Sarah MacEachern - Thu, 12/20/2012 - 00:00

Beginning on January 1, 2011, the oldest members of the Baby Boom generation celebrated their 65th birthday. In fact, on that day, today, and on every day of the next 17 years, an average of 10,000 baby boomers will reach age 65.

The Pew Research Center reports that the aging of this cohort of Americans (26% of the total U.S. population are Baby Boomers) will dramatically change the composition of the country. Currently, just 13% of Americans are age 65 and older.

Incredible statistics! With the huge number of people retiring over the next 17 years, there appears to be a golden opportunity to provide your donors with solutions for additional retirement income.

This article outlines several suggested solutions to help you help your donors find giving options that will benefit them in retirement, as well as your organization.

Tax-deferred Retirement Plans

According to the Investment Company Institute, United States retirement assets of all types totaled $18.5 trillion as of June 30, 2012. Individual Retirement Account (IRA) assets totaled $5.13 trillion. Much of the growth in these assets resulted from rollovers from employment-based qualified retirement plans, especially 401(k) plans. The total assets in 401(k) plans was $3.3 trillion. Retirement savings now account for 36 percent of all household financial assets.

The Potential Problem

Federal legislation over the years has limited the amount that individuals can contribute to IRA and 401(k) accounts. In 2013, the maximum contribution an individual can make to his or her IRA is $5,500. The maximum contribution by an employee to his or her 401(k) plan (or plans) is $17,500. In addition, since 2002, the IRS has allowed “catch-up contributions” for individuals over 50. In 2013, the catch-up limit for IRAs is $1,000 and for 401(k)s is $5,500.

Many donors who are in a high income tax bracket will hit these limits early in the contribution year. These donors may be left looking for a tax-advantaged way to put away more for retirement.

Life Income Solutions

A Deferred Gift Annuity

A deferred gift annuity is a simple way for your donor to increase her income during retirement. In exchange for an irrevocable gift of cash, securities or other assets, the charity agrees to pay one or two annuitants a fixed sum each year for life. The donor receives an income tax deduction in the year the gift is made.

With a deferred annuity, the payments must start at least one year after the gift is made. In a retirement income scenario, the first date of payment could be the year in which a donor and the donor's spouse would like to start receiving income, for example, when they become age 65.

A Flexible Deferred Gift Annuity

This type of deferred annuity allows an annuitant to pick when she would like to start receiving payments from a schedule of possible start dates agreed upon at the time of the gift. At the time when payments are needed, the annuitant contacts your organization within 90 days of the start date that year, and then your organization begins making payments. The later the start date elected by the annuitant, the greater the annuity amount she receives. This control of when payments will start can be appealing to donors who are unsure of when they will retire or otherwise uncertain when they will want to begin supplementing their income.

The potential payment start dates and their corresponding payment amounts must be listed in the gift annuity agreement. The donor receives a charitable income tax deduction in the year the gift is made. In general, the earlier the first elective payment start date, the lower the deduction that will be allowed. For example, the deduction for a flexible gift annuity made in 2012 whose earliest elective payment start date is in 2015 will tend to be lower than the deduction for a flexible gift annuity whose earliest elective payment start date is in 2020.

Note: The elective payment schedule of a flexible gift annuity, although not described in the internal revenue code, was approved by the IRS in Private Letter Ruling 9743054. The IRS reaffirmed its position in Private Letter Ruling 200449033. A PLR, however, can be relied upon only by the taxpayer who requests it; it cannot be cited as precedent by other taxpayers. Many practitioners nevertheless find enough comfort in these positive rulings and their logic to recommend the flexible gift annuity to prospects. For complete assurance, each donor of a flexible gift

annuity should first seek his or her own private letter ruling.

A Build-Up Deferred Annuity

Also known as a 'Laddered Gift Annuity', a build-up annuity is a plan where a donor creates a series of deferred annuities over a number of years that are all set to begin making payments at the same time, again perhaps when the annuitant is 65. This is a way for a donor to make a larger gift (the sum of all the deferred annuities) than she could have otherwise. This approach also allows the donor to spread her charitable deduction over more years, potentially allowing her to avoid limitations that would reduce the value of her deductions.

A Charitable Remainder Unitrust with a Flip Provision

A charitable remainder unitrust with a "flip" provision starts out as a *net income* unitrust that pays the income beneficiaries a fixed percentage of the trust's value as revalued each year, *or* the net income earned by the trust, whichever is less. This net income trust then "flips" to a regular charitable remainder unitrust in the year after the occurrence of an event specified in the trust instrument. In a retirement scenario, this 'triggering' event may be the specific date on which the income beneficiaries plan to retire.

This life income plan guarantees that trust principal is not invaded during the pre-flip time period, allowing the principal to grow until the date of retirement. This benefits the beneficiaries since subsequent payments will be based on a larger principal amount.

Testamentary Gift Annuity for a Surviving Spouse

A testamentary gift annuity is established under a person's will or living trust to provide payments to one or two surviving individuals. Specific language is included in the will to state whether the annuity would be created with a residual amount of the estate or with a specific sum.

A testamentary gift annuity can be created so that the payments begin upon the donor's date of death, or can be funded at death with payments to begin when a survivor reaches a certain age. Again, in a retirement scenario this may be approximately age 65. The donor may or may not die before the annuitant reaches age 65, so the annuity established at the donor's death can be immediate or deferred.

Provide Retirement Income for an Employee

An employer may want to reward a faithful employee with fixed payments for life. Possibly, the employer did not have a qualified retirement plan for employees, or if it did, the contributions were insufficient to provide adequate retirement income. In some instances, the employer may be an individual who wants to take care of a long term gardener or domestic helper.

One way for an employer to provide for an employee is to fund a gift annuity and name the employee as the annuitant. If the employer is a business, the entire amount contributed for the annuity is deductible. The present value of the payments is deductible as employee compensation, and the balance of the contribution is a charitable gift. In the event the annuity is funded with appreciated property, the employer will immediately recognize the gain allocated to the present value of the annuity payments. In the year the annuity is funded, the employee will have taxable income equal to the present value of the payments. See IRC Sec. 83.

However, if the employer were to reserve the right, exercisable anytime, to revoke the employee's payments, the employee would include in taxable income only the amount actually received year by year. The employer, correspondingly, could only deduct as employee compensation the portion of each annual payment that represents a return of capital.

Conclusion

If your donor is in a high income tax bracket, she may very well hit the limit on her retirement plan contributions early in the 2013 contribution year. Making her aware of one or more of the life income plans we have just reviewed may be just the solution she's looking for: a way to arrange additional cash flow for herself in her retirement while making a generous gift your organization.