PARTNER 135

When you wish to make a gift to ministry but you need to maintain the use of your property, consider a charitable income agreement. It's a gift that pays you income.

Charitable Income Agreement

What Kind of Gift Pays Income?

A transfer of cash or other assets to charity can be designed to pay income or, if real estate, allow you to continue to live in the property. When the transfer is irrevocable, you will also receive a current income tax charitable deduction.

Advantages

- You receive income as outlined in your agreement (monthly, quarterly, semi-annually, annually), or you have the full use of your property if you transfer a personal residence or farm.
- You receive income tax benefits, both now and in the future:
    - Because the remainder of the gift goes to charity, you receive an income tax charitable deduction when the agreement is established.
    - If your agreement pays you income, there is no capital gains tax payable on the sale of appreciated property.
    - The income you receive may be taxed at lower rates.
- When your agreement pays you income, that income is established for the entire term of the agreement.
- You have no management or investment worries (unless your transfer is your home or farm).
- You avoid estate and probate costs and delays.
- You leave a legacy that reflects your faith.

Types of Agreements

There are several types of agreements for your consideration.

Charitable Remainder Annuity Trust

When you transfer assets to a charitable remainder annuity trust, it will be managed as a separate trust fund for your benefit. It is never commingled with other funds.

Your income payments will be a ***percentage of the initial value*** of the asset transferred to the trust. Payments can be established for life or for a period not to exceed 20 years.

Charitable Remainder Unitrust

When you transfer property to a charitable remainder unitrust, it will also be managed as a separate trust fund for your benefit. However, the income you receive will be a ***percentage of the trust assets as valued annually*** and will increase or decrease with the value of the trust assets.

Life Estate Agreement

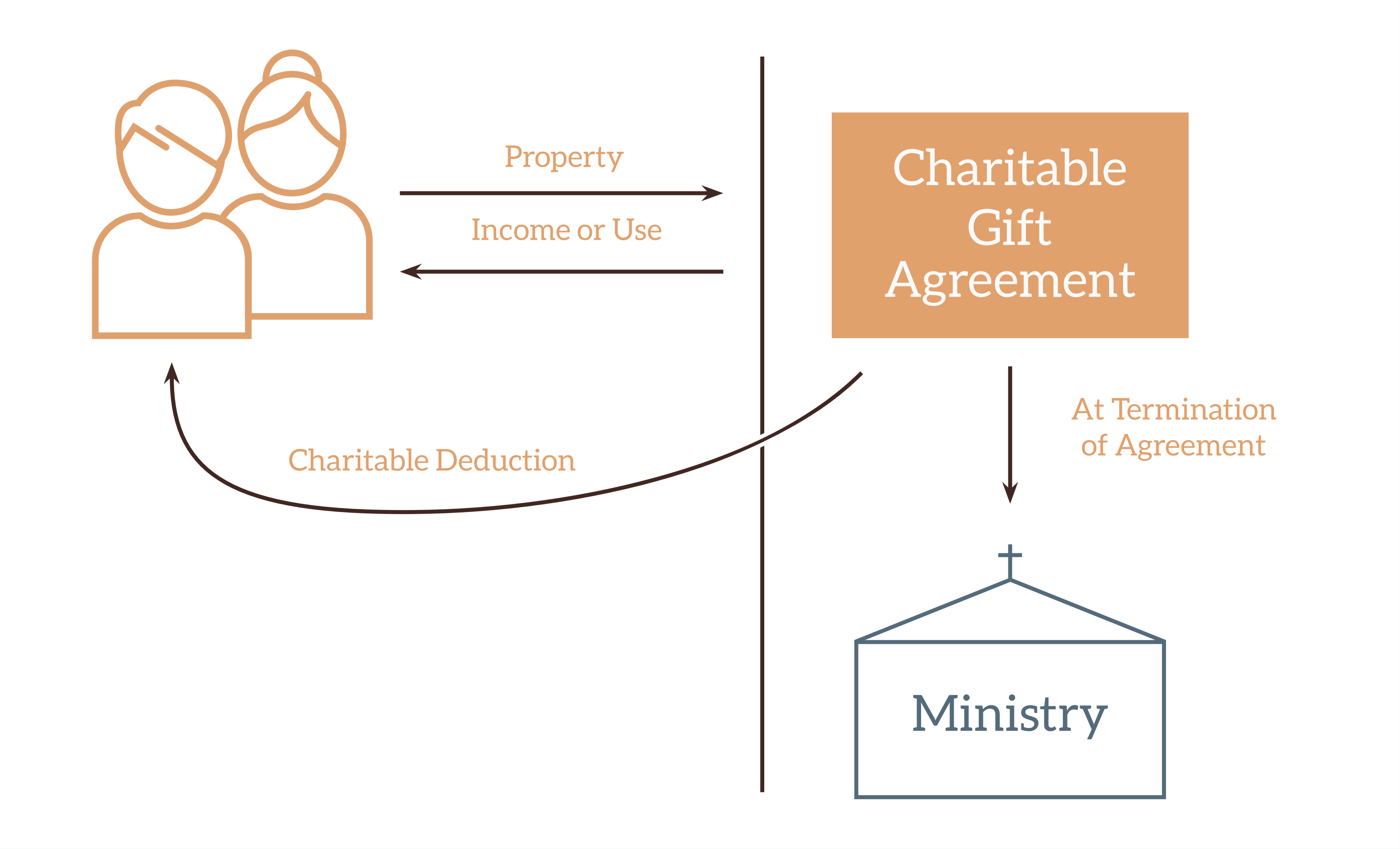
You can transfer your personal residence or farm to charity, retaining the right to use the property. You maintain all rights and responsibilities for the property during your lifetime. You can continue to live in the property, or if you choose to rent it you will receive the income. The property transfers to charity at your death.

