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In the vast majority of cases, a gift annuity will not end until the death of the sole or surviving recipient of the payments. Annuitants are generally delighted that they will continue to receive payments for life, and they wouldn't have it any other way. Yet, in certain instances an annuitant might be pleased to learn some options exist.

Assigning the Annuity Interest to the Issuing Charity

An annuitant who concludes that he or she no longer needs the annuity payments – and won't need them in the future either – could choose to assign to the charity the right to all future payments. If it is irrevocable, the assignment (which might be styled as a "relinquishment") effectively terminates the annuity. In contrast, if an annuitant simply directs the charity not to make any payments "until further notice", the annuity remains in force. In this case, the annuitant is regarded as having received the payments for tax purposes, although he or she is entitled to income tax charitable deductions for the payments kept by the charity, provided the charity properly acknowledges each such contribution.

Whether a permanent assignment to the issuing charity is permissible depends on the wording of the gift annuity agreement. Many agreements, such as those found in PG Calc's Planned Giving Manager contain language along the lines of, "This annuity is non-assignable except that it may be assigned to the charity." Other agreements, however, indicate that the annuity may not be assigned, period. Still, such language may not preclude an assignment. For example, legal counsel for the charity and for the annuitant might determine that preventing an assignment to the issuing charity would be contrary to the public policy of the state whose law governs the agreement. After all, language restricting assignment of the annuity interest is typically included in a gift annuity agreement for federal tax law purposes. In particular, this is done so that capital gain (in the event appreciated property is contributed and the donor is an annuitant) can be reported ratably over the donor's life expectancy. See Treasury Regulation Section 1.1011-2(a)(4)(ii).

An annuitant's assignment will qualify for an income tax charitable deduction. However, the amount of the deduction might turn out to be modest, perhaps even zero. This is because the deduction will be limited to the lesser of the present value

of the annuity interest and the portion of the original investment in the contract deemed not already to have been paid out as a return of capital (whether tax-free or as capital gain). (Note: Some legal advisors hold that the deduction would be for the present value of the annuity interest in any event.) Accordingly, no deduction at all can be taken if the assignment is made at a point when annuity payments are being taxed entirely as ordinary income.

Although a gift annuity is fundamentally just a series of cash payments made to a person for life, if an annuitant assigns to the charity his or her interest in the remaining payments, the annuitant is not making a gift of cash. Rather, the annuitant is giving a non-cash asset, specifically the right to receive cash in the future. If the charitable deduction associated with this right exceeds $500, the annuitant must complete Section A of IRS Form 8283 in order to claim the deduction. If the deduction exceeds $5,000, then Section B of the form will need to be completed, as well. Completion of Section B, in turn, will require the donor to secure a qualified appraisal. Even if the deduction will be less than $5,000, it may be advisable to have an appraisal done if the present value of the annuity interest exceeds $5,000 so that the annuitant can demonstrate to the IRS that the portion of the original investment in the contract not already paid out is in fact less than the present value of the annuity as of the date of the assignment.

The irony of the appraisal requirement is that the appraiser will be called upon to determine the present value of the annuity interest, which will almost always be more than the deduction. **While** the appraisal does indeed establish the value of what has been contributed to the charity (and the charity's books would reflect a gift of this amount), the actual deduction the annuitant will be able to claim is going to be a function not only of the appraised value but also of the original investment in the contract, as noted above. In any event, if a qualified appraisal is needed,

Cashing Out the Annuity

An annuitant should be able to cash out an annuity if the cash settlement does not exceed the present value of the annuity payments determined as of the date of settlement. The annuitant would be exchanging one property right (guaranteed payments for life) for another property right (a cash sum) of equivalent or lesser value. Here, as in the case of the sale of the income interest of a charitable remainder trust, it is advisable to secure an affidavit from a physician certifying that the annuitant has no known medical condition that could result in a shorter-than-

normal life expectancy.

In certain private letter rulings dealing with the so-called “college annuity” (PLR 200233023, for example), the IRS did approve an annuity contract under which an annuitant could “sell or assign” his or her annuity interest to the charity “or to a third party in return for a lump sum payment or installment payments over several years.” In Private Letter Ruling 200152018, however, concerning the exchange of an income interest in a remainder trust for a gift annuity, the IRS required that any commutation would be prohibited in the gift annuity agreement. Apparently, the IRS was specifically concerned about an indirect conversion of the income interest of the trust to either a lump sum payment or payments for a limited period of time, for in the later private letter ruling dealing with the college annuity, a commutation provision was approved. A cash-out of the annuity would be consistent with that position.

If the annuity had been funded with cash, the amount of the lump sum payment in excess of the unreturned investment in the contract would be taxed as ordinary income. If the annuity had been funded with appreciated property and the gain was being reported ratably because the donor was the annuitant, then the lump sum payment would be partly capital gain, partly tax-free return of capital, and partly ordinary income. The capital gain portion would equal the capital gain that had not yet been paid. The tax-free return of capital would equal the capital that had not yet been paid, i.e., the portion of the cost basis allocated to the present value of the annuity that had not yet been paid.

The Kitchen Sink

An annuitant may still be alive when the gift annuity terminates if that was the plan all along (although it is not possible to establish a term-of-years gift annuity, per se). The most common example of this would be a college annuity, in which the annuitant – or, more likely, the annuitant’s parent or guardian – would have elected years ago to commute a stream of lifetime payments into a fixed number of payments made over a limited period of time. When that period ends, so does the annuity, despite the fact that the annuitant might go on living for another 60 or 70 years.

Another situation in which the decision to terminate the annuity is made by someone other than the annuitant would be one involving a donor’s exercise of a

right of revocation. Frequently, for gift tax purposes – although conceivably as a result of different considerations, as well – a donor will establish a gift annuity for the benefit of one or two other persons but retain the ability to revoke the right of an annuitant to receive further payments. Depending on how the gift annuity is worded, that right could be exercised by a donor not only upon his or her death but also during life. If the right is exercised and there is not a second annuitant who is next in line to receive the payments, the annuity will terminate. If the gift annuity was established by two donors, a single donor's exercise of his or her right of revocation will terminate only the portion of the annuity attributable to that donor's contribution of assets to the charity.

It is even possible for an annuitant to terminate only a portion of a gift annuity. This would be the case if an annuitant assigned to the issuing charity merely a fractional undivided interest in the overall annuity interest. Theoretically, a partial cash-out would also be possible, as would a part assignment/part cash-out arrangement.

A final scenario would have the annuitant assigning to the charity the annuity interest associated with one gift annuity in order to fund a new gift annuity. For example, this could be realistic in the case of a deferred annuity that is near the end of the deferral period. At that point, the present value of the annuity interest associated with the existing annuity would be relatively high (perhaps exceeding the value of the assets originally contributed to the charity), and the charity might welcome the prospect of entering into a new agreement, especially if doing so resulted in a somewhat lower payment obligation going forward.

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