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Life income donors have a variety of charitable gift vehicles to choose from: Pooled Income Funds, Charitable Remainder Unitrusts, Gift Annuities, and Charitable Remainder Annuity Trusts. Each vehicle has its own special rules for funding, permissible terms, taxation, and management. Nonetheless, life income gifts can be divided into two primary categories. First are life income gifts that pay income that varies from year to year depending on the vehicle's investment performance. Second are life income gifts whose payments are fixed and do not fluctuate regardless of how the gift vehicle is invested and stock market conditions.

Gift annuities and charitable remainder annuity trusts belong to the category of life income gifts that make fixed payments. While a gift annuity looks very much like a charitable remainder annuity trust, in this respect, there also are significant differences. When a donor expresses an interest in a fixed payment from a life income gift, there may be situations where one vehicle is preferable to the other. We'll start with a review of the features of the gift annuity and charitable remainder annuity trust.

Charitable Gift Annuities

Of all the ways to create a life income gift, the charitable gift annuity is the most common life income gift vehicle. That is, in terms of the number of existing contracts, there are far more gift annuities than charitable remainder trusts or pooled income fund participants. The American Council on Gift Annuities (ACGA) conducts its survey of gift annuity programs every five years. Based on the 2017 survey and anecdotal evidence in the industry, there are likely substantially more than 100,000 gift annuity contracts in place as of this writing.

Why are gift annuities so popular? For donors, gift annuities are easy to understand, easy to establish, the minimum gift amounts are usually low, the payments are guaranteed for the life of the annuitant, and most charities with robust gift planning programs offer annuities. Also, gift annuity payment rates, which are based on the ages and number of annuitants, are attractive for annuitants in the typical age range. The older the annuitant, the higher the annuity rate.

Despite the low gift minimums, gift annuities can be appropriate for donors making six and even seven figure gifts. However, these large gifts represent the potential for significant risk if the annuity exhausts the original gift. Gift annuity policies may set maximum gift amounts (often in the range of \$500,000 or \$1,000,000 or more) above which the charity will not accept a gift before evaluating the risk of such a large gift.

Gift annuities are popular with charities for many of the same reasons. Annuities are easy to explain, easy to create, easy to administer, and easy to market. Nonetheless, many charities also have some reservations about their gift annuity programs. The annuity payments to the annuitant are guaranteed by the general resources of the charity, even if the original gift amount is exhausted. It is possible for a charity to make annuity payments that exceed the amount the donor gave in exchange for the annuity. In general, the residuum from an annuity, the amount

left at the death of the final annuitant, is nearly always less than the principal that funded the annuity. Also, state registration and annual compliance with state insurance department requirements can be time consuming and expensive for charities that issue annuities in certain states, such as California and New York. While gift annuity administration is straightforward, it is easy to make mistakes unless enough resources are devoted to overseeing operation of the program.

CGA Features

- CGAs are simple (one-page agreement) and easy to understand
- CGAs are straightforward to administer: one 1099-R annually
- CGAs must make payments to one or two annuitants for life
- CGA assets are pooled together and have low investment and administration fees
- CGAs can't benefit multiple charities and the charitable beneficiary can't be changed
- The payout rate for CGAs is set by a uniform schedule based on the age and number of annuitants
- Low minimum gift amounts (\$10,000 most frequently) present a low barrier to establishing a CGA
- It is common for CGA donors to establish multiple annuities
- CGAs are subject to state registration, and in some jurisdictions annual compliance reporting
- Taxation of all annuity payments is established at time of gift
- CGA payments are guaranteed for life regardless of investment performance

Charitable Remainder Annuity Trusts

The charitable remainder annuity trust (CRAT) is the least common life income plan. The IRS statistics of income for 2012 reported only 14,616 CRATs in existence. (By contrast, in that same year, there were 91,244 charitable remainder unitrusts.) Charitable remainder trusts (CRT, both annuity and unitrusts) are separately managed investment accounts governed by rules described in the Internal Revenue Code and Regulations.

Unlike a gift annuity, a charitable remainder trust is not a contract with a charity to make a guaranteed payment. The payments from the CRAT continue if the trust has enough assets to make the payments. If the principal is exhausted, payments to the beneficiary stop.