Charitable Gift Annuity

With a charitable gift annuity, you transfer cash or securities to a charitable organization in exchange for a fixed income for your life. Income is determined by your age at the time of transfer, and the annuity can be established for one or two lives. The charity invests your gift to secure your payments.

At your death (or at the death of the survivor beneficiary), the funds remaining from your gift will be available to the charity.

How a Charitable Income Agreement Works



Terms of Agreements

Each life income agreement is available in:

- A *single life agreement* that provides income to you for life
- A *survivorship agreement* that provides income to you for life and continues to pay income to a survivor (often your spouse) for life
- A *fixed period* annuity trust or unitrust that provides income for the designated trust term, not to exceed 20 years

Taxation of Charitable Income Agreements

Charitable Contribution

You will receive an income tax charitable deduction when you establish a charitable income agreement. If your agreement is funded with cash your gift can be deducted up to 60% of adjusted gross income in the year the agreement is established.

If your property has appreciated in value, your contribution is deductible up to 30% of adjusted gross income in the year the agreement is established.

If the amount of the deduction exceeds either percentage, any excess can be carried over for up to five additional years.

Avoidance of Capital Gains Tax

When you transfer appreciated property to a charitable remainder trust, there will be no capital gains tax payable at the time of transfer or when the property is later sold.

For a charitable gift annuity, there will be no capital gains tax payable on the gift portion of the annuity.

The capital gains attributed to the annuity portion will be prorated over your life expectancy.

When you transfer a personal residence or farm, retaining the right to live on the property, a portion of the capital gains tax will be payable only if the property is sold during your lifetime.

Taxation of Income

The taxation of your income will vary, depending upon the agreement you choose.

When cash or non-appreciated property is transferred for a charitable gift annuity, a portion of each payment you receive will be tax-free. A portion will be interest earned by the annuity investment and will be taxed to you as ordinary income.

When appreciated property is used to purchase a gift annuity, a portion of the income will be tax-free, a portion will be taxed as capital gain, and a portion will be taxed as ordinary income.

Income from a charitable remainder trust is taxed under a four-tier system:

First: as distribution of ordinary income earned

Second: as distribution of capital gains

Third: as tax-exempt income

Fourth: as tax-free distribution of principal

For a life estate agreement on your home or farm, any income you receive will be taxed as if you had not made the transfer.

