

**CHARITABLE GIVING:
SOME SIMPLER STRATEGIES**

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CHARITABLE GIVING: SOME SIMPLER STRATEGIES

I. INTRODUCTION

Increases and decreases in our clients' asset values can profoundly affect tax planning. In today's economic climate, many clients are worried about cash flow, shell shocked by their financial losses and too unsure of the future to engage in charitable planning. They may even hesitate to consult legal counsel because they are concerned about legal fees. This outline will focus on two charitable giving strategies that are easy and inexpensive to implement and that increase a client's cash flow immediately – charitable gifts of remainder interests in residences and charitable gift annuities. Both of these strategies benefit clients who are retired, living on a modest income and in need of more income.

II. CHARITABLE GIFT OF REMAINDER INTEREST IN RESIDENCE

A. Generally

If a client wants to remain in her residence for her lifetime, and if she believes none of her children will be able to afford it or want to keep it, she should consider deeding the house to her favorite public charity and retaining the right to live in it for her lifetime. This tax planning strategy, which works best if the home is free of debt¹, allows the client to increase her current cash flow while remaining in her residence. The client retains a life estate and the remainder passes to charity on her death. Life estate agreements are ideal planning vehicles for those individuals who want to make a

¹ As discussed more fully below, if the house is encumbered, the bargain sale rules under IRC Section 1011(b) apply. In PLR 9329017, the IRS ruled that, upon the transfer of the remainder interest to charity, the donor would realize the entire amount of the indebtedness for purposes of determining gain under the bargain sale rules, not just the debt attributable to the remainder.

testamentary gift of real property to charity and also enjoy a current and potentially substantial charitable income tax deduction.

1. General Description

A gift of a remainder interest in a personal residence or farm is described generally as a transaction in which an individual irrevocably transfers title to a personal residence or farm to a charitable organization with a retained right to the use of the property for a term that is specified in the gift agreement. At the conclusion of the measuring term, all rights in the property are transferred to the charitable remainderman.

2. Life Estate

Gifts of a remainder interest in a personal residence or farm can be measured by the life of one or more individuals, by a fixed term of years, or by a combination of the two. They are, however, most frequently established to operate for the life or lives of the residents of the contributed property. Accordingly, they are frequently referred to as “life estate agreements.”

B. How a Retained Life Estate Works

1. Deduction for Value of Remainder Interest

Since the client retains the right to live in her home, she hasn’t given up anything currently. However, she receives a substantial income tax deduction for the value of the remainder interest.² This lowers the client’s income tax liability and increases her current cash flow.

² See Treas. Reg. Section 1.170A-7(b)(3).

2. Lease or Sale of Residence

The donor can lease the home if she is unable to continue to live in it. If the donor leases the home, all rental payments made during her life are hers to keep. The donor can also sell the home. If she sells it, the net proceeds of sale are divided proportionately between the donor and the charity, based on the respective present values of the life estate and the remainder.

3. Asset Replacement for Heirs

If the client is concerned that her children will not receive the value of the home as part of their inheritance, her increased cash flow from this strategy may permit her to purchase life insurance for their benefit. The life insurance would be held by an irrevocable life insurance trust or owned by the adult children, so the insurance proceeds would not be included in her estate for estate tax purposes.

4. Gift Annuity Option

If the client wants even more cash, a licensed charity can issue a charitable gift annuity to her in exchange for her gift to it of the remainder interest in the home. As discussed at length below, a charitable gift annuity pays the client an income for life and is appropriate only if the client is 65 or older. Note that, because the client remains in her home, the charity must have sufficient other assets with which to make the annuity payments.

5. Written Gift Agreement

Although only a deed is needed to effect this type of gift, a written agreement with the charity usually outlines the donor's rights and responsibilities and those of the charity. The donor keeps exclusive use of her home during her lifetime and pays the usual obligations of a life tenant: mortgage, insurance, taxes and maintenance

expenses. The donor may make improvements to the home. A sample Gift and Sale of Remainder Interest and Life Tenancy Agreement is attached as *Appendix A*.

C. Definition of Personal Residence or Farm

1. Personal Residence

(a) The Treasury Regulations define a “personal residence” as any property used by the donor as a personal residence even though it is not used as the principal residence. For example, the donor’s vacation home may be a personal residence. Personal residences also include stock in a cooperative housing corporation if the co-op the donor is entitled to occupy is the donor’s personal residence.³

(b) The Service has also ruled privately that any capital improvements, such as the installation of a permanent new heating and air-conditioning system, constitute an additional contribution for which a proportionate charitable contribution deduction is permitted.⁴

(c) A personal residence does not, however, include household furnishings (such as furniture, paintings, silverware, etc.) that are not fixtures, and a gift of a remainder interest in such tangibles will not qualify for the estate tax charitable deduction.⁵ If such items are to be contributed, they should be bequeathed separately.

2. Farm Defined

A “farm” is defined as “any land used by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.” The term “livestock” includes “cattle, hogs, horses, mules, donkeys, sheep,

³ See PLR 8529014.

⁴ *Id.* And see PLR 9329017.

⁵ Rev. Rul. 76-165, 1976-1 C.B. 279.

goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry.” A farm also includes the improvements thereon.⁶

D. Federal Income Tax Consequences

Generally, no deduction is allowed for federal income tax purposes for any contribution of a partial interest in property to charity unless the contribution takes the form of a qualified charitable remainder annuity trust, charitable remainder unitrust, or pooled income fund. There are, however, several exceptions to this rule for transfers of partial interests in property not in trust. These exceptions include one for a contribution of a remainder interest in a personal residence or a farm.⁷

1. Present Value of Remainder Interest

The donor is entitled to a charitable contribution income tax deduction in an amount equal to the net present value of the charitable remainder interest. The computation is performed under the guidelines described in Treasury Regulation Section 1.170A-12 and is based on:

- The fair market value of the property (including improvements) on the date of the transfer;
- The fair market value of depreciable improvements and any depletable resources associated with the property on the date of the transfer;
- The estimated useful life of the depreciable improvements;
- The salvage value of the depreciable improvements at the conclusion of their useful life;

⁶ Treas. Reg. 1.170A-7(b)(4).

⁷ IRC Section 170 (f) (3) (B).

- The measuring term of the agreement (if measured by the life of one or more individuals, the date of birth of the individuals); and
- The 7520 rate⁸ in effect for the month of transfer or during either of the two immediately preceding months.⁹

2. Claiming the Charitable Contribution Income Tax Deduction

The majority of gifts of a remainder interest in a personal residence or farm are made to a public charity with property that has been held long-term by the donor. Accordingly, the present value of the remainder interest is deductible up to 30% of the donor's adjusted gross income, with a five-year carryover of any excess deduction. If the property would be subject to any depreciation recapture as ordinary income if sold on the date of contribution, those amounts are subtracted from the fair market value of the property for purposes of calculating the present value of remainder interest. The donor must include a copy of the computation with his or her income tax return. Furthermore, if the claimed deduction exceeds \$5,000, the fair market value of the property must be evidenced by a qualified appraisal.

