Retirement Options: Is Charity at the Table?

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In mid-September, leading a discussion on creative ways of using flexible deferred CGAs at an advanced planned giving workshop, we asked the participants how many of them had a thriving CGA program. As you might imagine, most everyone raised his or her hand. Then we asked how many had a deferred program, and far fewer hands remained. When we asked how many promoted flexible deferred CGAs as an alternative retirement vehicle, only one hand remained.

On the very same day we facilitated this discussion, the *New York Times* published a much-forwarded article on the burgeoning field of commercial deferred annuities. The largest players in the business, the life insurance companies, are promoting their products to "typical buyers . . . in their mid-to-late 50s . . . [who] set a waiting period of 5 to 10 years." "At that age," enthused a senior managing director in charge of retail annuities at New York Life, "you [can] have a great retirement."

For those people in their mid-to late 50s and 60s, how to save for retirement and what to do with retirement plans when they do decide to retire are questions with which they are bombarded, sometimes daily, through e-mails and snail mail. Insurance companies and financial institutions are more than happy to extol the joys of a variety of commercial products—much to the benefit of a for-profit institution.

<u>It is time for non-profits to come to the retirement table</u>. To do so, charities need to consider some economic and generational shifts that make retirement planning so very different, complicated, and difficult when compared to only ten to fifteen years ago. Here are three cultural changes that are of particular interest to those of your donors who are from mid-50s to late-60s.—especially to those who have not yet retired (and thus, who have not yet purchased a commercial annuity before learning about charitable annuities).

1. <u>No More Pensions</u>:
   Most of your donors under 70 no longer have pensions (or a Defined Benefit Plan). As recently as 1998, 52 percent of Americans over age 60 received income from a defined benefit pension, according to a new study by the National Institute on Retirement Security (NIRS). By 2010, that figure had fallen to 43 percent. In the private sector, the

decline has been more dramatic – down from 38 percent in 1979 to 15 percent in 2010. The number of donors with pensions is growing fewer each day.

But for those lucky enough to have a healthy defined contribution plan, a 401(k) or 403(b) plan where an employer has matched an individual's contributions, that plan can be the largest asset in an individual's estate.

These defined contribution plans can be the most tax savvy gift a donor can make. As we know, spouses can be a beneficiary of a defined contribution with "no taxable occurrence"; in other words a spouse does not have to pay taxes at the time a deceased spouse's plan is rolled over into hers (or his). But we also know that anyone other than a spouse who is a beneficiary of a defined contribution plan will have to pay income tax—at the beneficiary's rate. No simple combining of the decedent's plan with that of the beneficiary is possible for a non-spouse beneficiary.

While financial institutions of all stripes are competing to manage your donor's defined contribution plan, where are the charities? We can count on one hand the marketing materials we have seen promoting non-profits as an ideal beneficiary (or partial beneficiary) of a retirement plan. Non-profits need to let their prospects and donors know the tax benefits of including a charity as a beneficiary in retirement plans.

2. <u>The Retirement Roll-Over into Commercial Annuities</u>
   For-profit companies are out in force—sending countless letters and e-mails to people in their mid to late 60s. As in the *New York Times'* article on deferred commercial annuities, these companies promote "the good life" by rolling over the prospect's plan through one of their products or services. Some of these companies seek to sell new products, like deferred commercial annuities, as supplements to IRAs and 401(k)s; some are urging clients to switch the management of their qualified retirement plans to their organizations or to consolidate various plans under one roof—theirs! Some are suggesting that clients change the investment criteria and formulae within their plans. But rarely do these for-profit companies offer options that include charitable giving.

   Where are the charities? Why aren't they promoting flexible deferred CGAs or Charitable Remainder Trusts to those donors who are still working? Insurance companies are blanketing the market with the benefits of a commercial annuity, including these three typical types and their general payout rates:

   Example #1: Purchasing a commercial annuity, with no remainder left when he dies, a 65 year old man, deferring for five years, would receive a return of roughly 9.5% on his initial investment. Imbedded in that plan, however, are annual fees averaging 1.36%, according to a recent Morningstar survey and a hefty commission from the initial investment as well.

Example #2: That same 65 year old could also purchase an annuity contract that would return at least the amount invested in the contract if the annuitant died prematurely, but the rate of return then drops to around 8%.

Example #3: That same 65 year old could purchase an annuity that would also provide for a payment to a surviving spouse of half the original amount, with the initial payments in the 9% range, but the survivor benefits would be less than 5%.

By contrast, flexible DCGAs are simpler and the rates, when tax deductions are included, make the charitable annuity and the commercial annuity far more comparable than they initially appear. If our 65 year old funded a deferred CGA, he would receive a nominal 5.9% at age 70, but the benefit of his tax deduction, if his tax rate is 39%, brings his effective return up to 7.1%. with no fees and no commissions.

