Charitable Gift Annuity for Wealth Preservation, Enhancement and Portfolio Diversification

Case Study Approach to Integrating Charitable Gift Annuities into Wealth Preservation, Wealth Enhancement and Portfolio Diversification

James E. Connell FAHP, CSA
Connell & Associates
Charitable Estate and Gift Planning Specialists

For copy of all slides & outline in download form and to sign up for newsletter
www.connellandassoc.com/articles

Philanthropy has many faces

- Communitarian 26%
- Devout 21%
- Investors 15%
- Socialites 11%
- Repayers 10%
- Altruists 9%
- Dynasts 8%

Source: Russell Prince study

Financial Planning Personal Concerns

- Lifestyle
- YOU
- family concerns
- age
- tax law changes
- Changes

Life cycle giving

Financial Life Charitable Life

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Stages of our Financial Life

Hierarchy of Needs

Life cycle giving

Gift Annuity – America’s Most Popular Life Income Program

Account for about 90% of the activity and 80% of the dollars in life income plans

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Stock Funded Gift Annuity
Capital Gain Impact

Gain = 0  Gain spread
Gift  Investment

Annuity

Gift Annuity Payment Taxation

Payment
Capital gain

Life expectancy

ACGA Annuity Rate Assumptions

- Life expectancy Annuity 2000 tables
- All annuitants female and 2 years younger than their actual ages
- Total investment return 5.50%
- Administrative expense of 1% per year
- Residuum to charity will be 50% of contribution

ACGA approved July 1, 2010 rate structure

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Candidates for Gift Annuity

1. Certificates of deposit are maturing…
   “Desires increased cash flow”
   Solution: Immediate Payment CGA

2. Corporate bonds are being called…
   “Desires lifetime payments”
   Solution: Immediate Payment CGA

3. Municipal bonds being called…
   “Desires tax-free payments”
   Solution: Immediate Payment CGA

4. Has excess life insurance policy
   “Desires conversion without taxes”
   Solution: Immediate payment CGA

5. Freeze value of appreciates stocks
   “Google Effect”
   Solution: Immediate payment CGA

6. Freeze value of stock that is declining
   “Enron Effect”
   Solution: Immediate payment CGA

7. Convert dividend income to fixed guaranteed payments
   “Dividend Converter and Extender”
   Solution: Immediate payment CGA

8. Tax-free exchange of fixed or variable annuity
   “Annuity converter”
   Solution: Immediate or Deferred CGA

9. Guaranteed payments for a younger spouse
   “May-December Annuity”
   Solution: Deferred CGA

10. Decrease my taxes NOW…
    I don’t need more income now…
    But I may need income if I change my
    life style or living arrangements
    “Zero Coupon Charitable CD”
    Solution: Deferred CGA
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2009 Survey of Gift Annuities

- 568 organizations, higher education bias
- 72% of immediate annuities are issued to donors 80 and older
- 9% of annuities issued to donors 70 or younger
- Most annuities are funded with cash, and for one life (72.4%)
- Average size vary widely by type of organization
  - College and Universities - $78,548
  - Arts organizations - $22,195
- $3+ billion currently under management
- Average number of CGAs issued 16, median 5
- 28% of programs started after 1999

Gift Annuity Donor Cycle

Beneficiary

Donor

Asset

Payment

Annuity

Types of Gift Assets

- Cash
- Securities
- Bonds - Corporate
- Bonds - Municipal
- Bonds - US Savings
- Real Estate
  - residence
  - vacation home
  - investment property
- Mutual Funds
- Life Insurance
- Variable Annuity
- Personal Property
- Business Interests
  - S-corp
  - C-corp
- Retirement Assets
  - IRA
  - Keogh
  - Pension & Profit Sharing plans
  - 401k, 403b plans

Annuity payment rates

<table>
<thead>
<tr>
<th>Single Life</th>
<th>Two Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of Donor</td>
<td>Payment Rate</td>
</tr>
<tr>
<td>60</td>
<td>5.20%</td>
</tr>
<tr>
<td>65</td>
<td>5.50%</td>
</tr>
<tr>
<td>70</td>
<td>5.90%</td>
</tr>
<tr>
<td>75</td>
<td>6.40%</td>
</tr>
<tr>
<td>80</td>
<td>7.20%</td>
</tr>
</tbody>
</table>

ACGA rates effective July 1, 2010

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Gift Strategies – Standard Deduction-2011