3. Transferring Debt-Encumbered Property

A gift of a remainder interest in a personal residence or farm does not cause recognition of gain or loss on transfer by the donor if the property is not debt encumbered. If the property is subject to indebtedness, however, the transaction is subject to the bargain sale rules. When debt-encumbered property is transferred to charity by outright gift, the *entire amount* of the indebtedness is realized as taxable

⁸ The 7520 rate is 120% of the mid-term Applicable Federal Rate set by the IRS for the month of funding. Section 7520 of the Internal Revenue Code of 1986, as amended (the "Code" or "IRC") provides that the 7520 rate must be used to determine the present value of annuities, interests for life or for a term of years, and remainder or reversionary interests.

⁹ Treas. Reg. Section § 25.7520.

income by the donor in the year of the gift for purposes of application of the bargain sale rules of IRC Section 1011(b). In essence, the transaction is treated as though the charity has handed the donor cash in the amount of the indebtedness because the donor has been relieved of the payment obligation. It is logical to think that when a remainder interest in debt-encumbered property is transferred to charity, only that portion of the debt applicable to the charitable remainder interest should be used for purposes of determining realized gain. Logic, however, does not seem to apply to such transactions.

(a) Service Has Ruled Entire Gain Attributable to Indebtedness Realized by Donor

The only guidance offered by the Service on this issue is found in PLR 9329017. In the request for ruling, the taxpayer proposed to transfer the remainder interest in a farm to charity, retaining a life estate. The property had a fair market value of \$110,000 and was subject to an \$80,000 mortgage. The Service ruled that the present value of the remainder interest would be calculated based on the taxpayer's equity - \$30,000. In the years that followed the contribution, the taxpayer would also be entitled to claim additional charitable contribution deductions for the present value of the remainder interest attributable to the repayment of principal. The Service then ruled that the taxpayer would immediately realize the entire amount of the indebtedness for purposes of determining realized gain under the bargain sale rules. This result was surprising because, unlike an outright gift in which the taxpayer is relieved of the payment obligation, the taxpayer in this case was to remain responsible for future mortgage payments under the gift agreement. If the taxpayer had a low cost basis, the realized

gain could easily exceed the entire charitable contribution deduction. In other words, the donor could incur a net income tax liability and still have to make the mortgage payments.

(b) Application of \$250,000 Capital Gain Exclusion to Sales of Remainder Interests or Transfers of Debt-Encumbered Principal Residence

Gain from the sale or exchange of a personal residence up to \$250,000 for an individual or \$500,000 for a married couple meeting certain requirements is not includible in gross income if the property has been owned and used by the taxpayer as the taxpayer's principal residence for at least two years, in the aggregate, out of the five years immediately preceding the sale. This IRC Section 121(d) rule applies to the sale of one residence every two years. IRC Section 121(d)(8) also specifically provides that "at the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence." This exclusion should apply both to gain resulting from the sale of a remainder interest to charity, including the exchange of the remainder for a gift annuity, and also gain realized due to the transfer of a remainder interest in debt-encumbered property.

E. Gift and Estate Tax Considerations

Gifts of a remainder interest in a personal residence or farm to charity qualify for unlimited gift and estate tax deductions for the present value of the remainder interest. However, a gift or estate tax can be generated on the value of the life estate if it is transferred to someone other than the donor, the donor's spouse, or charity.

1. Donor as Sole Tenant

If a donor transfers a remainder interest in her personal residence naming herself as the sole life tenant, the transfer qualifies for a gift tax charitable deduction equal to the present value of the remainder interest in the year the transfer is made. Because the donor retains the life estate interest, there are no further gift tax consequences. Upon her death, the full value of the property is includible in her estate, but there is a fully offsetting estate tax charitable deduction.

2. Non-Donor as Tenant

When a donor creates a life estate agreement naming another person as a tenant, the donor has made a potentially taxable gift of a life estate interest to the tenant. When one or more non-donors are the life tenants of the agreement, the amount of the taxable gift is obtained by subtracting the present value of the remainder interest from the fair market value of the property.

Note: It is important to note that the computation of the present value of the remainder interest is *not* the same as used for income tax deduction purposes; computations for federal gift tax purposes do not consider the depreciable portion of the property.¹⁰ Thus, the entire fair market value of the property is considered non-depreciable property for purposes of this computation. This distinction results in higher gift tax deductions for the remainder interest than if depreciation were considered.

3. Availability of Annual Gift Tax Exclusion

If all or part of the income interest is given to someone other than a spouse, the \$13,000 annual gift tax exclusion is available if the non-donor recipient has a present interest rather than consecutive future interest. The annual gift exclusion can

¹⁰ Rev. Rul. 76-473, 1976-2 C.B.306.

be increased to \$26,000 with the consent of the donor's spouse – or without any gift splitting if the residence is community property. Any remaining taxable gifts can be further offset by the donor's lifetime gift tax exemption.

4. Marital Deduction

If the tenant is the donor's spouse at the time of transfer, the transfer will qualify for the unlimited *gift* tax marital deduction (provided the spouse or both spouses are the sole noncharitable tenants) under IRC Section 2523 (f). If the residence was co-owned by spouses and both are life tenants, then on the death of the first spouse to die, the survivor's life estate in the deceased spouse's 50% qualifies for the estate tax marital deduction under IRC Section 2056(b)(7). The estate tax marital deduction will not be available, however, if the couple divorces during the term of the agreement.

5. Power to Revoke Tenant's Interest

The author believes a donor can forestall the recognition of a taxable transfer to a non-spouse tenant by reserving the power in the gift agreement to revoke the non-spouse tenant's interest, thereby making the transfer incomplete for gift tax purposes. The Treasury Regulations under IRC Section 2511 generally provide that a transfer becomes complete for gift tax purposes when the donor has relinquished dominion and control as to the disposition of property. When a donor reserves the power to revoke the donee's interest in property, such transfers are generally considered incomplete for gift tax purposes.

The Code, Regulations, and IRS have been silent with respect to the availability of a retained power of revocation for transfers of retained life estates. It seems reasonable, however, that based on the body of law applicable to other split-interest charitable transfers (e.g., charitable remainder trusts), a retained power of

revocation should be a permissible device to avoid a completed gift beyond the current year. If the value of use of the residence for a year is within the gift tax annual exclusion amount, no gift tax will be payable and no gift tax exemption will be used.

6. All Donors Required to File Gift Tax Return

Any person making a gift of a remainder interest in a personal residence or farm in any amount should file a federal gift tax return (Form 709) for the year in which the gift is made, even if no gift tax is due. Even though contributions of a remainder interest in a personal residence or farm to charity qualify for the unlimited gift tax charitable deduction under IRC Section 2522, charitable contributions of a partial interest are not one of the specific exceptions under IRC Section 6019 that relieves donors from having to file a gift tax return.

F. Components of the Gift Agreement

Let's look at the sample gift agreement attached as Appendix A. As previously mentioned, property subject to a life estate agreement must be irrevocably transferred to charity. The gift agreement should also contain the following components:

1. Measuring Term

The agreement should define the measuring term of the retained estate:

- If the agreement is measured by the lives of one or more individuals, it should identify these individuals and the order in which they will receive their interest.
- If the agreement is measured by a term of years, it should identify the primary tenant(s) and also provide direction regarding successor tenants should the primary tenants(s) die prior to the expiration of the term of the agreement.

2. Tenant's Responsibilities

The agreement should describe responsibilities to be retained by the tenant:

- These generally include maintaining the premises, insuring the property against loss and liability, repairing the premises in the event of damage, and prohibiting any additional liens or encumbrances.

