CHARITABLE GIFT ANNUITIES AT THE UNIVERSITY OF CALIFORNIA

Charitable gift annuities are extremely effective financial and estate planning devices. If your estate and tax planning objectives include making a charitable gift, receiving a guaranteed income for life, reducing income tax substantially, providing additional income for other family members or increasing your income to help ensure a comfortable retirement, you may want to consider a gift annuity with the Regents of the University of California.

Your gift, to be used as you specify, will provide the continuing support that allows the University to maintain its tradition of excellence.

WHAT IS A CHARITABLE GIFT ANNUITY?

Annuities are contracts between an issuer and an individual (the annuitant) to pay a fixed amount of money to the annuitant for life or a term of years. Many people are familiar with commercial annuities issued by life insurance companies.

Gift annuities are similar arrangements except that they are issued by a charity rather than an insurance company. A charitable gift annuity is both a gift – a contribution to a charity of your choice – and the purchase of an annuity. The charitable organization is the issuer of the annuity and agrees to pay the income beneficiary(ies) a fixed income for life. Following the death of the annuitant(s), the charity receives the benefit of any portion of the gift (and the income earned by the charity from investing the gift) that remains after the charity has made all required annuity payments.

HOW DOES A CHARITABLE GIFT ANNUITY WORK?

In exchange for a gift of cash or certain other property to a charitable organization such as the University of California, you (or the person of your choice) will receive a contractually guaranteed annuity at the time the gift is made. The amount of the annuity paid each year will be a fixed dollar amount, calculated as percentage of your gift. The payment rate for a charitable gift annuity depends upon the beneficiary's age; the older the beneficiary, the greater the payment rate and the greater the annual income.

Another factor that affects the annuity rate is the number of beneficiaries. If there are two beneficiaries rather than one, the income payments generally will be smaller.

The University of California has adopted charitable gift annuity rates suggested by the American Council on Gift Annuities. These rates are designed to ensure that the charity receives at least 50 percent of the contribution amount, and take into account the most recent life expectancy tables, investment assumptions, and the cost of administering gift annuities.

Prior to entering into a gift annuity contract with the Regents of the University of California, each prospective donor will receive a customized illustration of the exact payout rate and other tax and financial benefits available to him/her under this plan.

Example

Mrs. Roberts, a youthful octogenarian, would like to make a gift to the University of California to support undergraduate programs. After consulting with her attorney and financial advisor, she decides that a charitable gift annuity is the most beneficial way for her to make the gift.

Using appreciated securities valued at $20,000, Mrs. Roberts establishes a charitable gift annuity through the Regents of the University of California.

In exchange for her gift, Mrs. Roberts receives a yearly annuity of $1,500 (annuity rate of 7.5 percent) for the remainder of her life. She may also claim an income tax charitable contribution deduction of over $10,300, which, in effect, reduces the cost of making her gift. (Note: the exact amount of the charitable deduction depends on the expected future value of what the University will ultimately receive. This in turn depends upon the Internal Revenue Service discount rate, an interest rate which floats monthly and is used to calculate the deduction.)

A portion of each annuity payment will be considered a tax-free return of principal (i.e. tax-exempt income); some will be capital gain; and some will be ordinary income.

DEFERRED GIFT ANNUITIES

Charitable gift annuities offer the option of receiving annuity payments immediately or deferring them. A "deferred gift annuity" works in the same way as an ordinary charitable gift annuity except that payments do not begin until a later date, usually retirement.

The deferred gift annuity often appeals to the younger donor who has a high current income, would like a current tax deduction, and is interested in augmenting potential retirement income on a tax-sheltered basis.

When establishing a deferred gift annuity, the donor may claim an immediate income tax charitable deduction for the "gift" portion of the transfer—the amount the charity is expected to receive after making all required annuity payments. As with the regular gift annuity, a portion of each annuity payment will be considered tax-free return of principal.

Example

Mr. Oyami, in his mid-50's, is a successful accountant who would like to make a gift to the University of California, his alma mater. While he is concerned with receiving an income tax deduction, he doesn't really need additional income right now. He would like to supplement his income when he retires in approximately 10 years.

Mr. Oyami decides to invest $10,000 in a deferred gift annuity through the Regents of the University of California. He would like the remainder of his gift annuity eventually go to the University for undergraduate scholarships at his campus.

In 10 years, he will begin receiving yearly annuity payments of $800 under current rates (8 percent annuity rate). At the time he makes the gift, Mr. Oyami is entitled to claim an income tax charitable contribution deduction of approximately $3,000, reducing the overall cost of making a gift.

USING ANNUITIES IN RETIREMENT PLANNING

In recent years, deductions for contributions to some retirement savings plans (including IRAs and Keogh plans) have been eliminated or restricted for many taxpayers.