Federal Gift Tax Implications

When husband and wife are the beneficiaries of a charitable agreement, there are no gift tax implications.

When the agreement provides an interest to an individual other than a spouse, a taxable gift is made. The value of the gift is based upon the beneficiary's age, the amount of the payments, and when the payments begin.

With careful planning, the agreement can be designed so that the gift is not considered a lifetime gift, subject to gift tax.

Federal Estate Tax Implications

There are no federal estate tax implications when a husband and wife are the only beneficiaries of the agreement.

However, when another individual, other than a spouse, is named to receive income from your agreement, the value of his or her right to receive income may be taxable in your estate, based upon the survivor's age and the amount of the payments.

A Case Study: *Mrs. Smith*

Mrs. Smith, age 75, has been a generous giver to ministry for many years.

Several years ago, Mrs. Smith purchased stocks that have proven to be a very successful investment. However, Mrs. Smith would like to receive more income than the dividends from the stock provide, and she would like to be relieved of investment responsibilities. Mrs. Smith is also concerned about her estate plan and would like to give a portion of her estate to ministry.

A charitable gift annuity, funded with $50,000 in appreciated stock, will provide Mrs. Smith the following benefits:

- She will receive income each year of $3,300—some will be tax-free.
- Mrs. Smith receives a current income tax charitable deduction of $24,070, resulting in a tax savings of approximately $6,740 in a 28% combined federal and state income tax bracket.
- Mrs. Smith originally paid $20,000 for the stock. If she sold the stock, she would pay capital gains tax on $30,000. With the gift annuity, capital gains tax is only payable on approximately 52% of her gain, and it is prorated over her life expectancy. This results in an additional tax savings of more than $2,750.
- The charitable gift annuity will not be part of Mrs. Smith's estate, avoiding tax, probate costs, and delays.
- With the charitable deduction tax savings, avoidance of capital gains tax, and tax-free income Mrs. Smith will receive, we have calculated that she would have to earn 8.75% on a fully taxable investment to equal the benefits of the charitable gift annuity.
- Mrs. Smith has the satisfaction of knowing that she is making a substantial gift to ministry.

A Case Study: *Mr. & Mrs. Jones*

Mr. and Mrs. Jones are both 64 years of age and are planning for their retirement. They own investment real estate which has an appraised value of $600,000. The property was purchased for $240,000 in 2004 and has no mortgage.

While Mr. and Mrs. Jones believe the property is an excellent investment, it does not meet their retirement income needs. After reviewing a comparison of charitable income agreements, Mr. and Mrs. Jones decided that a charitable remainder unitrust would help them meet their immediate and long-range financial goals.

Their benefits will be as follows:

- They will receive income equal to 5% of the trust assets, as valued annually. This provides an initial income of $30,000, increasing to $53,265 during their anticipated life expectancy, assuming a 7% total return.
- They will receive a current income tax charitable deduction in the amount of $198,342, which provides a tax savings of approximately $55,535 in their 28% combined federal and state income tax bracket.
- With their $240,000 cost basis, Mr. and Mrs. Jones would have a capital gain of $360,000 if they sold the property. However, when they transfer it to a charitable remainder unitrust, they pay no capital gains tax on the appreciation at the time of transfer or when the property is sold by the trust. This results in an additional tax savings of approximately $75,600, assuming they are in a 21% combined federal and state capital gains tax bracket.
- Mr. and Mrs. Jones are satisfied in knowing that the property which has provided for them during their lifetimes will eventually help provide financial security for the ministries they have been supporting.

How to Create a Charitable Income Agreement

Based upon your personal circumstances, a proposal will be made for you to consider with your personal legal and tax advisers. Once you have decided to proceed:

- An agreement is prepared and presented to you for review by your legal and tax counsel.
- You sign the agreement and transfer title of the specific assets to the agreement. This qualifies you to receive an income tax charitable deduction.
- If the agreement provides income, your payments begin according to your chosen pay period (monthly, quarterly, semi-annually, annually) and continue until the end of the agreement.
- Once completed, you will receive all the necessary information to assist you in claiming your income tax charitable deduction and reporting any income from your agreement.