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Joint</th>
<th>Household</th>
<th>Married Separate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>$5,800</td>
<td>$11,600</td>
<td>$8,500</td>
<td>$5,800</td>
</tr>
<tr>
<td>65+</td>
<td>$7,250</td>
<td>$12,750(1)</td>
<td>$9,950</td>
<td>$6,950</td>
</tr>
<tr>
<td>Blind</td>
<td>$7,250</td>
<td>$12,500(1)</td>
<td>$9,950</td>
<td>$6,950</td>
</tr>
<tr>
<td>65+ Blind</td>
<td>$8,700</td>
<td>$13,600(1)</td>
<td>$11,400</td>
<td>$8,100</td>
</tr>
</tbody>
</table>

Gift Strategies – Cost of Gift

<table>
<thead>
<tr>
<th></th>
<th>A – Give Cash</th>
<th>B – Sell &amp; Give Cash</th>
<th>C- Give Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Tax savings (25%)</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$1,250</td>
</tr>
<tr>
<td>Capital gains tax savings $4,000 gain</td>
<td>$0</td>
<td>$600 paid</td>
<td>$600 saved</td>
</tr>
<tr>
<td>Total Tax Savings</td>
<td>$1,250</td>
<td>$650</td>
<td>$1,850</td>
</tr>
</tbody>
</table>

Gift Strategies – Proper Asset Selection

<table>
<thead>
<tr>
<th></th>
<th>Investment A</th>
<th>Investment B</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$0</td>
</tr>
<tr>
<td>Ordinary tax savings (25%)</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$0</td>
</tr>
<tr>
<td>Capital gains tax savings A $4,000 gain B $1,000 gain</td>
<td>$675</td>
<td>$150</td>
<td>A) $525 more</td>
</tr>
<tr>
<td>Total Tax Savings</td>
<td>$1,925</td>
<td>$1,400</td>
<td>A) $525 more</td>
</tr>
<tr>
<td>After tax cost of gift</td>
<td>$3,075</td>
<td>$3,600</td>
<td>B) $525 less</td>
</tr>
</tbody>
</table>

Gift Strategies Capital Gain Offset

<table>
<thead>
<tr>
<th></th>
<th>Tax Bracket</th>
<th>Capital Gain</th>
<th>Charitable Gift</th>
<th>Capital Gain Offset</th>
</tr>
</thead>
<tbody>
<tr>
<td>25%</td>
<td>15%</td>
<td>$1.00</td>
<td>$1.66</td>
<td></td>
</tr>
<tr>
<td>28%</td>
<td>15%</td>
<td>$1.00</td>
<td>$1.86</td>
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<tr>
<td>33%</td>
<td>15%</td>
<td>$1.00</td>
<td>$2.20</td>
<td></td>
</tr>
<tr>
<td>35%</td>
<td>15%</td>
<td>$1.00</td>
<td>$2.33</td>
<td></td>
</tr>
</tbody>
</table>
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April, 2011

Technical Considerations

- Donors in 25% or 28% Federal tax bracket
- Assumed Section 7529 rate, Charitable Mid-term Federal Rate = 3%
  - Lower rate = lower deduction
  - Lower rate = higher tax-free payment
- Cash deductible up to 50% of AGI
- Appreciated assets deductible up to 30% of AGI
- American Council on Gift Annuity rates unless noted
- All gifts qualify for the IRS required 10% charitable deduction (IRS Sec. 514(c)(5)).

Gift Strategies #1
Gift Annuity Income Enhancement - Cash

- Mr. Thomas, 67, receives pension income, social security payments, dividends from a few stock and interest from CDs. His cash flow has been declining as interest rates have fallen. CDs yielding only 2%.
- To increase cash flow he gifts $100,000 from a CD maturity to a hospital that treated his late wife.

Charitable Gift Annuity

Mr. Thomas - Age 67
5.60% Annuity

Property $100,000
Principal $100,000
Charity $50,000

Gift Strategies #1
Gift Annuity Income Enhancement - Cash

2. Annuity of $5,600.00 for one life. Tax-free amount $3,752.00. Estimated one-life payout of $108,640. Effective payout rate 7.7%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.

Prior to Gift

<table>
<thead>
<tr>
<th>Property invested</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>$2,000</td>
</tr>
<tr>
<td>Net spendable</td>
<td>$1,440</td>
</tr>
</tbody>
</table>

After the Gift

<table>
<thead>
<tr>
<th>Contributed</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual payment</td>
<td>$5,600</td>
</tr>
<tr>
<td>Ordinary income</td>
<td>$1,848</td>
</tr>
<tr>
<td>Tax-free*</td>
<td>$3,752</td>
</tr>
<tr>
<td>Income tax (28%)</td>
<td>$517</td>
</tr>
<tr>
<td>Net spendable</td>
<td>$5,083</td>
</tr>
<tr>
<td>Bonus savings</td>
<td>$8,764</td>
</tr>
</tbody>
</table>

252% increase in net spendable income plus one time bonus

2. Annuity of $5,600.00 for one life. Tax-free amount $3,752.00. Estimated one-life payout of $108,640. Effective payout rate 7.7%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.