3. Possibility Tenant Will Move Out

The agreement should also anticipate the possibility of the tenant vacating the property:

- If the property is to be rented or leased, the gift agreement can require that the charity join in the lease agreement in order to limit the period by which the lessee is permitted to occupy the property beyond the expiration of the measuring term of the retained estate.
- The gift agreement can also provide options for the sale of the property. These can include a sale and repurchase of a new property with continuation of the retained estate, a division of the proceeds in accordance with the value of each party's interest, or combination of the above.

4. Division of Certain Costs

The agreement should apportion the costs of agreed upon major structural changes and extraordinary assessments between the tenant and the charity proportionate to their interests.

5. Access for Inspection

Finally, the agreement should permit the charity reasonable access to the property for periodic inspection.

G. Planning Opportunities

Life estate agreements are generally contemplated by individuals who plan to spend their final years in their current residence. Circumstances and planning goals do change, however. What if the life tenant can no longer maintain or occupy the property? What if the donor needs additional income more than she needs an income tax deduction?

1. Rental of Property

The life tenant retains all beneficial lifetime rights in the property. This includes the ability to rent the property and receive the income therefrom. The gift agreement should contemplate this possibility and establish responsibilities for property management and maintenance if the life tenant vacates the property.

2. Selling the Property and Dividing Interests

Another option available to the donor and charity is to sell the property and divide the net sales proceeds according to each party's interest at the time of the sale. For this purpose, a present value of the remainder interest is calculated using the net sales proceeds and the date of sale. Any expenses, such as outstanding property taxes, that would otherwise be attributable to the life tenant are deducted from the life tenant's share prior to distribution. The present value of the remainder interest is then distributed to charity with the remaining proceeds distributed to the donor. The donor realizes gain based on her proportionate share of the sales proceeds. The gift agreement cannot compel the charity to sell its interest prior to the expiration of the measuring term stated in the gift agreement; to do so, according to Revenue Ruling 77-

305, could defeat the charity's remainder interest in the residence itself.¹¹ The decision to sell must therefore be voluntary on the part of both parties and not subject to a condition subsequent in the gift agreement.

3. Accelerating the Remainder Interest

Yet a third option involves the donor contributing the balance of the life estate to the charity, thereby accelerating the gift of the remainder interest. In such cases, the donor is entitled to receive an additional charitable contribution income tax deduction based on the present value of her remaining life. The present value of the remainder interest is calculated using the fair market value of the property on the date the retained life estate is transferred. The present value of the remainder interest is subtracted from the fair market value of the property to produce the present value of the remaining life estate. This amount qualifies for charitable deduction purposes.

4. Bargain Sale of Remainder Interest in Personal Residence or Farm

In many cases, an individual's personal residence or farm represents a major component of her estate. Ideal candidates for life estate agreements are retired, may have modest income, and may be in need of or desire supplemental income. In a traditional life estate agreement, the donor contributes the entire remainder interest in the property to charity. However, the donor is not required to do so. As an alternative, a prospective donor can offer to sell a portion of the remainder interest to the charity in conjunction with a contribution of the remaining portion. In such cases, the charity may offer payments in the form of cash, an installment note, or a charitable gift annuity (if available). In essence, the concept represents a sophisticated form of a bargain sale.¹²

¹¹ Rev. Rul 77-305, 1977-2 C.B. 72.

¹² See PLR 8806042.

H. How the 7520 Rate Affects Valuation of the Retained Life Estate

A decrease in the 7520 rate increases income, estate and gift tax deductions for the value of the charitable remainder interest. When the 7520 rate is low, the retained life estate has a lower value. A higher 7520 rate has the reverse effect. This strategy gives rise to the most tax benefits when the 7520 rate is low because the 7520 rate is used to value the client's retained right to live in the property. If the 7520 rate is 6%, the IRS assumes the client will receive benefits equal to 6% of the fair market value of the residence from the use of the residence each year until she dies. If the 7520 rate is only 2%, the IRS valuation of the retained life estate is much lower, so the income tax deduction for the value of the charitable remainder is correspondingly higher.

Here is an example of the tax benefits:

Example 1:

Ted and Ann are both 62 years old. Their farm is worth \$600,000, and they paid only \$150,000 for it long ago. Their gross income is \$200,000 per year and their taxable income is \$165,000. If they give the remainder interest in their farm to charity when the 7520 rate is 4.6%, they will be entitled to an income tax deduction of \$168,631. (See *Appendix B*). If they make the gift when the 7520 rate is 1.5%, they will be entitled to an income tax deduction of \$337,790, slightly more than a 100% increase over the deduction if the 7520 rate were 4.6%. (See *Appendix C*). They will increase their annual disposable income for each year they claim a deduction because they will pay less in income taxes. The five-year income tax charitable deduction carry forward applies, so they have a total of six years in which to utilize the deduction. The maximum charitable deduction they can claim in any one year for a gift of appreciated

property to a public charity is 30% of their adjusted gross income (\$200,000 x 30% = \$60,000). Thus, over 6 years, they will be able to fully utilize the \$337,690 income tax deduction and pocket roughly \$20,000 annually they would not otherwise have had.

III. CHARITABLE GIFT ANNUITIES – STABLE INCOME IN UNSTABLE TIMES

A charitable gift annuity is described generally as a transaction in which an individual transfers cash or property to a charitable organization in exchange for the charity's promise to make fixed annuity payments to one or two life annuitants.

Most gift annuity donors are retired, want to increase their cash flow, seek the security of guaranteed payments and would like to save on taxes. A charitable gift annuity can work well for clients in any of the following circumstances:

- The interest rates on their CDs and other fixed-income investments have declined, and they would like to increase their cash flow.
- They own appreciated stock or mutual fund shares and have considered selling some of the shares and reinvesting the proceeds to generate more income, but they don't want to pay tax on the capital gain.
- They would like to count on fixed payments which are unaffected by interest rates and stock prices and which they cannot outlive.
- They want to assure continuation of payments to a surviving spouse without the delay of probate proceedings.
- They would like to provide financial assistance to an elderly parent, sibling, or other person in a tax-advantaged manner.

A. What Is a Charitable Gift Annuity?

1. Gift and Purchase

As its name suggests, a charitable gift annuity consists of two elements: (i) an outright charitable gift and (ii) the purchase of a fixed income annuity contract. The payment period can be measured by one annuitant's life (who is usually the donor) or by the lives of two joint and survivor annuitants (who are usually husband and wife). Charitable gift annuities are not issued for a fixed term of years.

2. Charity's Obligation to Make Annuity Payments

Unlike charitable remainder trusts, where the obligation to make payments is limited solely to the contributed assets, a charitable gift annuity is considered a general obligation of the issuing charitable organization. Charitable gift annuities, therefore, take on many of the same characteristics as commercial annuities, with the issuing charity acting as the insurer.

3. Annuity Rate Ranges

Charitable gift annuities are particularly popular when interest rates are low because they provide a reliable income stream for older donors at higher rates of return, and with substantially lower risk, than otherwise available. Rates for immediately payable charitable gift annuities (available to donors 65 and older) currently range from 4.7% for a 65 year old to 9% for a donor who is 90 or older. The amount of the annual fixed payment is generally determined by the age of the annuitant and the fair market value of the gifted asset.