A charitable income agreement provides many tax advantages and allows you to make a substantial gift to ministry.

If you would like to have a conversation about how a charitable income agreement might fit your generosity desires

A Free Service for You

We are here to assist you in considering and completing your gift. Our services can help you look at the bottom line to make certain that your gift provides the greatest benefit for you and for charity.

We would be honored to hear your generosity desires, help you evaluate your potential gift assets, and prepare appropriate gift illustrations. There is no cost or obligation to you–may we help?

Contact us today!

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479-430-0898

Frequently Asked Questions

Q: Are charitable income agreements designed for wealthy people?

A: While the tax advantages available to people in higher income tax brackets may make the agreements attractive from a financial point of view, many people establish them with little or no tax advantage to fulfill their charitable desires and provide income.

Q: How do I know my charitable beneficiary is financially secure?

A: With the exception of a charitable gift annuity, the financial security of the charity is immaterial to the financial security of your agreement. Property is held by an independent trustee for your benefit, and the strength of the property held by the trust provides financial security.

Q: Are my income payments always the

A: Only with the charitable remainder annuity trust or the charitable gift annuity. With the charitable remainder unitrust, income is determined by applying a fixed percentage to the value of the trust assets, as valued annually.

Q: What happens to my agreement on my death?

A: If the agreement is for your life only, on your death the remaining assets are distributed to ministry. If your agreement provides income to a survivor beneficiary, it will continue for as long as he or she lives. At the death of the surviving beneficiary, it will terminate and the assets will be distributed to charity.

For a fixed-period agreement, if death occurs prior to the end of the agreement term, income may be paid to an individual of your choosing or to the beneficiary charity. You get to choose.

Q: Can I make additional contributions to my agreement?

A: Additional contributions can be made to the charitable remainder unitrust. However, federal law prohibits additional contributions to the charitable remainder annuity trust or the charitable gift annuity. Additional property would have to be placed in a separate agreement.

Q: When I establish an agreement, can I withdraw the funds later?

A: No. The agreement is irrevocable. To qualify for the income tax charitable deduction and avoidance of capital gains tax, the agreement must meet certain requirements, which do not allow withdrawals in excess of annual income.

Q: Can I establish an agreement and make someone else the beneficiary of the income payments?

A: Yes, and this is often done as part of a total estate plan. You should consult your tax adviser for gift tax implications.

Q: Will my agreement be part of my taxable estate?

A: If the agreement covers your life only, the assets go directly to charity upon your death, avoiding estate taxes. However, if the agreement covers the life of a survivor other than a spouse, a portion (depending upon the age of the survivor) may be included in your estate. In either case, the agreement will be excluded from the probate estate.

Q: What if my charitable deduction exceeds the amount I can deduct from my income tax return this year?

A: If your charitable deduction exceeds the amount deductible in the year you establish the agreement, you may carry over the excess for up to five additional years.

Q: Is my income absolutely guaranteed?

A: Under the terms of the agreement, the trustee or the charitable organization has full responsibility to use the assets to secure your payments, even when there is no remainder for charity.

Q: What secures my agreement when the property I transfer is sold?

A: When the agreement is a trust, the trustee is required to reinvest the proceeds in prudent investments for your security. At no time is any property transferred or sold from your trust without proper security in return.

Charitable gift annuity income is secured by the general assets of the charitable organization.

Q: Which plan is best?

A: The plan which is best for you will be based upon your age, the type of assets to be transferred, and your short- and long-range financial goals. We are happy to prepare a side-by-side comparison for review with your legal and tax advisers.

Q: I do not understand taxes. What assistance will I receive from my trustee?

A: You should rely upon your own counsel. However, we will provide information to assist you in securing the maximum deductions on your federal and state income tax returns. Also the trustee will report to you annually how the income you receive should be reported for income tax purposes.

Q: Can I remember a friend or relative by creating one of these agreements in my will?

A: Yes, you can insure a safe, reliable income to your friend or relative by establishing an agreement in your will. Many times this is better than leaving property outright.

