Jeopardy!

Alex Trebek, I'll Take Annuities for $1,000

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Why talk about “annuities?”

Today's Presentation

- Charitable gift annuity
- Pension annuities
- Commercial annuity
- Charitable remainder annuity trust
- Single premium immediate annuity
- Reinsurance

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Answer Key

Answer in the form of a question

"What is.........?"

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Jeopardy Category: Annuities for $100

Answer:

A fixed sum of money paid to someone each year or at other regular intervals – typically for the rest of his or her life

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Traditional Applications for “Annuity”

- True pension – defined benefit pension plan
- Not a defined contribution plan like a 401(k)
- Fixed payments and not a lump sum

Jeopardy Category: Annuities for $200

Answer:

A charitable gift planning vehicle where a donor gives money or an asset directly to a charitable organization in exchange for fixed payments for the lifetime of 1 or 2 annuitants, and the income payments begin within 12 months of the gift date.

Charitable Gift Annuity Basics

- Started in the 1800's
- Offered by some charities – not all
- Partial income tax deduction on present value of remainder interest
- Fixed payments for life
- Lifetime of 1 or 2 annuitants aka income beneficiaries
- Regulation by states
  - Heavy regulation
  - Little or none
- www.acga-web.org
- Popular with older adults

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Charitable Gift Annuity Example

- 75-year-old (male or female – unisex rates)
- $100,000 cash donation
- $6,600 annually
- If payment mode is monthly - $45,792 income tax deduction
- Tax-favored payments – 2 or 3 taxation tiers depending on asset donated
  - In this example

    $4,369 tax free return of principal

    $2,231 taxed as ordinary income

    $6,600 total payment

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Jeopardy Category: Annuities for $300

Answer:

A charitable gift planning vehicle where a donor gives money or an asset directly to a charitable organization in exchange for fixed payments for the lifetime of 1 or 2 annuitants and the payment start date is 12 months or more after the date of the gift.

Deferred Payment Charitable Gift Annuity Example

- 75-year-old (male or female – unisex rates)
- $100,000 cash donation
- Donor defers receipt of the first payment for 5 years (age 80)
- Payments are $9,400 (up from $6,600) annually
- If payment mode is monthly – income tax deduction is $60,569 (up from $45,792) income tax deduction
- Tax-favored payments
- What happens if income beneficiary dies before first payment?

Jeopardy Category:
Annuities for $400

Answer:

A charitable gift planning vehicle where a donor gives money or an asset directly to a charitable organization in exchange for fixed payments for the lifetime of 1 or 2 annuitants and the payment start date is in the future within a range of dates the donor can choose from when ready, but the exact start date is undetermined as of the date of the gift.

Flexible Deferred Payment Charitable Gift Annuity Example

- 75-year-old
- $100,000 cash donation
- Donor has the option to defer receipt of the first payment for some time frame; in this case between the ages of 80-90
- On the donor's 85th birthday, donor elects to begin payments; payments are $13,200
- Income tax deduction at age 75 when gift was funded is $60,570

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Compare 75 year-old Donor

CGA

- Income tax deduction - $45,792
- Payments - $6,600

5 YEAR DEFERRED

- Income tax deduction - $60,569
- Payments - $9,400

FLEXIBLE CGA

- Income tax deduction - $60,570
- Payments - $13,200 starting at age 85
- Start range 80-90

Daily Double!

Jeopardy Category:
Annuities for $500

Answer:

A charitable gift planning vehicle where a donor gives money or an asset directly to this type of trust he or she creates with their own attorney and the trustee pays fixed payments for the lifetime of the income beneficiaries, or a fixed period of time of no more than 20 years, or certain combinations of the two.

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Charitable Remainder Annuity Trust

- Cousin to the charitable remainder unitrust
- Only one contribution allowed
- Similar to a CGA due to fixed payment
- Donor selects fixed payment %; minimum 5%
- Can be difficult to use if donating hard-to-sell assets and the trust is cash poor
- Ponder: does the charitable remainder <u>unitrust</u> pay an “annuity”?

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Charitable Remainder Annuity Trust Example

- 75-year-old (male or female)
- $100,000 cash donation
- 6% - can’t do due to 10% rule; max % 5.17
- Income tax deduction is $29,929; 4.4% IRC 7520 rate
- 4-tiered taxation of payments
  - Tier 1 – ordinary income/dividends
  - Tier 2 – capital gain
  - Tier 3 – tax free gain
  - Tier 4 – tax free return of principal

Compare CGA and CRAT

CGA

- Fixed payments for life
- Tax deduction available
- Offered by certain nonprofits
- Gift is made directly to the nonprofit
- Made with a simple 1-2 page contract
- Donor does not select payment rate as it is based on age (nearest birthday)
- A charitable gift of the remainder

CRAT

- Can be fixed payments for life only but can be fixed periods of time
- Tax deduction available
- Any nonprofit can be the beneficiary of a CRAT
- A charity might not know they are the beneficiary
- Is a separate trust document with tax identification #; donor needs a lawyer to draft
- Donor can select payment % within range allowed by IRC
- A charitable gift of the remainder

Jeopardy Category: Annuities for $600

Answer:

An investment vehicle typically offered by insurance companies through commissioned agents or brokers, and which is purchased generally by older adults as a way to save for retirement; funded with after-tax dollars or with pre-tax dollars (e.g., IRAs); grows tax-deferred; but does not provide the owner with an income tax deduction; and can morph into a stream of fixed payments at some time in the future when the policyowner makes an election to do so.

