Flexible Deferred CGAs—A Poor Person's Trust

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Just last week three different clients asked us for advice on how they could help solve their donors' problems. All three clients had donors who wanted to give a large gift, but could not seem to do so because of a family "issue." In all three cases, the client had sensibly recommended a trust, but all three donors rejected a trust for a variety of reasons ("too damned expensive," "I hate lawyers," "just too complicated for me to understand."). We helped them solve their problems—and get a large gift—by suggesting a flexible deferred gift annuity, which, we have discovered, has far more uses that most of us have realized.

In most cases, we tend to think of flexible DCGAs as a method for donors in their 50s and 60s to supplement retirement income when they are uncertain when they might retire. And, indeed, a flexible DCGA is a marvelous way of accomplishing just such a goal, while making a significant gift. But a flexible DCGA can also work as a "poor person's trust" in several ways.

Flexible deferred CGAs are not as widely used as immediate payment CGAs or even as regular deferred charitable gift annuities in which the start date of the annuity payments is fixed in the contract. However, as more people defer retirement—or have other family needs-- and remain uncertain when they might actually need the additional income a CGA can bring, flexible deferred CGAs have grown in popularity. Although the donor must specify at the time of the gift the earliest possible start date for the annuity payments and, therefore, determine the income tax deduction to which he or she is entitled, the beneficiary can elect to defer the start date for an additional year or years. That ability to defer for additional years can continue for as long as the contract allows. For each year of deferral, the payout rate increases according to a schedule determined at the time of the gift and included as part of the original annuity contract.

What follows are the stories of the three donors who were able to solve their family problems through a flexible DCGA.

1. Using Flexible DCGA to Ensure the Comfort of a Second Spouse

Sam was 85 years old and had lived at Happy Acres Continuing Care Community for nearly 15 years. Sam was settled into his life and expected little in the way of surprises in his remaining years when Mabel moved in to the apartment down the hall. A widow herself, Mabel was only 69 but she found Sam an interesting and engaging dinner partner, and Sam found an energy he had not felt in years. Much to both Sam and Mabel's surprise, they found themselves married a year later. Sam had had plenty of income to care for their needs so long as he was living, but he was concerned that Mabel have a secure stream of income herself, should he die first. They both were philanthropic and wanted to thank Happy Acres for the gift of their new-found love.

Solution: Sam used 1000 shares of Apple stock he bought in the mid-1990's, when Apple was selling at \$80 a share, to fund a flexible DCGA for Mabel. Now trading at roughly \$310, his stock, which provided him with no dividend income, was valued at over \$300,000. By making a gift of the shares to Happy Acres in exchange for a flexible DCGA with Mabel as the beneficiary and by deferring for one year the date at which Mabel could, if she chose, begin receiving payments, Sam could accomplish everything he wanted. He received a nice charitable income tax deduction this year of roughly \$113,000. He feels assured that, should he die, Mabel would have instant access to a consistent and secure stream of income—6.1% after the first year, rising to 7.9% if Sam lived another five years and she deferred taking the income until she was 75—without having to wait for his estate to be settled. He locked in the value of his highly appreciated stock. And, he made a major gift to Happy Acres without cutting into his current cash flow one penny.

In this case, a Flexible DCGAs works as a simpler—and less expensive--version of a FLIP unitrust, but with no legal fees, no annual reporting requirements, no complicated documents. It has an added benefit that the beneficiary can exercise the option of beginning to receive payments in any year, including before the death of the donor if unforeseen circumstances make additional income appealing.

2. Using a Flexible DCGA to Care for a Dependent

Sara, now 75, has long cared for her 55 year old daughter Nancy financially. The two travel together and enjoy one another's company, but Nancy has never been able to manage money, and Sara reconciled herself years ago to the fact that she would have to support Nancy. Nancy's joyful outlook on life and the attention she pays to her mother on a daily basis have more than made up for her financial dependency. Both volunteer for several local charities, including the local soup kitchen and Habitat for Humanity. But Sara worries about what might happen when she dies as she does not want to leave Nancy a large sum of money all at once.

Solution: Sara rolled over \$500,000 worth of CDs into a flexible DCGA for Nancy with the local community foundation, and deferred the initial payment for at least five years. Her immediate income tax deduction is in the range of \$74,000, and Nancy will be able to receive a secure income stream of \$32,000 at age 60, or \$42,000 if Nancy waits to begin her payments at age 65, or \$55,500 if she waits until she is 70. Her income stream will not run out no matter how Nancy decides to spend the money. In the meantime, Sara also can provide a substantial long-term gift to the charities for which she volunteers, several of which operate on a shoestring and cannot afford a fundraising staff of their own.

3. Using a Flexible DCGA to Ensure Support for an Aging Parent

Bill and Louise have done well financially, especially since they both came from modest upbringings. Louise's mother is still alive at age 80, living in an assisted living facility not far from Bill and Louise's home. Bill and Louise visit her regularly and take her to dinner every weekend. They also pay for her care, since Louise's mother has few resources of her own. So long as Bill and Louise are able, they are happy to provide this support and look forward to their weekly dinners and regular visits. However, they worry that Louise's mother would be left destitute should something happen to them or should their financial circumstances change. They would like to ensure that Louise's mother has financial stability regardless of their own circumstances, and they would love to provide for a long-term gift to their alma mater, where they met.

Solution: Bill and Louise have a deferred commercial annuity they purchased some years ago for $200,000 that has grown in value to $300,000. They do not need the annuity for their own future income and would like to use it to care for Louise's mother. By cashing in the annuity, they must recognize the appreciation of $100,000 as ordinary income, but by putting the resulting $300,000 into a flexible deferred CGA, deferring the income for the minimum one year, they also generate an income tax deduction of roughly $153,000, more than enough to offset the tax owed from the cashing out of the commercial annuity. They also know that Louise's mother will have 7.7% of the $300,000 (or $23,100) available to her the following year, an amount that will grow to $30,000 if she waits for five years. Louise, who holds her mother's Power of Attorney, can elect any time to begin the flow of income to her mother, or, should Louise not be able to exercise that role, the successor POA can begin the stream of income.

Planned giving professionals have many options and opportunities available to them as they seek to marry solutions to donor problems with charitable intent. Finding ways to accomplish both without the donor having to choose between a personal financial goal and a desire to help charity will help most planned giving directors close more gifts. Flexible deferred charitable gift annuities are one vehicle that may have far more uses than we ever envisioned, as we discovered in our thinking about solutions to the issues posed by our own clients. We expect many more families have just such concerns and may also find flexible DCGAs to be a low cost, simple and effective solution to those concerns, while providing for charity at the same time.