Note: The information in this planning report is of a general nature and should not be interpreted as legal advice. Illustrations were calculated using a 5.2% mid-term AFR rate. The rate in effect in the month of a transfer or in either of the two months preceding the transfer will be used to calculate the charitable deduction available for a specific gift.

For Professional Advisors

The information in this booklet is of a general nature and should not be interpreted as legal advice. The following citations of authority will help your legal and tax advisers verify its applicability to your specific circumstances.

Charitable remainder unitrust: Specifies that income beneficiary will receive annual payments determined by multiplying a fixed percent (which cannot be less than 5%) by net fair market value of trust assets, as determined each year. On death of beneficiary (or survivor beneficiary, if more than one) charity gets the remainder. IRC §664(d)(2).

A variation calls for trustee to pay only trust income if actual income is less than stated percent. Deficiencies in distributions (i.e., where trust income is less than stated percent) are made up in later years if trust income exceeds the stated percent. Another variation provides that deficiencies are not to be made up. IRC §664(d)(3); Reg. §1.664-3(a)(1)(i)(b).

Charitable remainder annuity trust: Specifies a fixed dollar amount (at least 5% of initial net fair market value of transferred property), which is to be paid annually to income beneficiary for life. On death of beneficiary (or survivor beneficiary, if more than one) charity gets the remainder. IRC §664(d)(1).

Charitable gift annuity: Donor transfers money or property to charity in exchange for its promise to pay fixed amount annually to donor (and a survivor, if desired) for life. Transfer is part gift and part purchase of an annuity.

Charitable life estate agreement: Donor transfers remainder interest in a personal residence or farm to a charity and retains for self a life estate.

Income tax: *Contribution deduction allowed for value of remainder interest.* For charitable remainder unitrust and charitable remainder annuity trust, deduction allowed for remainder interest, computed using Treasury tables. Unitrusts: IRC §170 (f)(2); Reg. §1.664-3(c) and §1.664-4; IRS Pub. 723B. Annuity trusts: IRC §170(f)(2); Reg. §1.664-2(c); Reg. §20.2031-10; IRS Pub. 723A.

For charitable gift annuity, charitable deduction allowed for excess of amount transferred over what it would cost to purchase comparable annuity from commercial insurance company, determined by Treasury tables. Rev. Rul. 72-438, 1972-2 CB 38.

For charitable life estate agreement, deduction allowed for value of remainder interest, taking straight line deprecation or cost depletion into account, with value discounted at 10% per annum. IRC §170(f)(3)(B)(i); Reg. §1.170A-7(b)(3) and (4); Reg. §1.170A-12.

When funded with cash or non-appreciated property, remainder interest deductible up to 50% of donor's adjusted gross income. IRC §170(b)(1)(A); Reg. §1.170A-8. Five-year carryover allowed for any excess. IRC §170(d)(1), Reg. §1.170A-10(a).

When funded with securities or real estate held long-term, remainder interest is deductible up to 30% of adjusted gross income. IRC §170(b)(1)(D)(I); Reg. §1.170 A-8(d)(1). Five-year carryover allowed for any excess. IRC §170(b)(1)(D)(ii).

Under election, donor can increase deduction to 50% of adjusted gross income (with five-year carryover) by making the same gift. but:

1. Reducing the amount of the deduction for all long-term property gifts during the year by the appreciation, and

2. Similarly reducing the deduction for long-term property gifts being carried over from earlier years

IRC §170(b)(1)(D)(iii); Reg. §1.170A-8(d)(2).

How payments taxed to recipient: For a charitable remainder unitrust or charitable remainder annuity trust, amounts paid to the recipient retain the character they had in trust. Each payment is treated as follows:

First: as ordinary income to the extent of the trust ordinary income for the year and undistributed ordinary income for prior years

Second: as capital gain to the extent of the trust capital gains for the year ad undistributed capital gains for prior years

Third: as other income (e.g., tax-exempt income) to the extent of the trust's other income for the year and undistributed other income for prior years

Fourth: as a tax-free distribution of principal

IRC §664(b); Reg. §1.664-1(d).