4. Basics of the Vehicle

To set up a charitable gift annuity, the donor makes a donation to a licensed public charity in exchange for the charity's paying him an income stream for

life. The donor receives a current income tax deduction equal to the difference between the value of the annuity he will receive and the value of the property or cash he donated. As he receives the annuity payments, a portion of each payment is tax-free until he has recovered his investment in the contract.

5. Liquidity to Pay Annuity

Most charities issue gift annuities only in exchange for gifts of cash and publicly traded securities. Unless the charity has a large endowment the income from which can be used to make the annuity payments to the donor, it will have to use the gifted cash or the net proceeds from the sale of the gifted securities to make the annuity payments.

6. Deferred Annuity Available

For younger donors who cannot qualify for an immediate gift annuity, the payment of the annuity can be deferred until a specific later time, such as the donor's 65th birthday. If the donor is not sure when he plans to retire but wants his annuity to start then, he can reserve the right to pick a future start date from, for example, 10 to 20 years after he donates his cash or securities. His deduction will be based on the *earliest date* on which the annuity payments could commence. When the donor defers the annuity start date, he is entitled to a greater income tax deduction than if his annuity started immediately.

7. Licensing and Documentation

In most states, including California, a charity must be licensed to issue charitable gift annuities, and strict regulations regarding reserves ensure the charity will have funds to pay the annuity. The arrangement is easily documented by the charity itself, so the donor pays little or no legal fees to implement the planning.

8. Larger Annuity but Lower Deduction

Lower 7520 rates decrease the income tax charitable deduction but increase the annuity payments, and donors with fixed incomes are seeing reliable higher rates of return than they could otherwise get without excessive risk. Therefore, gift annuities are very popular even though the deduction is lower.

Example 2:

Here is an example of how an immediate two-life charitable gift annuity works:

Mark, age 80, and Lila, age 78, are husband and wife. They donate \$250,000 in exchange for a charitable gift annuity to make fixed quarterly payments to them for life. They claim an income tax charitable deduction of \$87,989. They receive \$15,500 per year as an annuity, of which \$12,090.35 is tax-free recovery of their investment and \$3,409.65 is taxed as ordinary income for the first 13.4 years. Their annuity rate is 6.2%, a good rate of return in this economy. (See *Appendix D*). After 13.4 years, the fully annuity payment is ordinary income.

Example 3:

Here is an example of how a deferred charitable gift annuity works:

Max, age 50, donates \$100,000 in exchange for a charitable gift annuity, with annuity payments to start in 15 years, when he is 65. He claims an immediate income tax deduction of \$14,695. (See *Appendix E*). When he turns 65, he starts receiving \$9,500 from the charity annually. Of this, \$4,273.14 is tax-free recovery of his investment in the charitable gift annuity, and \$5,226.86 is taxed as ordinary income.

Note: A series of deferred gift annuities can supplement the retirement savings of a younger client who is already contributing the maximum to retirement plans.

To see all of the current charitable gift annuity rates, visit the website of the American Council on Gift Annuities at: <http://www.acga-web.org>

B. The 10% Test.

When a charitable organization issues a gift annuity, it creates a liability equal to the expected return to the annuitant. Under IRC Section 514(c)(5), such acquisition indebtedness will cause the issuing organization to have to pay tax on unrelated business income to the extent of such liability unless it meets four conditions. One of those conditions is that the present value of the annuity must be less than 90% of the net fair market value of the property on the date of transfer. In other words, the donor's gross charitable deduction (prior to percentage limitation reductions under IRC Section 170) must be at least 10% of the amount transferred.

1. 7520 Rate

A declining 7520 rate increases the minimum age that individuals must be to qualify to obtain charitable gift annuities. The current minimum age for an immediate annuity is 60.

2. Two-Month Rate Lookback

Those entering into gift annuity arrangements can apply the two-month lookback rule to elect to use the highest available 7520 rate.

C. Reduced Annuity Rates and Interaction with 7520 Rate.

A reduction in the 7520 rate causes an increase in the present value of the annuity payments and a corresponding reduction in the value of the charitable gift. In

response to rapidly falling interest rates and actuarially longer life expectancies of donors, in August of this year, the Board of Directors of the American Council on Gift Annuities (ACGA) approved a new schedule of suggested maximum gift annuity rates for gifts established by donors after January 1, 2012. The new schedules reflect (i) the Council's long-standing residuum target of 50%, with an additional requirement that the present value of the residuum be at least 20% of the gift amount; (ii) the results of a recent study on charitable gift annuitant mortality conducted by the ACGA's actuarial consultants and (iii) a more conservative investment return assumption.

Generally speaking, the new rate schedule contains slightly lower rates for single-life annuities for ages 69 and younger, and slightly higher rates for single-life annuities at age 75 and older. Similar changes apply to two-life gift annuity rates.

1. Passing the 10% Test

Lowering annuity rates lowers the age at which annuitants can satisfy the 10 percent test. When the 7520 rate drops below the annuity rate, the annuitant is in danger of failing the 10% test.

2. Deferred Annuity Option

If the donor cannot qualify under the 10% test for an immediate payment gift annuity, the donor should consider a deferred payment gift annuity. Deferring the annuity starting date will not only increase the donor's income tax deduction but will also increase the annual payments he ultimately receives.

D. Income Taxation of Annuity Payments

1. Generally

If the gift annuity is funded with cash, part of the payments will be taxed as ordinary income and part will be tax-free. If funded with appreciated securities or real

estate owned more than one year and the donor is receiving the annuity payments, part of the payments will be taxed as ordinary income, part as capital gain, and part may be tax-free. The charity that issues the annuity will send a Form 1099-R to the annuitant. This form will specify how the payments should be reported for income tax purposes. *As the 7520 rate goes down, the tax-free portion of each annuity payment goes up. A greater portion is considered return of principal if the assumed income component is reduced by the low 7520 rate.*

2. Investment in the Contract

The computation of these amounts is based on three factors:

- The investment in the contract;
- The expected return, and
- The exclusion ratio

The “investment in the contract” is a term that is synonymous with the present value of the annuity. If, however, the charity reinsures its payment obligation by purchasing an annuity contract from a commercial insurance carrier, the investment in the contract is the aggregate amount of premiums transferred to the insurance company. Otherwise, it is calculated as illustrated in the examples above.¹³ The expected return multiple is also subject to adjustment for the payment frequency of the annuity. These adjustment factors are found in Treasury Regulation Section 1.72-5(a)(2).

3. Exclusion Ratio

The “exclusion ratio” represents the percentage of each annuity payment that is considered a recovery of principal and therefore excluded from the annuitant’s

¹³ Treas. Reg. Section 1.72-6.

gross income. It is calculated by dividing the investment in the contract (i.e., the present value of annuity) by the adjusted expected return. The remainder of each annuity payment is considered ordinary income.¹⁴ It is important to note that once the annuitant's principal has been repaid completely, the entire amount of each future annuity payment is treated as ordinary income.

E. Recognition of Gain on Transfer of Appreciated Property

A charitable gift annuity is by definition part gift and part purchase of an annuity contract. It is a sale of property by the donor to the issuing organization for less than fair market value. Accordingly, if appreciated property is transferred as consideration for a gift annuity, the transaction is subject to the bargain sale rules under IRC Section 1011(b).