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Gift Strategies #2
Gift Annuity Income Enhancement -Stock

- Mr. & Mrs. Wilson, 70/70 have been stock investors all their lives. They wish to convert some of their stock investments to more secure assets. They have several highly appreciated stock but most are returning only 2% in dividend payments.
- There CPA and investment advisor are concerned about the capital gains taxes as they will reduce the capital they have for reinvestment.
- Mr. Wilson had a recent emergency hospital admission and is very grateful for his cardiac care and the hospital has plans to remodel its cardiac unit.

Mr. Wilson - Age 70     Mrs. Wilson - Age 70
5.40% Annuity
Property $100,000
Principal $100,000
Charity $50,000

- Gift property to charity. Partial bypass $75,000 gain may open $2,784. Income tax deduction of $24,746 may save $6,929.
- Annuity of $5,400.00 for two lives. Tax-free amount $918.79. Estimated 2 lives payout of $117,720.
- Quarterly payments for two lives. Property passes to charity with no probate fees. There are also no estate taxes, if married.

Gift Strategies #3
Retirement Gift Annuity

- John, 60, a successful businessman is trying to save extra funds for retirement at age 70. He makes maximum contributions to his IRA and pension plan accounts.
- His long term goal is to endow a fund for a local charity to support community based health prevention activities.
- He has the ability to set aside $25k cash for the endowment but does not want to lose the economic value of the assets in case he needs it for retirement. He would also like to lock in some stock gains to fund his retirement.
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Gift Strategies #4
Capital Gain Offset - Annuity

Charitable Gift Annuity

Tom Jones - Age 67  Betty Jones - Age 67

Property $52,500

5.20% Annuity

Principal $25,250

Charity $26,250

1,500 share to annuity
Capital gain offset $20,128
805 shares sold for reinvestment

1. Gift property to charity. Partial bypass $34,500 gain may save $1,067. Income tax deduction of $10,822 may save $3,030.
2. Annuity of $2,730.00 for two lives. Tax-free amount $618.88. Estimated two lives payout of $66,612. Effective payout rate 6.4%.
3. Quarterly payments for two lives. Property passes to charity with no probate fees. There are also no estate taxes, if married.

Gift Strategies #5
Gift annuity to endow annual gift

Mrs. White - Age 80

Property $100,000

7.20% Annuity

Principal $100,000

Charity $50,000

One Life

1. Gift property to charity. Partial bypass of $50,000 gain may save $3,673. Income tax deduction of $48,977 may save $12,244.
2. Annuity of $7,200.00 for one life. Tax-free amount $2,714.82. Estimated one life payout of $73,440. Effective payout rate 9.6%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.

Prior to Gift
Invested in stock $100,000
Dividends 2,100
(2.1%)
Tax (28%) $588
Net spendable 1,512
Capital gift 3,488

After Gift
Annuity $100,000
Payment 7,200
Net after tax 6,295
Gift amount $5,000
Net $1,295
Bonus + $13,713

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Gift Strategies # 6a
Mother established annuity for daughter
Gift annuity offset

Charitable Gift Annuity

Nora Jones - Age 60
5.20% Annuity

Property $10,000
Principal $10,000
Charity $5,000
One Life

Offsets $3,997 capital gain
$7,851 life interest for daughter, retain right to revoke, no completed gift

1. Gift property to charity.
   Gift annuity contract with fixed payments.
   Income tax deduction of $2,149 may save $602.

2. Annuity of $520.00 for one life.
   Tax-free amount $326.04.
   Estimated one life payout of $13,104.
   Effective payout rate 6.9%.

3. Quarterly payments for one life.
   Property passes to charity with no probate fees.
   There are also no estate taxes.

Gift Strategies # 6b
Mother established annuity for son
Stock gift, Gift annuity offset

Charitable Gift Annuity

Son Buddy Jones - Age 65
5.50% Annuity

Property $10,000
Principal $10,000
Charity $5,000
One Life

Cost basis $5,000
Capital Gain offset $5,228
Reportable gain $3,599
Reportable gift $7,199

1. Gift property to charity.
   Partial bypass $5,000 gain may save $210.
   Income tax deduction of $2,801 may save $784.

2. Annuity of $550.00 for one life.
   Tax-free amount $361.90.
   Estimated one life payout of $11,550.
   Effective payout rate 7.5%.