Those with charitable motivations, however, are finding that gift annuities can be a way to recoup many retirement savings benefits while contributing to a favorite organization.

If you are holding highly appreciated but low-yielding assets, consider the advantages of using them to fund a gift annuity and augment your retirement benefits. A gift annuity is not a replacement for sound retirement investments, but can supplement your plans when charitable giving is a priority.

JOINT LIFE ANNUITIES

Gift annuities can be established to benefit one or two annuitants. When there are two beneficiaries, payments can be made to one person for life, and then to a survivor for his or her life. Alternatively, annuity payments can be paid jointly to (or divided equally by) two beneficiaries during their joint lifetimes, and then paid entirely to the survivor.

Any two persons can receive income from a charitable annuity. A joint life annuity can benefit not only a husband and wife, but also a brother and sister, a parent and child, unmarried partners, or friends.

As one might expect, the payout rate for a joint and survivor gift annuity will be less than the payment rate for a single-life annuity. The lower payment reflects the fact that the annuity will continue after the death of the first annuitant.

There may be gift or estate tax consequences whenever an annuitant is someone other than the donor and his or her spouse. Consult your tax advisor if you are considering a gift annuity to benefit someone besides yourself and/or your spouse who is US citizen.

TAXATION OF ANNUITY PAYMENTS

As with other types of annuities, part of each annuity payment is treated as a return of the original investment. Consequently, in most cases a portion of the annual income generated by your gift annuity is tax-exempt. The amount of tax-free income is based upon 1) the amount of the appreciation in the property to be used to make a gift, and 2) the donor's life expectancy.

We would be pleased to provide an estimation of the tax treatment of payments you would receive from a charitable gift annuity through the University of California.

When you fund a charitable gift annuity with appreciated securities, only a part of the capital gain is taxable. The capital gain attributable to the "gift" part of the donation will never be taxed; only the capital gain attributable to the non-deductible portion of your donation (the portion used to purchase the annuity) will be taxable. If you are one of the annuitants, the taxable portion of the gain is reported over your life expectancy. Part of each payment will be treated as capital gain on the exchange of appreciated securities for the annuity, with the remainder of the annuity payment categorized as a combination of ordinary income and tax-free return of principal.

Example

Mrs. Goldstein, age 90, transfers appreciated securities worth $50,000 (several years ago they cost her $10,000) for a gift annuity that will pay her $4,750 per year. If she had sold the securities, she would have had a capital gain of $40,000.

However, under IRS regulations, she will only need to report approximately one-half of the capital gain. This gain is included in her annuity payments over the next five years; as a result, approximately $3,155 of each year's payments is capital gain, $789 is return of principal and $808 is ordinary income. After this five-year period, her entire $4,750 annuity payment will be characterized as ordinary income.

What is more, if you create a charitable gift annuity and name others as annuitants, the capital gain will be payable in the year of the gift. In certain circumstances, the tax savings generated by the charitable deduction may completely offset any capital gain resulting from the transfer of appreciated property for a gift annuity. This might be the case if securities that had enjoyed only modest appreciation were transferred in exchange for a gift annuity.

LEGAL CONSIDERATIONS

Charitable gift annuities are part of a "family" of gifts sometimes called "life-income gifts" or "planned gifts". This terminology is used because these gifts require a certain amount of planning before a transaction is completed. We strongly encourage every potential donor to seek his/her own tax and legal counsel before making a planned gift to the University.

As part of this process, we suggest that donors consider other life income arrangements (charitable remainder trusts and pooled income funds) as well as charitable gift annuities. The brochure entitled "Life Income Gift Options" provides additional information on these different plans.

While charitable gift annuities share certain characteristics with other life income gifts, there are certain distinctions that merit some attention.

A gift annuity is a contract between the charity and the donor whereby the charity agrees to pay a fixed lifetime annuity to a maximum of two beneficiaries.

The gift annuity agreement contains the relevant terms of the contract: a listing of the property transferred in exchange for the annuity, the charitable purpose for which the funds will ultimately be used, the name of the annuitant or annuitants, and the amount and timing of each annuity payment. The amount of the gift annuity payment will **<u>not</u>** vary over time.

The funds received in consideration for a charitable gift annuity are invested in a state-mandated reserve fund. This reserve fund is managed by the treasurer of the UC Regents.

In addition to the reserve fund, gift annuities are backed by all funds available to the president of the University of California. The reserve fund (and the additional funds which back a gift annuity) are exempt from securities registration under the Charitable Gift Annuity Antitrust Relief Act of 1995 and the Philanthropy Protection Act of 1995.

If you would like us to provide you with a sample calculation showing the annuity rate, annuity payments and charitable deduction for a charitable gift annuity to the University, please contact us:

UNIVERSITY OF CALIFORNIA

Charitable Gift Annuities

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