In the case of a charitable gift annuity, the investment in the contract is considered an amount realized by the donor for purpose of the bargain sale rules. Therefore, the adjusted cost basis in the property must be apportioned between the investment in the contract and the contributed portion to determine the amount of the gain recognized by the donor.

Gain that is recognized from the bargain sale of appreciated property may be reported ratably over the life expectancy of the annuitant provided the following conditions are met:

- The transfer qualifies for a charitable contribution income tax deduction under IRC Section 170
- The donor is at least one of the annuitants; and

¹⁴ Treas. Reg. 1.72-4.

- The annuity is non-assignable except to the issuing organization.¹⁵

F. Recognition of Gain on Transfer of Debt-Encumbered Property

When debt encumbered property is transferred in exchange for a gift annuity, the amount of debt plus the investment in the contract is considered an amount realized by the donor for purposes of application of the bargain sale rules.

It is important to note that gain attributable to the debt-encumbered portion of the property does not appear under the Treasury Regulations to qualify for ratable reporting. The investment in the contract is determined based on the net fair market value of the property transferred. Because net fair market value is obtained by subtracting all indebtedness, the gain attributable to the debt does not appear to qualify under Treasury Regulation Section 1011-2(a)(3). The donor recognizes all of the gain attributable to the indebtedness presumably in the year of transfer.

When the transferred property is both appreciated and debt encumbered, the portion of the gain that qualifies for ratable reporting is determined by first dividing the investment in the contract by the total amount realized, then multiplying the product by the total realized gain. The difference is reportable in the year of transfer.

G. Gift Tax Considerations

1. Gift Tax Return Required

A charitable gift annuity consists of part outright charitable gift of a present interest and part purchase of an annuity contract. Section 6019 of the Regulations provides a list of gifts that are exempt from the requirement of filing a gift tax return. These exceptions include annual exclusion gifts to charities. Accordingly, even though the donor might be the only annuitant, if the amount transferred less the present value

¹⁵ Treas. Reg. 1.1011-2(a)(4)(ii).

of the annuity exceeds the annual gift tax exclusion amount, a gift tax return is required for the amount transferred to charity.

2. Gifts of Annuity Payments to Non-Donors

If annuity payments are made to any person other than the donor, the donor has made a gift to the non-donor in an amount equal to the present value of the annuity payable to the annuitant. If the annuity payments commence immediately, the gift is of a present interest and qualifies for the annual gift tax exclusion. Conversely, if the transfer is made to a deferred gift annuity or the non-donor is a participant of a joint-and-survivor annuity, the gift is of a future interest and does not qualify for the annual gift tax exclusion.

3. Rights of Revocation

A donor can avoid generating a taxable gift when the annuity is created by reserving the right to revoke a non-donor's annuity interest. Taxable gifts will occur as payments are actually received by the annuitant and, as gifts of a present interest, will qualify for the annual gift tax exclusion.

4. Gift Tax Marital Deduction

If a donor creates a charitable gift annuity for the sole benefit of a spouse, the gift will qualify for the unlimited gift tax marital deduction.¹⁶ The rules become more complicated, however, when the husband and wife are co-annuitants. The unlimited gift tax marital deduction is available to a husband and wife only if both spouses are the sole annuitants and each has the right to receive payments prior to the death of the first spouse. In other words, the annuity must be payable jointly and then to the survivor.¹⁷

¹⁶ Treas. Reg. Section 25-2523 (b)-1 (b)(6)(iii).

¹⁷ IRC Section 2523(f)(6).

If a donor creates an annuity with his or her separate property, the entire annuity payment is paid to the donor, and then the donor's spouse receives survivor payments, the gift will not qualify for the gift tax marital deduction. Therefore, the donor should reserve the right to revoke the spouse's interest in order to make the gift incomplete. As discussed below, if the donor spouse dies first, the present value of the annuity included in the donor spouse's estate will qualify for the unlimited estate tax marital deduction.

If a married couple creates a joint-and-survivor annuity with their community (or joint tenancy) property whereby they will receive equal payments, a taxable gift will exist if the present value of the survivor annuity of each spouse differs because they are not the same age. The gift is equal to one-half the differential. The resulting amount will qualify for the unlimited gift tax marital deduction.¹⁸

H. Estate Tax Consequences

1. Donor as Sole Annuitant

If the donor is the sole annuitant of a charitable gift annuity, the only amount that may be includible in his or her estate is the amount of any annuity payment that is due, but has not yet been received, on the date of death. The gift to charity was completed when the annuity was issued. Many charitable gift annuity agreements provide that the obligation to make payments ends with the last regular payment prior to the death of the annuitant. If not, any final prorated payment will be included in the estate of the annuitant.

¹⁸ Ibid.

2. Non-Donor Annuitant

If a donor creates an annuity for the benefit of a non-donor annuitant, the present value of the annuity (less the gift tax annual exclusion, if applicable) is included in the donor's adjusted taxable gifts. No amount is includible in the donor's estate. If, however, the donor retains the right to revoke the annuitant's interest, then only the current year's payments are a completed gift, and they qualify for the gift tax annual exclusion as gifts of present interests.¹⁹ If the donor then predeceases the annuitant, the present value of the annuity as of the date of the donor's death is includible in the donor's gross estate. Continuing with this example, if the annuitant is the donor's spouse, the amount includible in the donor's estate will qualify for the unlimited estate tax *marital* deduction.

3. Separate Property for Joint and Survivor Annuitant

If a donor exchanges separate property for a joint-and-survivor annuity payable to himself and his spouse, and if the donor then predeceases the spouse, the present value of the spouse's annuity as of the donor's date of death will be included in the donor's gross estate. The amount so included will qualify for the unlimited estate tax *marital* deduction.

4. Community Property for Joint and Survivor Annuity

If a married couple creates a joint-and-survivor annuity with their community (or joint tenancy) property whereby they will receive equal payments, and each retains the right to revoke the other's interest as to their one-half interest, upon the death of the first spouse, one-half of the present value of the surviving spouse's annuity

¹⁹ Treas. Reg. Section 25.2503-(3)(b).

interest will be includible in the estate of the deceased spouse. The amount included will qualify for the unlimited estate tax *marital deduction*.

I. Tax Considerations for Issuing Organization

When a charitable organization issues a gift annuity, it creates a liability equal to the expected return to the annuitant. Under IRC Section 514(c)(5), this acquisition indebtedness will cause the issuing organization to have unrelated business income to the extent of such liability unless the following conditions are met:

- The obligation to pay the annuity must be the sole consideration for the property transferred;
- The present value of the annuity must be less than 90% of the net fair market value of the property on the date of transfer;
- The annuity must be payable over one or two lives in being at the time the annuity is issued; and
- The annuity contract does not guarantee a minimum or maximum number of payments and does not provide variable payments.

Also, if the property transferred for the gift annuity is debt encumbered, the issuing organization will not have acquisition indebtedness for ten years after the date of issue if:

- The donor has held the property for at least five years prior to the date of transfer;
- The debt has been in place for at least five years prior to the date of transfer; and

- The organization accepts the property “subject to” the indebtedness rather than “assuming” it.

J. Re-Cap of Advantages of Gift Annuities

1. Low Cost

Charitable gift annuity agreements are provided by the issuing charitable organization and are not generally subject to modification. This fact eliminates the need for drafting a customized gift agreement for each individual donor (although donors may want the agreement to be reviewed by professional advisors). When compared to a charitable remainder trust, which requires an individually prepared trust instrument with its attendant cost, charitable gift annuities are very economical and convenient to implement. Furthermore, the minimum investment for a charitable gift annuity is usually significantly less than for a charitable remainder trust.

