Giving a Gift and Getting a Return

By JAN M. ROSEN November 10, 2010

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FOR retirees increasingly worried as interest rates on their savings accounts and money market funds have plunged below 1 percent, an appeal from their alma mater or a respected charity, offering a return of 5 percent or more on a charitable gift annuity, can seem like a rare opportunity.

Is it? Or is there a catch? The answer to both questions is no. But the questions are simplistic.

Better to ask yourself: "Do I want to support the charity?" and "Is a gift annuity a wise choice for me?" If you answer the first one with a yes, then you need to assess your finances and understand what charitable gift annuities are and how they work.

"Some people assume it's like a bank account," said Avery E. Neumark, a retirement specialist and partner in the New York accounting firm Rosen Seymour Shapss Martin & Company. "But it's not. It is just what the name says — a gift. You give away the principal, and you get a guaranteed lifetime income. You can't compare that with today's money market rates. The downside is you are locked in."

The rates, which far exceed today's annual 1.1 percent inflation rate, might seem low years from now if inflation heats up.

For the choice to be a wise one, Mr. Neumark said, people should generally be nearing retirement and charitably inclined, have liquid assets and other income and have taken care of other needs. "I had one client who did very well," he said. "He was 90 years old, so the rate was very high, and he lived until he was 103."

The American Council on Gift Annuities defines the product as a contract under which a charity, in return for a gift of cash or property, agrees to pay a fixed amount over the term of either one or two lives, usually the donors'. Most reputable charities use rates recommended by the council, which vary with the annuitants' ages and whether there are one or two. Because of the charity, there are tax benefits.

For a single life, the latest rate table called for a 55-year-old to receive 5 percent a year, a 60-year-old 5.2 percent, a 65-year-old 5.5 percent, a 70-year-old 5.8 percent, an 80-year-old 7.2 percent and someone 90 or older 9.5 percent.

Prospective donors can calculate their own rates and tax benefits at the Web site: pcalc.ptec.com/hosts/989357365/CGA. For a $100,000 gift annuity covering one person aged 65 and another aged 62, the site calculator showed an immediate tax deduction of $12,179.50 and an annual annuity payment of $5,000. Of the latter, $3,326.53 would be tax-free because it represented a return of principal and $1,673.47 would be taxed as ordinary income. After 26.4 years, their joint life expectancy, all payments would be taxable as ordinary income. Conrad Teitell, a lawyer in Stamford, Conn., who represents the council and a number of large charities, said donors could donate appreciated assets and avoid immediate payment of capital gains tax. The gain is prorated annually over the donor's life expectancy, and the taxable portion of the annuity payments is divided into ordinary income and capital gains.

Donors do not have to begin taking annuity payments immediately, he said; they can defer payments for a year or more. That can be a good option for people who are employed and in a high tax bracket, but who expect to retire in a year or so.

Some states require charities to meet criteria, including initial registration, notification and annual filing, to sponsor charitable gift annuities. Others are silent. Many are somewhere in between. Mr. Teitell advised prospective donors to check on their own states at the American Council on Gift Annuities Web site (www.acga-web.org/regs/regsoverview.html).

If one's home state does not require charities to meet any criteria, see whether a charity is authorized to offer annuities in a stricter state, and check its financial soundness at the Better Business Bureau (www.bbb.org/us/charity) and Charity Navigator (www.CharityNavigator.org).

A sound approach is not to become involved with a charity that does not meet the standards of a tougher state, because annuity payments are a general obligation of the charity. Though failure to meet the obligation is rare, some charities take out reinsurance, a matter worth discussing with a prospective recipient.

Paul Horrocks, vice president of the New York Life Insurance Company, which sells individual annuity policies and also works with charities on gift annuities, said donors could "accomplish the same thing in two ways," either through a charitable gift annuity that might pay 5 percent or by dividing the amount into an outright gift to the charity and a commercial annuity that would pay about 7 percent.

Don Greene, national philanthropic product executive for Bank of America Merrill Lynch, favors charitable gift annuities. They are a way for "lower-end donors" to enter the world of "structured philanthropy," he said, and "they offer tax advantages and a consistent level of support for a spouse."

The gift is irrevocable, he added, but a person who is committed to charity, by including a bequest in her will, for example, might want to consider a gift annuity instead and enjoy making the gift during her life.