

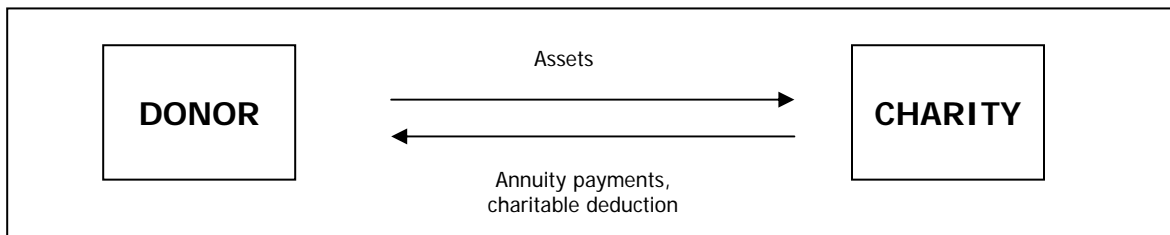


## CHARITABLE GIFT ANNUITIES

Charitable gift annuities are the simplest form of life income gift. Like charitable remainder trusts and pooled income funds, charitable gift annuities give the donor an immediate income tax deduction and regular income payments for life, while providing long-term financial support to the Vermont Land Trust. They are easy to establish, require a minimum gift of only \$5,000, and allow donors to increase their income. Charitable gift annuities can be funded with virtually any type of property, including land. Although the annuity payments may be subject to capital gains taxes, the tax is greatly reduced and can be spread out over the period of the donor's life expectancy.

### WHAT IS A CHARITABLE GIFT ANNUITY?

A Charitable Gift Annuity (CGA) is partly a charitable gift and partly a purchase of an annuity contract. The donor transfers property (usually appreciated securities or land) to the Vermont Land Trust. In return, VLT enters into a contract agreeing to pay the donor and, if desired, one other beneficiary a fixed annuity for life.



### ARE THERE AGE LIMITATIONS IN MAKING A CHARITABLE GIFT ANNUITY TO VLT?

VLT will generally accept a gift annuity from a donor who is at least 60 years of age. This guideline is based on the cost of managing the annuity and payments to the donor for his/her lifetime, relative to the eventual income to VLT. VLT will accept an annuity from a younger person, provided the annuity payments can be deferred until the donor is at least 60 years old.

### WHAT BENEFITS DO I GAIN FROM A CHARITABLE GIFT ANNUITY?

A charitable gift annuity is most useful when a donor owns an appreciated asset that earns a relatively low rate of return (like stock) or one that costs the donor money to maintain (like land). When VLT sells the asset, no capital gains tax is due on the sale, although a portion of the annuity income may be taxed as capital gains income when the donor receives annuity payments. Thus the CGA allows a donor to convert a low-earning asset into a higher-earning one. The donor also benefits by gaining a charitable income tax deduction in the year the gift is made. The amount of the deduction depends on the value of the donated property, the number and ages of the income beneficiaries, and the annuity rate selected. If the donor cannot use the entire deduction in the year of the gift, he/she can carry the deduction forward for up to five years and

apply it against subsequent income. Since a gift annuity is usually not included in the donor's estate, it can also lower one's estate taxes. Finally, for charities like the Vermont Land Trust, gift annuities provide significant long-term financial support, including the establishment of permanent endowment funds.

### **WHAT ARE THE DISADVANTAGES?**

The major disadvantage is that the donor and the heirs no longer have access to the principal. Therefore, before establishing a charitable gift annuity, donors should consider carefully whether they have other capital resources sufficient to meet their future needs.

### **WHAT DOES THE VERMONT LAND TRUST DO WITH THE GIFTED PROPERTY?**

VLT sells the property and sets the proceeds aside in a reserve account, managed by an outside investor on behalf of VLT. Income from the reserve account is used to make the quarterly payments. If the gift annuity is funded with land that has conservation value, VLT will place a permanent conservation easement on the land prior to selling it to a conservation buyer.

### **HOW IS THE AMOUNT OF THE ANNUITY PAYMENT DETERMINED?**

The amount of the annuity payment is determined by three factors: (1) the age and number of the annuitant(s), (2) the annuity rate selected, and (3) the federal "discount rate" in effect at the time of the gift and sale of the asset.

A CGA can have one or two life-income beneficiaries. The American Council on Gift Annuities has established gift annuity tables for beneficiaries of different ages, which are based upon actuarial life expectancies. The older the annuitant, the higher the maximum annuity payment. In most cases, the annual annuity payment will be in the range of 5.5% to 10% of the value of the donated property.

The donor has the option of selecting an annuity payment rate lower than the one recommended by the American Council. A lower percentage usually results in a higher charitable income tax deduction upon the creation of the CGA.

### **HOW IS THE TAX DEDUCTION DETERMINED?**

The tax deduction is also a function of the age of the annuitant(s), annuity rate selected, and the federal discount rate. If the donor selects the rate recommended by the American Council, the deduction will be approximately 35% and 50% of the value of the gifted property. That deduction will increase if the donor elects a lower annuity payment rate or if the donor chooses to defer the start of the annuity payments for one or more years.