3. Quarterly payments for one life.
   Property passes to charity with no probate fees.
   There are also no estate taxes.
   Retain right to revoke, no completed gift

Gift Strategies # 7
Savings bond, annuities, life insurance converted to Flexible Deferred CGA

n Saving bonds
  n 30 year maturity
  n Accumulated interest taxable
n Life insurance policy
  n No longer need policy for original purpose
  n Accumulated dividends taxable
n Commercial annuities, variable annuities
  n Accumulations taxable

Gift Strategies # 7
Savings bond, annuities, life insurance converted to Flexible Deferred CGA

Deferred Gift Annuity

John West - Age 65
First Payment on December 31, 2015
Annuity Amount of $1,725

Initial Amount $25,000

Flexible Annuity Options
Payout at Age 65
$1,725.00
Payout at Age 75
$2,350.00

Deferred Gift Annuity

Charity $12,500
One Life

1. Property transferred to charitable organization.
   Total tax deduction of $8,873 may save income taxes of $2,485.

2. Annuity payout of $1,725 distributed for one life.
   Tax free payout $990.15.
   Estimated one life total payouts are $28,118.

3. After annuity payments distributed to annuitant,
   approximate remaining value given to charity.

Flexible Annuity Options
Payout at Age 65 $1,725.00
Payout at Age 75 $2,350.00
Charity $12,500

$5,000 bond cost $2,500, FMV $10,236, Interest $7,736

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Gift Strategies # 7
Commercial annuities

DOB February 25, 1941,
age 69, Married

Assets:
- 2 USAA annuity contracts
- # 1 FMV $23,988
  - Taxable gain $13,988
- # 2 FMV $17,057
  - Taxable gain $7,057

Total assets: $41,045
Total gain: $21,045
AGI $175,000
Tax rates 33%, 15%

Charitable intent
Cash in annuity assets
Offset gain with charitable gifts
Possible immediate or future income
No income for spouse
Other charitable gifts this year

Deferred Gift Annuity

Allan W - Age 69
First Payment on December 31, 2015
Annuity Amount of $3,504.16

Gift Strategies # 8
Commercial annuities

Zero Coupon Charitable CD

Decrease my taxes now...I do not need more income now...but may need income if I change my living arrangements

"Zero Coupon Charitable CD"
Solution: Deferred CGA for seniors

70 year old donor, with $100,000 in appreciated stock could receive 8.4% in 2016, but deduction today = $49,851 or $12,463 tax saving

Deferred Gift Annuity

Mary Teacher - Age 70
First Payment on December 31, 2016
Annuity Amount of $8,400

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Gift Strategies #9
Lifetime partnership or May/December annuity

- Bill, 72, is concerned about providing economic support for his spouse Sara, 59 once he dies
- Sara will lose payments from his pension
- Bill and Sara could use an income tax deduction this year to offset taxes on required minimum withdrawals from Bill IRA
- Stock portfolio is underperforming
- Solution: Deferred gift annuity with options

Deferred Gift Annuity
Bill O’Brien - Age 72 Sara O’Brien - Age 59
First Payment on December 31, 2019
Annuity Amount of $8,000

Flexible Annuity Options
- Annual Annuity Option
- Payment Age 75/70
- $15,000 - $20,000
- Lifepool Annuity Option
- Payment Ages 74/61
- $4,518.36
- Payment Ages 90/77
- $13,200.00

Gift Strategies #10
Dividend substitute, major gift

- Donors 70/70
- 2,200 shares, ExxonMobil
- FMV $154,000, Cost $75,000
- Dividend 2.3%
  - $3,696 gross
  - $3,141 after tax
- Strategy: 1,000 share = gift, $70,000
  1,200 shares = two-life gift annuity
Gift Strategies #11 - Gift annuity with wealth replacement

Charity → Age 65 → Insurance $100,000** → Annuity → Heirs

$100,000 Cash

5.50% after tax
$4,973*

2010 ACGA rate

**premium $1,977 - $2,561 permanent life

Gift Strategies #11 - What is the cost to purchase $100,000 of permanent life insurance from after tax payment from a $100,000 gift annuity?

<table>
<thead>
<tr>
<th>Sex/Age</th>
<th>(Income*)</th>
<th>$100,000 Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Female 60 ($4,656)</td>
<td>$1,179 - $1,470</td>
<td></td>
</tr>
<tr>
<td>Male 65 ($4,973)</td>
<td>$1,977 - $2,561</td>
<td></td>
</tr>
<tr>
<td>Male 70 ($5,300)</td>
<td>$2,681 - $3,484</td>
<td></td>
</tr>
<tr>
<td>Joint 65/65 ($4,596)</td>
<td>$1,263 - $1,507</td>
<td></td>
</tr>
<tr>
<td>Joint 70/70 ($4,916)</td>
<td>$1,569 - $1,962</td>
<td></td>
</tr>
</tbody>
</table>

* After tax income in 28% Federal tax bracket, 2010 ACGA rates

Gift Strategies #11 - How much insurance can be purchased with the after tax payment from $100,000 gift annuity?

