Folks:

Take-Away: A charitable gift annuity (CGA) is much simpler to implement but probably not as tax efficient as a charitable remainder trust if an individual is exploring end-of-the-year philanthropy.

Background: In the last quarter of 2024, some wealthy individuals will be thinking about end-of-the-year charitable gifts, while others who do not itemize their income taxes may be less inclined to engage in philanthropy. Then there will be many retirees who plan to manage their required minimum distribution (RMD) obligation for the year through qualified charitable distributions (QDC.) Many individuals, however, may consider making a charitable gift in 2024 in light of the success of their investment portfolios. If those individuals are charitably inclined, they should at least consider a charitable gift annuity (CGA) due to its simplicity to be put in place before the calendar year ends.

QCD: We've covered in the past qualified charitable distributions, so they will be ignored in this missive, primarily because a QCD does not generate a charitable deduction- the QCD distribution to charities is not included in the retirement account owner's reportable income for the year.

CGAs: This summary will focus on charitable gift annuities (CGA) since more and more charities are willing to offer a charitable gift annuity to their donors, and CGAs can be put in place relatively quickly. A CGA will be compared with a charitable remainder trust (CRT), to distinguish the pros and cons of a CGA.

CGA Basics: The basic principles behind a charitable gift annuity include the following:

> **Bargain Sale:** Practically speaking, a charitable gift annuity (CGA) is a bargain sale by its donor to a charity. Property, like marketable securities, is transferred to the charity in exchange for an annuity stream paid to the donor that is worth less to the donor than the value he/she transferred to the charity. The difference in those two amounts is an immediate charitable income tax deduction that the donor can claim on his/her income tax return.

Amount: As a generalization, a CGA will pay to its donor, in the present value of annuity payments, roughly 50% of the value of the assets transferred to the charity. This ignores, though, the value of the charitable income tax deduction that the CGA generates.

Gift Tax: A CGA will satisfy the federal gift tax charitable deduction. If two lives are to receive the CGA, then there will be a gift from the donor to the person who receives the second life interest in the CGA. It that second person is the donor's spouse, that transfer will satisfy the federal gift tax marital deduction. Less clear, however, is whether the marital deduction applies when the annuity is paid to the donor for life, and then to the donor's surviving spouse for life. It is better for the CGA to be structured for their joint lives of the two spouses.

Estate Tax: The death of the annuitant of a one-life CGA ends all rights in the annuity, such that there is no estate inclusion for federal estate taxes in the decedent's estate.

Charitable Income Tax Deduction: The primary benefit of a CGA is that the donor receives an immediate income tax deduction, which makes the CGA a better than an estate tax charitable deduction for the donor, since the annuity + income tax deduction improves the donor's cash-flow, and in a period of high estate tax exemptions, the donor may not even have a taxable estate.

Unsecured Promise to Pay: The annuity paid by the charity to the donor is not secured though, so the solvency of the charity is an important factor that the donor must consider. The charity cannot guarantee a minimum or a maximum amount of payments to the donor. Accordingly, a start-up charity might not be a good candidate to fulfill its promise to pay the donor an annuity for the balance of the donor's lifetime.

CGA Rates: The American Council on Gift Annuities recommends the maximum annuity rates that most charities follow. The charity could always offer a lower rate, which would increase the donor's allowable charitable income tax deduction, but that might not make sense unless the donor itemizes his/her income taxes.

The CGA rates assume 50% male and 50% female. 1% is assumed as an annual expense rate. And the earnings rate assumption for the CGA is 5%.

The charity cannot provide for adjustment of the annuity amount paid to the donor based on the income received from the contributed property. This makes the CGA

not as good an option as a charitable remainder unitrust, which increases payments to the donor as the CRUT assets appreciate in value.

Comparison with a CRT: There are several differences between a CGA and a CRT, some of which are obvious, and some of which are technical.

Simplicity: A CGA is simple to set-up. The charity, not the donor, is saddled with the obligation to maintain the CGA and to make the payment and issue annual statements. It is usually a one to two page agreement.

Charitable Deduction: If the CGA annuitant dies before his/her life expectancy and he/she had not fully recovered their full 'investment' in the annuity contract, the remaining unrecovered basis/'investment' is allowed as a charitable income tax deduction on the deceased donor/annuitant's final income tax return.

10% 'Test:' Like the CRT the CGA must meet the 10% test, meaning that at least 10% of the value initially transferred to the charity (or the CRT) must be dedicated to (vested in) the charity. However, the CGA 10% 'test' only affects the charity, not the donor. If a CRT fails to pass the 10% test, it is not a qualified charitable trust, without any of the tax benefits. That will not happen with the CGA.

No 5% 'Test:' A CRT has an additional 5% 'exhaustion' test that it must pass before it qualifies as a CRT; there is no 5% 'exhaustion' test for a CGA. Accordingly, if marketable securities were transferred to a charity in exchange for the CRT, the 10% test might be satisfied but the 5% exhaustion test that CRT's must satisfy might not be met. The CGA does not present this initial hurdle.

Charity Cannot Be Changed: Unlike a CRT, a CGA cannot have its charitable 'remainder' beneficiary changed. The charity that issues the CGA is the charity that will receive the residue benefit once the annuity dies.

Limited to Two Lives: A CGA is limited to one or two lives. With a CRT several lives can benefit from a CRT as the lifetime beneficiaries (but that is seldom the case with CRTs.)

S Stock: A CGA can hold stock in an S corporation.

No Control of Annuity Investments: Unlike a CRT, the donor of a CGA cannot control the investments held in a CGA. Often the charity will purchase an annuity from a commercial insurer to fulfill its obligations under the CGA.

Private Foundation Rules Do Not Apply: Unlike a CRT, a CGA is not subject to the Tax Code's onerous private foundation (PF) rules and restrictions on self-dealing, not to mention the PF's annual reporting obligations.

No 'Self-Dealing' Rules: Unlike a CRT that must comply with self-dealing prohibitions, there are none with a CGA. For example, a donor could transfer closely held business stock to the charity in exchange for the CGA. A family member could later re-purchase the business shares at fair market value from the charity that issued the CGA. This could never occur with a CRT.

Deferral: Unlike a CRT, the annuity paid to the donor can be deferred. If the annuity is deferred, the rates paid to the donor are higher than for an immediate annuity. This provides greater flexibility using the CGA than a CRT. With the deferred CGA, leaving the start date open, the longer the annuity is deferred before it commences to be paid, the larger the annuity payment the donor will ultimately receive.

Conclusion: Charitable gift annuities are often used by donors of modest means, who are charitably inclined, but who like the idea of creating a fixed cash-flow to themselves for the rest of their lives. That said, a CGA is not nearly as tax efficient as a CRT which can generate a much larger income tax deduction, reducing the charity's interest to 10% of the value of the assets transferred to the CRT, while enhancing the settlor's return on the CRT's assets, especially with a CRUT. As such, the ultimate trade-off with a CGA is its simplicity in setting it up, against a more modest 'return' to its donor.