- A donor could also contribute closely held stock to a charity in exchange for a charitable gift annuity and a family member could later purchase the stock from the charity at its fair market value as determined by independent appraisal; or
- A donor planning to sell a personal residence may wish to contribute the residence to charity in exchange for an income interest but wishes to reside in the residence until it is sold. Because of the self-dealing rules, this arrangement is not possible with a charitable remainder trust even if fair market value rent is paid, but a gift annuity will work in this situation.

### ACGA Rates are Maximum Rates

Don't forget when you talk to donors that the ACGA recommended rates are *maximum* rates. You can always suggest to the donor that if the donor

is willing to take a smaller annuity, the charity will benefit more and the donor will get a larger income tax deduction if the donor itemizes deductions. A donor holding highly appreciated stock paying a two percent dividend may be happy accepting a five percent annuity rather than, say, a six percent annuity and deferring much of the capital gain to boot.

### **Are You Asking Donors If They Itemize Their Tax Deductions?**

This is important because in computing all of the various interests in a charitable gift annuity, the donor has a choice of three interest rates to use—the interest rate for the month of the gift or for either of the two prior months. Electing a higher interest rate results in a larger income tax deduction. However, with a lower interest rate, less of each annuity is taxable. This has become more important than it used to be because so many older donors no longer itemize deductions. State and local taxes are capped by current law at \$10,000, and many donors no longer have mortgage deductions. These same older donors may also no longer have a charitable income tax deduction because they make their charitable contributions by IRA charitable rollover. Electing a lower interest rate results in more of each annuity payment being a nontaxable return of basis. But unless you ask the donor what they would choose, you will not know what illustrations to present to them nor, once the gift has been made, how to report to the annuity administrator how to report the payments to the donor on the 1099-R. 📌