2. Attractive After-Tax Returns

Given the favorable income tax benefits associated with charitable gift annuities — both in terms of the charitable income tax deduction and favorable taxation of annuity payments — those evaluating them should consider the net cost of the contribution and the effective after-tax yield of the annuity payments.

3. Transferring Debt-Encumbered Property

Whereas the transfer of debt-encumbered property to a charitable remainder trust is either prohibited or presents significant tax risks, the transfer of such property in exchange for a charitable gift annuity may offer an ideal solution. Because a charitable gift annuity does not utilize a trust, the transfer of debt-encumbered property does not run afoul of the grantor trust rules. As discussed earlier, such transfers do not give rise to acquisition indebtedness for a period of ten years if (i) the donor has owned

the property at least five years (ii) the debt has been on the property at least five years and (iii) the charity does not assume the debt, thereby providing the charitable organization ample time to dispose of the property or retire the indebtedness.

4. Deferred Gift Annuities with a Variable Starting Date

Traditional deferred charitable gift annuities have been established bearing a fixed annuity commencement date.²⁰ The annuitant can also be given the right, subsequent to the creation of the gift annuity, to elect when payments will commence.

In two separate private letter rulings, the Service has permitted annuitants the ability to start receiving payments either prior to or after the scheduled commencement date. The first request for ruling involved a joint and survivor annuity agreement which provided that in the event the first annuitant died prior to the commencement date, the surviving annuitant could elect to receive payments prior to the scheduled commencement date. Such a change was ruled to have no effect on the charitable deduction.

In the second ruling, the Service permitted an arrangement whereby the annuity contract allowed the annuitant to elect the commencement date of payments at any time after the annuitant, who was age 50, reached age 55. The election was to be made by the annuitant with the annual annuity payment determined based on the age of the annuitant in accordance with pre-existing tables.²¹

The key to modifying the commencement dates is to maintain the relationship of the amount claimed as a charitable deduction to the amount of economic

²⁰ PLR 9017071.

²¹ PLR 9743094.

benefit being conveyed to the annuitant. Because the deduction is produced when the contract is created, the only modification available is an adjustment of the annuity payment. If payments begin *before* the scheduled commencement date, the annuity amount is *reduced*. Conversely, if payments begin at some time after the scheduled commencement date, the annuity amount is *increased*.

5. Bargain Sale of Remainder Interest in Personal Residence or Farm in Exchange for Gift Annuity

(a) One very creative planning technique involves combining a life estate agreement with a charitable gift annuity. This combination enables a donor to contribute the remainder interest in his personal residence or farm to charity, retain the lifetime use of the property, receive an income payable for life, and receive a current income tax charitable deduction. A Gift and Sale Agreement for such a transaction is attached as *Exhibit A*.

(b) The technique begins by calculating the present value of the remainder interest in the personal residence; however, instead of contributing the entire remainder interest to charity, the donor transfers it as consideration in exchange for an immediate or deferred payment charitable gift annuity. The annuity payments are based on the contributed remainder interest with a portion of the remainder interest qualifying as a charitable contribution income tax deduction.

(c) As with transfers of entire interests in appreciated real property, the transfer of the remainder interest in appreciated real property in exchange for a gift annuity is considered a bargain sale. The donor realizes gain attributable to the portion of the remainder interest used to purchase the annuity. This gain realized may qualify to be reported ratably as discussed above.

(d) Because the purchasing charitable organization must make annuity payments from sources other than the contributed remainder interest, acceptable donors for this technique are generally older and have property that is debt-free or significantly debt-free.

IV. SUMMARY

Gift annuities remain attractive to many donors for the traditional reasons of guaranteed fixed income for life and tax-free income, even when a low 7520 rate results in a lower charitable deduction. Gifts of remainder interests in a residence or farm allow the donor to remain in her home while obtaining a current income tax deduction. Donors for whom large charitable deductions are essential may wish to consider a retained life estate and both obtain the large income tax deduction and also increase cash flow by exchanging the remainder interest for a gift annuity. Planners should keep these two easy-to-implement charitable strategies in mind.

United States Internal Revenue Service (IRS) Circular 230 disclosure:

To ensure compliance with requirements imposed by the IRS, we inform you that, unless and to the extent we otherwise state, any U.S. federal tax advice contained in this outline (including any attachments) is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

GIFT AND SALE OF REMAINDER INTEREST AND LIFE TENANCY AGREEMENT
(in Exchange for Gift Annuity)

This agreement is entered into this ____ day of _____, _____, between _____, _____ ("Donor") and _____, a California nonprofit public benefit corporation ("Charity"), in connection with a gift and sale of a remainder interest in Donor's property (the "Gift") in exchange for a charitable gift annuity. The purpose of this Agreement is to clarify the intent of the Donor with respect to the use of the Gift by Charity and the mutual duties and expectations of the parties.

WHEREAS, the Donor has this day executed a deed giving to Charity a remainder interest in Donor's property in _____ (the "Premises"), which is legally described in Exhibit "A" attached hereto and incorporated herein by this reference, in exchange for a charitable gift annuity payable by Charity.

NOW, THEREFORE the parties hereto agree as follows:

1. Gift and Sale of Remainder Interest

(a) The parties acknowledge and agree that the Premises have been appraised at a value of _____ Dollars (\$_____).

(b) Based upon the appraised value of the Premises set forth in subparagraph (a) above, the parties further acknowledge and agree that the sum of _____ Dollars (\$_____) will represent the value of a one hundred percent (100%) remainder interest in Donor's interest in the Premises.

(c) Donor agrees to give and sell to Charity a one hundred percent (100%) remainder interest in his interest in the Premises, valued at _____ Dollars (\$_____), in exchange for a charitable gift annuity, which shall provide the Donor with the sum of _____ Dollars (\$_____) per year for his lifetime, as set forth in that certain Charitable Gift Annuity Agreement executed concurrently herewith. The charitable gift annuity shall be payable by the Charity. Concurrent with the Donor's gift and sale described in this subparagraph (c), Donor shall execute a deed giving to Charity a one hundred percent (100%) remainder interest in Donor's interest in the Premises.

(d) Donor and Charity acknowledge and agree that, upon the completion of the transactions described herein, Donor will have made a net gift to Charity in the amount of _____ Dollars (\$_____), consisting of the gift arising from the gift annuity payable by Charity.

2. Gift Arrangement

(a) Donor shall, during his lifetime, have the sole right to occupy and utilize the Premises as his residence and to lease the Premises to any other person for use as a personal residence.