Why are CRATs so much less popular than CGAs? The minimum amount to fund a CRAT is much higher, often \$250,000 or more. The CRAT is more expensive and complicated to establish, invest, and administer. The CGA is generally a cheaper, easier, and better suited fixed

income vehicle than the CRAT in most situations. The CRAT does have some advantages over the CGA, however. A CRAT can be established to make payments for a fixed term of up to 20 years and/or to more than two beneficiaries. A CRAT can have multiple charitable beneficiaries, its charitable beneficiary can be changed, and it is not subject to regulation by state insurance rules applicable to a CGA.

CRAT Features

- CRATs are expensive to establish (\$2,000 to \$5,000 minimum) and require the donor to have legal counsel
- Gift minimums for a CRAT are high, typically \$250,000 or more
- A CRAT can have more than two income beneficiaries and it can last for lives, a fixed term of up to 20 years, or a combination of fixed term and lives
- The donor can act as trustee of the CRAT and act as the trust's investment manager or select a professional trustee and investment manager
- A CRAT must file a multi-page IRS Form 5227 (Split-Interest Trust Information Return) and taxation is reported on a Form K-1
- Multiple charities can benefit from one CRAT and the donor can retain the power to change the charitable beneficiaries
- Taxation of CRAT payments varies from year to year depending on the investment of the trust assets
- CRAT needs an accountant and investment manager to properly complete the Form 5227 and invest the trust assets
- CRATs are not subject to regulation by state insurance commissions
- CRAT payments will end if the trust exhausts its principal

When to Use the CGA or the CRAT

There are some situations where either a CRAT or a CGA would be appropriate, and there are other situations where one or the other is clearly preferable. Here are some of the features common to both the CGA and CRAT:

- Fixed payments
- Payments do not vary with fluctuations in investments
- The payment amount is established at the time the gift is created
- Payments are at least partially taxable

The Prototype Gift Annuity Prospect

Supporters who are older, risk averse, and want the security of fixed payments are the prototype gift annuity prospect. These may be donors of modest means concerned about outliving their resources. The guaranteed payments from the CGA make it an attractive gift vehicle. The fixed income from the CGA does not keep pace with inflation. Nonetheless, CGA prospects are less concerned with the purchasing power of the payments than the reliability of fixed payments for life. The low gift minimums associated with a gift annuity lets prospects “try out” a life income gift without putting significant assets at risk.

The prototype gift annuity donor is age 78 or older. The ACGA Survey of Charitable Gift Annuities has reported consistently that the average annuitant age at first annuity has hovered in the range of 77 to 79 years since the survey began in the 1990's. The gift annuity rate for a single annuitant age 78 is 6.8% as of this writing. A safe, guaranteed annuity paying 6.8% is attractive to these elderly donors.

The Prototype Charitable Remainder Annuity Trust Prospect

Like the gift annuity prospect, the typical CRAT prospect will be older and wants reliable fixed payments. The difference is that the CRAT prospect typically is wealthier, probably more financially sophisticated, and more comfortable with financial risk than the CGA donor. A CRAT prospect may live in California, New York, or one of the several other states that subject charities to significant registration and annual compliance hurdles to operate a gift annuity program.

CRAT prospects, like CGA prospects, are likely to be older because they are less concerned with the erosion of purchasing power from inflation than they are with the reliability of fixed payments. As just mentioned, a CRAT prospect typically is wealthier than a CGA prospect, but not always. A CGA could be funded with a six or seven figure gift, but see the discussion above about the due diligence required before accepting such a gift.

A CRAT can theoretically run out of money and payments could end. The prospective CRAT donor should understand that investment returns in the trust must be enough to meet the trust's payment obligations and the trust's fees and expenses. Even if investment returns in the trust match the trust payout, excessive fees, commissions, and expenses may erode the principal. For that reason, a CRAT prospect should be comfortable understanding the risks of investment performance and operational expenses.

Financially sophisticated prospects may want control over the management and investment of the trust assets. A CRAT donor can act as trustee, manage trust investments, or appoint an outside investment manager of their choice. Some charities will act as trustee of a CRT, but that is not common. What's more, a CRAT can have more than two income beneficiaries and can make payments for a fixed term of up to 20 years, or for the shorter of or longer of a fixed term and lives, not just for the lifetimes of one or two beneficiaries. The CGA does not permit any of these options to accommodate the investment and planning flexibility that a CRAT donor may desire.

Conclusion

While the CGA and CRAT prospects look very much alike at first blush, the details of how each of these life income plans operate may influence which vehicle is most appropriate. Discuss the

features and risks associated with the gift plan with the donor and her advisor. Document these conversations in writing to the prospect to ensure your donor chooses the gift vehicle that best suits her needs.

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