Commercial Deferred Annuity

- Very popular with older adults
- Not a charitable gift
- Sold by commissioned agents/brokers
- No tax deduction
- Surrender charges for a certain number of years - varies by product/company (e.g., 7-25 years)
- “Can” be turned into an income stream down the road – called annuitization – happens 1% of the time

Jeopardy Category: Annuities for $700

Answer:

An investment vehicle offered by insurance companies through commissioned agents or brokers and which is purchased usually by older adults as a way to provide fixed payments for typically their lifetimes; it can be funded with after-tax dollars or can be funded with pre-tax dollars (e.g., IRAs); does not grow in value; does not offer an account balance but instead the purchaser/policyowner has a right to a stream of fixed payments for a period of time he or she selects; the period of time/age/sex/premium paid all determine the amount of the payments which begin immediately.

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Commercial Single Premium Immediate Annuity

- Not very common
- Income stream
  - Life only – pays for the lifetime of the person; no remainder
  - Life with period certain (life with 10; life with 20; life with 30) – pays for the lifetime of the person but if they die before the end of the period certain, the named beneficiaries will receive the remaining payments through the end of the period certain.
  - Fixed period – pay for a fixed period of time unrelated to sex or age.
  - Can be for a single life or joint lives
- Not a charitable gift
- Sold by commissioned agents/brokers
- No tax deduction

Commercial Single Premium Immediate Annuity Example

- Susan age 65 has IRA worth $100,000 invested in CDs
- She wants to turn that into a fixed income stream
- She can invest the IRA in a Single Premium Immediate Annuity(SPIA)/IRA with an insurance company
- Trustee to trustee transfer from the CD/IRA to the SPIA/IRA
- She elects monthly payments for her "**life only**"
- She can never outlive the income stream
- No tax deduction available; no account balance available
- Payment amount based on her age and annuity option chosen

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Compare CGA and SPIA

CGA

- Fixed payments for life
- Tax deduction available
- Offered by certain nonprofits
- A charitable gift of the residuum
- Can accept cash and sometimes other assets to fund

SPIA

- Can be fixed payments for life or can be other periods of time
- No income tax deduction
- Offered by insurance companies
- No charitable gift involved
- Only funded with cash
- Can be pre or post tax money

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Jeopardy Category: Annuities for $800

Answer:

If a donor wants to donate a commercial deferred annuity with a $100,000 value and a $67,000 cost basis, this negative tax issue occurs?

Deferred Commercial Annuity Taxation

- Jane, age 75, wants to donate a commercial annuity worth $100,000.
- Cost basis of annuity is $67,000
- $33,000 growth in the annuity is taxed to the owner upon gift to charity (rare) or surrendered for cash (much more common)
- Taxed as ordinary income (not long-term capital gain)
- Therefore, $33,000 ordinary income (not a good result) to donor
- $100,000 income tax deduction if donated to charity

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Jeopardy Category: Annuities for $900

Answer:

Internal Revenue Code Section 1035

IRC Section 1035

- Allows one annuity to be exchanged for another annuity under this code section on an income tax-free basis
- (Also allows a life insurance policy to be exchanged for an annuity but that would likely never happen)
- This applies to a commercial annuity for a commercial annuity
- Often asked if this applies to a CGA – answer is "no"
- Therefore, a donor cannot take a commercial deferred annuity and move it to a CGA on a tax-free IRC Section 1035 basis

Jeopardy Category: Annuities for $1,000

Answer:

The concept where a charity purchases a single premium immediate annuity (SPIA) from an insurance company to provide the exact payment amount to a charitable gift annuity income beneficiary; hence eliminating the risk of:

- how long the income beneficiary lives (mortality risk) and
- how well the charity can invest the donor’s gift long-term (investment performance risk).

Reinsurance

- Used <10% of the time with CGAs
- Most charities will assume the risk of mortality and investment performance
- Can reinsure entire annuity pool or just larger CGAs in proportion to the pool

Reinsurance Example

- 75-year-old (female – NOT unisex rates)
- $100,000 cash donation
- $6,000 annually
- Reinsurance is where the charity purchases from an insurer
  a single premium immediate annuity for $X in premium.

$X in premium is determined by the insurance company based on the following:

1) male or female
2) payment mode
3) payment amount
4) annuitization option selected

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Reinsurance Example

$X is determined by:

1) male or female -- in this case a 75-year-old female
2) payment mode -- monthly
3) payment amount -- $6,000 annually or match to monthly amount
4) annuitization option selected -- her lifetime (only)

$X = $84,500 premium

Reinsurance – WHY?

Out of the $100,000 cash donation, charity keeps $15,500 in cash and purchases the SPIA for $84,500 from the insurer

1. Allows charity to spend $15,500 now instead of waiting until donor dies to use the CGA residuum
2. No matter how long the annuitant lives, the charity never has to worry because the charity will never have to pay any additional money
3. Had the charity not used reinsurance, it would have had to make sure it invested the money properly to try to achieve the 50% residuum at her life expectancy. With reinsurance the charity has no investment worries.

Reinsurance – WHY?

- Balancing this:
  - $15,500 NOW with no mortality or investment risk

  or

  - Do the CGA without reinsurance and have the mortality and investment risk and not spend the residuum until the donor dies……Could be higher or lower than $15,500 – that's the risk

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QUESTIONS?

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