### **HOW ARE THE ANNUITY PAYMENTS TAXED?**

If the CGA is funded with an appreciated asset like stock or land, the annuity payments will be broken into three parts for income tax purposes: One part will be tax-free, representing a return of the donor's purchase price or "tax basis;" one part will be taxed as capital gains income; and one part will be taxed as ordinary income. If the life income beneficiaries live beyond the donor's actuarial life expectancy, subsequent annuity payments will all be treated as ordinary income.

The amount of the annuity payment, size of the tax deduction, and the tax treatment of payments are difficult to calculate by hand. However, the Vermont Land Trust has the computer capability to make the calculations easily, allowing the donor and VLT to examine different alternatives in setting up a CGA or other forms of charitable giving.

#### **AT WHAT AGE IS A CHARITABLE GIFT ANNUITY MOST ADVANTAGEOUS?**

Most donors who establish a CGA are in their mid-sixties or older. Donors in their fifties or early sixties may find it advantageous to establish a deferred gift annuity. By deferring the start of the annuity payments until after retirement (when they may be in a lower tax bracket), these donors are able to take advantage of a higher tax deduction and reduced taxes on the annuity payments.

#### **WHO ADMINISTERS THE GIFT ANNUITY?**

All CGAs are administered by the Vermont Land Trust's staff accountant and overseen by its vice president for operations. Investments of gift proceeds are handled by an outside investment advisor in accordance with policies established by the board of trustees. VLT mails annuity payments four times annually, on the last day of each quarter. Each January, VLT sends its gift annuity donors a statement describing how the payments received in the previous year should be declared for income tax purposes.

If a donor wishes to contribute additional amounts to the Vermont Land Trust after having established an initial annuity, the donor must create a new annuity contract each time, because one cannot add more funds to an existing annuity. A donor with multiple annuities with VLT can receive income checks in one lump sum per quarter.

Further, if, after establishing an annuity, the donor decides he/she no longer wishes to receive the annual income, the donor can terminate the annuity payments, thereby accelerating passage of the assets to VLT and generating additional income tax benefits.

Here are two actual examples of CGAs established by VLT members:

*Example #1* - A donor, age 72, owned \$5,000 in stock. Current dividends were \$200 (4%) annually. She donated the stock to the Land Trust. The Land Trust paid her an annuity of \$335 per year (6.7%) for life. The donor claimed a \$2,155 tax deduction on her federal income tax return.

*Example #2* - A donor, age 80, owned \$76,000 in stock. The company paid dividends of \$2,813 (3.7%) annually. If she sold the stock to invest for higher income, federal and state capital gains taxes could take as much as \$14,000. Instead, she donated the shares to the Land Trust, receiving, in return, annual annuity payments of \$5,320 (7%) for life. She also received an income tax deduction of \$42,783 (61.6% of the stock value). Had she selected a 8.0% annuity, the rate fixed by the American Council for a single-life annuitant age 80, the annuity payments would have been \$6,080 annually and the tax deduction \$38,038.

Note: The annuity rates recommended by the American Council and used by most charities change from time to time, and the federal discount rate changes every month. For this reason, the outcomes in the two examples would be different if the gifts were made today.

#### **COMPARING CHARITABLE GIFT ANNUITIES TO CHARITABLE REMAINDER TRUSTS**

Charitable gift annuities work well for smaller gifts (\$5,000-\$100,000 range). They also work for larger gifts, when the donor is older (80+ years) or does not wish to retain any control over

the investment of the assets. CGAs can provide an assured “stream” of income, more favorable income tax treatment than CRTs, and a simple and predictable gifting vehicle. On the other hand, charitable remainder trusts may be advisable for donors who wish to make a planned gift with a value of \$100,000 or more, and also want to retain lifetime control over investment of the assets so they can invest for growth and/or income, as they desire. Donors can make additional contributions to the trust over time as their assets and personal objectives permit. Charitable remainder trusts work particularly well when the beneficiaries are relatively young and the trust principal and annuity payments may appreciate over their lifetimes.

### **HOW DO I GET STARTED?**

The Vermont Land Trust has the computer software necessary to run gift annuity calculations and determine both the annuity rate and income tax deduction.

We will need the following information from you: (1) the date(s) of birth of the annuitant(s); (2) the estimated fair market value of the asset you intend to use to fund the gift annuity; and (3) your “cost” or tax basis in that asset. We can then run the preliminary calculations.

*If you are funding the gift annuity with land, you must obtain a qualified appraisal of the land’s fair market value before the transaction is finalized. Once the appraisal is complete, you have a 60-day window after the date of the appraisal to complete the gift annuity, or you will need an appraisal update (usually in the form of a letter). If your gift is in the form of securities on the stock exchange, we will run the final calculations after the transfer, to determine the exact value of the securities on the day of transfer. As with any planned gift, we urge you to consult with your attorney and financial advisor before completing the transaction.*

NOTICE: A charitable gift annuity is not insurance under the laws of Vermont; it is not subject to regulation as insurance by the Vermont Department of Banking, Insurance, Securities and Health Care Administration; and an insurance guaranty association does not protect it.

For more information, please contact Darby Bradley at [Darby@vlt.org](mailto:Darby@vlt.org) or at the phone number below.

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