The flexible DCGA has three additional benefits that make it more desirable than a commercial annuity:

- first, it allows the beneficiary to retain the ability to continue the deferral period in return for an increased payout;
- second, the contract can be funded with appreciated assets and some of the capital gain disappears because of the charitable remainder;
- Finally, the flexible DCGA will allow a full benefit to a surviving spouse with no reduction in the amount.

When tax benefits and internal fees are taken into account. a flexible deferred CGA can offer rates not that different from a commercial CGA, plus it can give a donor a tax deduction, tax-advantaged income, and an ultimate gift to a charity he or she supports (rather than income to a middle man at a for-profit company).

If charities do not begin marketing these ideas, many of their donors will roll over their plan into a commercial annuity with no beneficiaries and no remainder to anyone.

3. <u>Age 65 is no longer means retirement and golf</u>
The first boomers are only three years away from having to take a required minimum distribution on their 401(k), 403(b), and IRA plans. For those who grew up not trusting anyone over 30, the imminent approach of such an obvious signifier of “old age” can be daunting.

Some of your donors will not have put enough away for retirement and will need to work long into their 70s and, perhaps into their 80s just to make ends meet. Others fear they will not have enough retirement income. For those who fear they have not saved enough for retirement, but who do have considerable assets and retirement income, you can offer a CGA for a secure payment for life. Security is often the principal non-charitable benefit of a CGA, and, for many boomers (as for their older counterparts), CGAs offer returns considerably higher than the CDs or Money Market Funds that occupy such a high percentage of the investment portfolios of the most security-conscious donors. A CGA does not force these donors to choose between their philanthropic desires and their retirement security.

Other of your donors, who do have a comfortable retirement income, may well resist/resent taking the required minimum distribution: For those who do not want to take the required minimum distribution (and pay the resulting taxes), you can offer your organization as a beneficiary of their required distribution once they turn 70.5--or even before. Most gift planners are acutely aware of the opportunity to roll as much as $100,000 directly from an IRA to a charity without tax (at least in 2013) and to have that rollover count as the required minimum distribution. Whether this direct rollover will carry over into 2014 and beyond remains unclear, although it has been reaffirmed, even by an often contentious Congress, for many years in succession.

But what most of your donors do not understand is that the fate of the direct rollover should not keep them from giving to you through their retirement accounts. Donors can, at any age over 59.5, use their retirement plans as a vehicle for a charitable gift. This gift just requires two steps instead of one. By withdrawing from a retirement account, the donor, of course, incurs a new taxable income. But by turning around and contributing the same amount to charity, the donor receives an offsetting income tax deduction. We, as gift planners, would do well to remind our wealthier donors of this option.

Many donors in their mid-late 60's, 70's, or even 80's show no desire or intention of retiring in the traditional sense, but rather of continuing to work at professions they enjoy or changing to a new avenue of work as they age. Some, therefore, will continue to contribute to a 401(k) plan long after age 70.5 and can, as a result, delay having to take the required minimum distribution. Some simply have no idea when they might need increased income and want to retain control over the timing of their retirement income.

For these people, a deferred flexible CGA is a perfect vehicle. We have found an eager market for deferred flexible CGAs among these (at least in their minds), ageless boomers—especially for those who cannot predict their retirement. For many people, the knowledge that they *could* access an income stream at any time is worth as much as the income stream itself. And the idea of receiving an immediate tax deduction and recognition from the charities they care about is only added incentive.

The flexible DCAG can also be important for spouses whose connection to the charity may be more tenuous and who may fear that an outright gift will “undermine their long-term security.” We have participated in a number of gift transactions in which the deferred flexible CGA was key to overcoming spousal resistance. In those cases we suggested a DCGA to be created specifically for the more nervous spouse, thus allowing her (yes, it is usually a ‘her”) to retain control over the potential income from the gift, even though in almost all these cases, the concern for running out of money was far more psychological than real.

Finally, many of your donors in their 60s may want to make sure their children receive the benefit of whatever is left in their retirement plan but do not want their children to pay income tax on the gift. To those donors, we suggest funding a testamentary charitable remainder trust with their retirement plan to provide income for a set number of years to the children. This plan allows donors to avoid any tax, provide an income based on the full value of the plan, and direct an ultimate gift to charity as well.

Our donors are aging, even if they do not like it. The commercial brokers and financial management firms are already seated at the retirement table. They have picked up their forks and knives and the hors d’oeuvres have been served. If charities do sit down and participate in the discussion from the beginning, they will be left with only the scraps.