Appendix A

(b) Donor agrees to assume sole responsibility for the duties described below as the life tenant of the Premises:

(i) To make necessary repairs and to maintain the Premises in a good condition, including necessary upkeep of improvements to protect the Premises against waste;

(ii) To make all property tax payments and a "Fair Proportion" of extraordinary assessments benefitting the entire property interest. "Fair Proportion" means the ratio of the then current values of the parties' respective interests (Donor's life estate and Charity's remainder interest). The then applicable Federal Table will be used to determine the percentage of the life estate and the remainder interest, with the land and building value determined either by mutual agreement or independent appraisal;

(iii) To pay all ordinary Homeowners' Association fees and charges;

(iv) To insure the Premises against the risk of fire;

(v) To maintain any and all homeowners' insurance policy(ies) insuring the Premises that are in full force and effect as of the execution of this Agreement, and to name Charity as an additional insured with respect to such policy(ies);

(vi) To permit representatives of the Charity to visit the Premises from time to time upon reasonable notice;

(vii) To consult and reach a mutual agreement with the Charity before making major structural changes or improvements. Such changes or improvements shall be approved by the Donor and the Charity jointly, and the cost of such approved changes or improvements will be divided according to the "Fair Proportion" ratio defined in section (b)(ii) above, unless otherwise agreed;

(viii) To consult the Charity before major changes in the use of the Premises, including the rental thereof. Donor and the Charity should join together to lease their respective interests provided that such term shall not continue for more than one (1) year beyond the date of death of Donor and provided further that Charity shall be entitled to the rent from the Premises from Donor's date of death. During Donor's lifetime, Donor shall be entitled to receive all rental receipts, unless otherwise agreed.

(ix) To consult and reach a mutual agreement with the Charity before a sale of the Premises. The Charity shall promptly review and consider, in good faith, any sale of the Premises proposed by the Donor. Should the Donor and the Charity join in the sale of the entire fee, the following options may be available upon the mutual agreement of the Charity and the Donor, which agreement shall be negotiated in good faith and shall not be unreasonably withheld.

(A) Reinvest the proceeds in another residence with retained life estate and remainder interest;

Appendix A

- (B) Invest the proceeds in a life income arrangement;
 - (C) Divide the proceeds according to the "Fair Proportion" ratio defined in section (b)(ii) above, unless otherwise agreed;
 - (D) Use a combination of the above.
 - (x) To consult the Charity regarding issues which may arise that are not covered by the Agreement, and to mutually resolve such issues.
- (c) In the event that Donor becomes incapacitated, an attorney-in-fact appointed by Donor while Donor has capacity shall have the power to act on Donor's behalf to fulfill the Donor's obligations set forth in this Agreement. The Donor shall, within ten (10) days of executing this Agreement, provide Charity with a true and correct copy of a legally enforceable Durable Power of Attorney appointing an agent for Donor to act on Donor's behalf under this Agreement if Donor becomes incapacitated.
- (d) If Donor fails to satisfy his property tax obligations, homeowner's association obligations, homeowners' insurance, or any other obligations set forth in Paragraph (b) above, the Charity, in the Charity's discretion, may advance funds to pay for said unpaid obligations. Any such funds advanced by the Charity shall be treated as a loan, bearing interest at the prime rate set by Bank of America, at the time the funds are advanced, and shall be repaid to the Charity upon the Donor's death as a claim against the Donor's estate.
- (e) Donor shall not, without the Charity's consent, suffer any lien or mortgage to be placed on the Premises.
- (f) In the event of any damage to the Premises, the Donor, at his sole expense, shall cause such damage to be repaired unless the Donor and Charity shall agree that it is impractical to do so, in which case any insurance proceeds resulting from such damage shall be divided between Charity and the Donor in accordance with the value of their respective interests as of the date such damage occurred. For purposes of determining the value of the Charity's remainder interest in the event of such loss, the value shall be determined in the same manner as is used to value a gift of a remainder interest in a personal residence or a farm as is provided in U.S. Treasury Regulations Section 1.170A-12 or any corresponding Treasury Regulations then in effect.
- (g) Donor agrees to hold Charity harmless against any and all liability arising from the Premises during Donor's lifetime.
- (h) Donor may at any time or times at his sole expense make improvements to the Premises, provided that such improvements shall not result in a reduction of the value of the Premises.

3. Donor's Representations and Warranties

Donor hereby makes the following representations and warranties to Charity:

Appendix A

(a) that, to the best knowledge of Donor, there are no hazardous or toxic wastes, substances or materials situated in, at, under or about the Premises;

(b) that, to the best knowledge of Donor, the Premises are not in violation of any building codes or any other applicable laws, rules or regulations, and no portion of the improvements, if any, have been constructed without proper building permits and approvals as may be required by law;

(c) that, to the best knowledge of Donor, there are no material defective conditions in the improvements situated at the Premises that are not visible upon reasonable inspection; and

(d) that, to the best knowledge of Donor, Donor holds clear and marketable title to the Premises and is authorized to transfer the Premises to Charity pursuant to this Agreement.

Donor intends and agrees that Charity shall be entitled to rely upon the foregoing representations and warranties. Accordingly, Donor hereby further agrees to indemnify, defend and hold Charity harmless from and against any and all claims, demands, liabilities, losses, damages and expenses incurred by Charity resulting from the inaccuracy of any of the foregoing representations and warranties.

4. Charity's Interest in the Premises

Charity shall have a one hundred percent (100%) remainder interest in the Premises.

5. Conditions of Gift

Except as otherwise set forth herein, there are no preconditions to this Gift.

6. Purpose and Use of Gift

The Donor and Charity agree to use the Gift to further the Charity's charitable purposes.

7. Binding Obligation

This Agreement shall be binding upon and inure to the benefit of Donor and Charity, and their respective successors, heirs, assigns, administrators, trustees and executors.

8. Exempt Status

(a) Charity represents that it is qualified as a charitable organization, gifts to which qualify for charitable contribution tax deductions under Internal Revenue Code Sections 170(b)(1)(A), 170(c), 2055 and 2522.

Appendix A

9. Miscellaneous

(a) Situs: This Agreement is executed in and shall be governed by the laws of the State of California.

(b) Amendment: This Agreement may be amended at any time by written agreement signed by each of the parties.

(c) Irrevocable: Except as otherwise provided, this Agreement shall be irrevocable.

(d) Effective Date: The effective date of this Agreement shall be the date set forth above.

(e) Execution in Counterparts: This Agreement may be executed in multiple counterparts, each of which shall be deemed an original Agreement, and all of which, when taken together, shall constitute one and the same original.

Executed by:

Donor: _____

Date: _____

a California nonprofit public benefit corporation

By: _____

Date: _____

Title: _____

Appendix B



Charitable Life Estate Agreement for Two Lives

Prepared for: Ted & Ann

A. Input Assumptions

Fair market value of property transferred	\$600,000.00
Current value of depreciable property (improvements)	\$200,000.00
Estimated useful life of depreciable property in years	40
Expected salvage value of depreciable property (improvements)	\$20,000.00
Using user specified discount rate of	4.60%
The mortality table is based on the census taken in	2000
Nearest age of Ted on the date of the gift is	62
Nearest age of Ann on the date of the gift is	62

B. Calculation of Income Tax Deduction

1. Current fair market value of life estate property	\$600,000.00
2. Current value of depreciable portion of life estate property	\$200,000.00
3. Salvage value of depreciable life estate property	\$20,000.00
4. Portion of property considered to be depreciable (Line 2 minus Line 3)	\$180,000.00
5. Net value of property not subject to depreciation (Line 1 minus Line 4)	\$420,000.00
6. Remainder interest factor based on tenant ages	0.338790
7. Remainder interest factor for real property which depreciates	0.146330
8. Value of remainder interest in real property	
(a) Value not subject to depreciation (Line 5 * Line 6)	\$142,291.80
(b) Value subject to depreciation (Line 4 * Line 7)	\$26,339.40
(c) Total value of remainder interest (Line 8(a) + Line 8(b)) (the tax deduction)	\$168,631.20

We invite you to [contact us](#) for additional information regarding this gift instrument or your other gift planning options.