For a charitable gift annuity, annuitant's return is part capital and part interest; only the interest portion is taxable. To determine the amount received tax-free (the exclusion ratio), apply the following formula:

$$\frac{\text{Investment in Contract [determined under Rev. Rul. 72-438(supra)]}}{\text{Expected Return [determined using tables in Reg. §1.72-9]}}$$

Unitrusts and annuity trusts are exempt from taxation: But a trust is not exempt in any year it has income, which would be taxable unrelated business income if trust were an exempt organization. IRC §664(c). Payments to income beneficiary taxed as described above.

Governing instrument requirements: To assure charitable deductions and avoid adverse tax consequences for a charitable remainder unitrust or charitable remainder annuity trust, governing instrument must contain specific provisions. See: Reg. §1.664-1 through §1.664-3; IRC §508 (e); IRC §4947(a)(2); Rev. Rul. 72-196, 1972-1 CB 94; Rev. Rul. 72-395, 1972-2 CB 340.

Capital gain: No capital gain incurred on transfer of appreciated assets to a charitable remainder unitrust or charitable remainder annuity trust. Rev. Rul. 55-275, 1955-1 CB 295; Rev. Rul. 60-370, 1960-2 CB 203.

Nor is there capital gain to donor on a sale by trust (except as taxable under four-tier system). Exception: Gain taxable to donor if trust assets sold and invested in tax-exempt securities pursuant to express or implied agreement between donor and trustees. Rev. Rul. 60-370, 1960-2 CB 203.

There is a capital gain when gift annuity is funded with appreciated property. Amount of gain is smaller than gain would be if appreciated property was sold instead of transferred for charitable gift annuity. Furthermore, gain is not all reportable in year of transfer for gift annuity, as it would be on a sale of property. Gain is reported ratably over annuitant's life expectancy when annuity is non-assignable and donor is sole annuitant or one of the annuitants in a two-life annuity. Reg. §1.1011-2(a)(4); 1.1011-2(c) (Example 8).

There is no capital gain tax implication on transfer of appreciated property for a life estate agreement, nor upon the subsequent sale, except as applicable to the life estate portion.

Estate tax: [IRC §2055(e)(2)(A)].

One life (donor is beneficiary).

Fair market value of assets transferred to charitable remainder unitrust or charitable remainder annuity trust at death included in gross estate and then deductible as charitable contribution—resulting in a washout.

For annuity, none. IRC §2039.

For life estate, none.

Two lives (funded with donor's separate property, donor is first beneficiary and another is to be survivor beneficiary).

For charitable remainder unitrust or charitable remainder annuity trust, fair market value of assets at donor's death included in gross estate but then fully deductible as charitable contribution if second beneficiary not surviving. If second beneficiary survives, charitable remainder based on survivor's age at donor's death is deductible as charitable contribution.

For annuity, if second annuitant not living on donor's death, no amount included in donor's gross estate. If second annuitant survives, included in donor's gross estate is value of annuity paying same amount to survivor annuitant (at survivor's age at donor's death) as donor received during life. IRC §2039(b). Any estate tax paid by donor's estate attributable to annuity deductible by survivor over life expectancy. Reg. §1.691(d)-1.

For life estate, if second recipient not living at donor's death will not be included in donor's gross estate. If second recipient survives, included in donor's gross estate is value of the life estate of survivor recipient (at survivor's age, at donor's death).

Marital deduction. Qualifies for unlimited marital deduction as qualified terminable interest property. [IRC §2056(b)]

Gift tax [IRC §2522(c)(2)(A)]. Value of the charitable remainder is fully deductible and thus charitable gift is immune from gift tax. Where there is a life interest other than donor's, there is a gift by donor to non-charity beneficiary of value of beneficiary's life interest.

For charitable remainder unitrust or charitable remainder annuity trust, value of gift depends on type of property ownership and when other beneficiary's payments are to begin. It is often possible to draft agreement so that a gift is not deemed made to non-charity beneficiary by reserving right by will only to revoke life beneficiary's interest. Reg. §1.664-3(a)(4); Rev. Rul. 74-149, 1974-1 CB 157.

Gift to survivor may be of future and terminable interest, with no annual exclusion.