NOTE: This calculation is provided for educational purposes only. The type of assets transferred, the actual date of the gift, and other factors may have a material effect on the amount or use of your deduction. You are advised to seek the advice of your tax advisors before implementing a gift of this type.

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Appendix C



Charitable Life Estate Agreement for Two Lives

Prepared for: Ted & Ann

A. Input Assumptions

Fair market value of property transferred	\$600,000.00
Current value of depreciable property (improvements)	\$200,000.00
Estimated useful life of depreciable property in years	40
Expected salvage value of depreciable property (improvements)	\$20,000.00
Using user specified discount rate of	1.50%
The mortality table is based on the census taken in	2000
Nearest age of Ted on the date of the gift is	62
Nearest age of Ann on the date of the gift is	62

B. Calculation of Income Tax Deduction

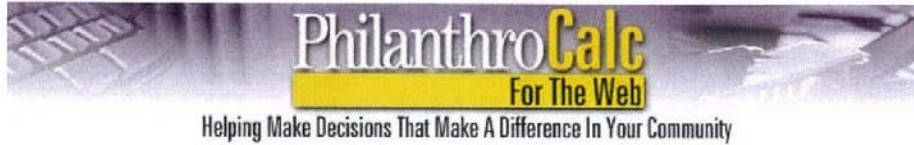
1. Current fair market value of life estate property	\$600,000.00
2. Current value of depreciable portion of life estate property	\$200,000.00
3. Salvage value of depreciable life estate property	\$20,000.00
4. Portion of property considered to be depreciable (Line 2 minus Line 3)	\$180,000.00
5. Net value of property not subject to depreciation (Line 1 minus Line 4)	\$420,000.00
6. Remainder interest factor based on tenant ages	0.689730
7. Remainder interest factor for real property which depreciates	0.267240
8. Value of remainder interest in real property	
(a) Value not subject to depreciation (Line 5 * Line 6)	\$289,686.60
(b) Value subject to depreciation (Line 4 * Line 7)	\$48,103.20
(c) Total value of remainder interest (Line 8(a) + Line 8(b)) (the tax deduction)	\$337,789.80

We invite you to [contact us](#) for additional information regarding this gift instrument or your other gift planning options.

NOTE: This calculation is provided for educational purposes only. The type of assets transferred, the actual date of the gift, and other factors may have a material effect on the amount or use of your deduction. You are advised to seek the advice of your tax advisors before implementing a gift of this type.

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Appendix D



Charitable Gift Annuity for Two Lives - Immediate

Prepared for: Mark & Lila

A. Input Assumptions

Date of transfer	November 28, 2011
Fair market value of property transferred	\$250,000.00
Date of first payment	December 31, 2011
Annual annuity rate for immediate annuity	6.2%
Payment frequency	Quarterly
This table uses a hypothetical future discount rate of	2.20%
The mortality table is based on the census taken in	2000
Nearest age of Mark on the date of the gift is	80
Nearest age of Lila on the date of the gift is	78

B. Present Value of Remainder Interest - Immediate

1. Net fair market value paid for annuity	\$250,000.00
2. Annual annuity rate	6.2%
3. Annuity amount payable on an annual basis	\$15,500.00
4. Factor for present worth of a two life annuity (based on table R(2))	10.3673
5. Adjustment factor based on payment frequency from Pub. 1457, Table K	1.0082
6. Adjusted value of \$1.00 (Line 4 * Line 5)	10.4523
7. Adjusted annuity value (Line 3 * Line 6)	\$162,010.65
8. Excess of actual 1st payment over pro rata 1st payment (0 for pro rata first payment)	\$0.00
9. Present value of annuity (Line 7 + Line 8)	\$162,010.65
10. Minimum value of annuity (lesser of line 1 and line 9)	\$162,010.65
11. Present value of remainder interest (Line 1 - Line 10)	\$87,989.35

Depending on the type of asset you contribute, a portion of your payment may be taxable to you as a combination of ordinary income, long-term capital gain, and a tax-free return of principal. This report has been calculated assuming a contribution of cash. Each of your next **13.4** years payments of **\$15,500.00** will contain **\$12,090.35** of tax-free income and **\$3,409.65** of ordinary income. All income will be ordinary after **13.4** years.

We invite you to [contact us](#) for additional information regarding this gift instrument or your other gift planning options.

Note: In September, 2012, Mark and Lila would have to be 81 and 84-85 to get a 6.2% payout.

Appendix E



Helping Make Decisions That Make A Difference In Your Community

Charitable Gift Annuity for One Life - Deferred

Prepared for: Max

A. Input Assumptions

Date of transfer	November 28, 2011
Fair market value of property transferred	\$100,000.00
Date of first payment	December 31, 2026
Annuity starting date (payment period before 1st payment)	September 30, 2026
Annual annuity rate for immediate annuity	5.3%
Payment frequency	Quarterly
Deferred annuity interest adjustment factor	1.7896
Annual annuity rate adjusted for deferral	9.5%
This table uses a hypothetical future discount rate of	2.20%
The mortality table is based on the census taken in	2000
Nearest age of Max on the date of the gift is	50

B. Present Value of Remainder Interest - One Life Deferred

1. Age nearest to annuity starting date	65
2. Age nearest to date of transfer	50
3. Value of Dx from IRS Pub. 1457, Table H based on	
(a) Line 1 age	19984.37
(b) Line 2 age	31527.48
4. Line 3(a) divided by Line 3(b)	0.633871
5. Unadjusted value of \$1 of single life annuity from IRS Pub. 1457, Table S based on Line 1 age	14.0064
6. Adjustment factor based on payment frequency from Pub 1457, Table K	1.0082
7. Adjusted value of \$1 of single life annuity (Line 5 * Line 6)	14.1213
8. Value of \$1 of deferred single life annuity (Line 4 * Line 7)	8.9511
9. Annual annuity rate for deferred annuity	5.3%
10. Deferred annuity interest adjustment factor	1.7896
11. Deferred annuity rate (Line 9 * Line 10)	9.5%
12. Net fair market value paid for annuity	\$100,000.00
13. Annuity amount payable on an annual basis (line 11 * Line 12)	\$9,500.00
14. Present value of annuity (Line 8 * Line 13)	\$85,035.45
15. Minimum value of annuity (lesser of Line 12 and Line 14)	\$85,035.45

Appendix E

16. Present value of remainder interest \$14,964.55

Depending on the type of asset you contribute, a portion of your payment may be taxable to you as a combination of ordinary income, long-term capital gain, and a tax-free return of principal. This report has been calculated assuming a contribution of cash. Each of your next 19.9 years payments of **\$9,500.00** will contain **\$4,273.14** of tax-free income and **\$5,226.86** of ordinary income. All income will be ordinary after 19.9 years.

We invite you to [contact us](#) for additional information regarding this gift instrument or your other gift planning options.

NOTE: This calculation is provided for educational purposes only. The type of assets transferred, the actual date of the gift, and other factors may have a material effect on the amount or use of your deduction. You are advised to seek the advice of your tax advisors before implementing a gift of this type.

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