<table>
<thead>
<tr>
<th>Sex/Age</th>
<th>(Income*)</th>
<th>Insurance Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Female 60 ($4,656)</td>
<td>$275,732</td>
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</tr>
<tr>
<td>Male 65 ($4,973)</td>
<td>$173,809</td>
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</tr>
<tr>
<td>Male 70 ($5,300)</td>
<td>$139,357</td>
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<tr>
<td>Joint 65/65 ($4,596)</td>
<td>$283,758</td>
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<tr>
<td>Joint 70/70 ($4,916)</td>
<td>$229,248</td>
<td></td>
</tr>
</tbody>
</table>

* After tax income in 28% Federal tax bracket, 2010 ACGA rates

Gift Strategies #12 - Gift annuity for 85% real estate

- Rannow’s vacation home value $440,000
- Rannow’s annuity value $374,000
- Age 80 payment rate 7.5%
- Fixed guaranteed lifetime payments
- Payment amount $21,920 with $14,945 tax-free
- Lifetime $223,584
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Gift Strategies # 13
Gift annuity for 85%, real estate

- Double deductions
  - Discount of $66,000
  - Annuity of $128,670
  - Total deductions $194,670 @30% of AGI
- Tax savings @ 33% = $64,241

Gift Strategies # 13
Super flexible CGA

- Roger, 50, not knowing when he wishes to retire and concerned about future health issues that might force early retirement does not wish to pre-commit to a fixed date for starting annuity payments.
- To maximize flexibility Roger simultaneously establishes 10 flexible deferred gift annuities each funded with $10,000 in appreciated stock, with option to begin payments between age 61 to 71.

Gift Strategies # 13
Super flexible CGA

- Roger decides to turn two agreements on at age 62, three at age 65 and one each year beginning at age 66.
- Charitable deduction $10,800 (CMFR 2.6%)

Beginning age | Payment
---|---
62 | $1,780
65 | $4,930
66 | $6,030
67 | $7,200
68 | $8,450
69 | $9,770
70 | $11,150

Gift Strategies # 14
Security and inflation

- Mildred, 65, wants her payments to increase with anticipated inflation for the next eight years
- She has $125,000 available for gifting
Charitable Gift Annuity for Wealth Preservation, Enhancement and Portfolio Diversification

April, 2011

Gift Strategies # 14
Security and inflation

<table>
<thead>
<tr>
<th>Type</th>
<th>Amount</th>
<th>Begin Date</th>
<th>Payment</th>
<th>Total</th>
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</thead>
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<tr>
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<td>12/31/2010</td>
<td>$5,500</td>
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<td>12/31/2012</td>
<td>$199</td>
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<td>12/31/2013</td>
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<td>$213</td>
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<td>$245</td>
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Gift Strategies # 15
Charitable reverse mortgage

- It is possible to give the remainder interest in a home for a gift annuity.
- Donor continues to live in the home and receive payments
- Donor pays all expenses
- Charity must front payments and assumes longevity risk

Gift Annuity For Home

Dr. Johnson - Age 74    Mrs. Johnson - Age 75
Annuity $22,041.43

Property $750,000
Remainder Value $400,753
Charity $750,000

1. Owner remains in home to
   2. Owner pays insurance and
   3. Owner pays property and
   4. Owner pays property and
   5. Owner pays property
   6. Owner pays property
   7. Owner pays property

Gift Strategies # 16
Gift annuity for survivor

- Gift annuity like a charitable trust may be established at the end of life to provide payments to survivors. Maximum two beneficiaries
- "I give...the sum of .......to (Charity) provided if (annuitant) survives me, (Charity) shall pay to (him/her) in quarterly installments a life annuity, the annual payments shall be equal to the value of the property transferred to (Charity) multiplied by the charitable gift annuity rate suggested as of the date of my death by the American Council on Gift Annuities for a person their age."
- Testamentary CGA may be funded with IRA or other retirement assets

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 .... Fax 910-295-6866
“Building Endowments for American Charities”
Substantiating charitable gifts

- Close is not good enough
- Gifts under $250, donor must have a bank record or written communication from charity with name, date and amount of gift
- Over $250, donor must have written receipt and include a statement that no goods or services were received in return for the transfer
- Over $500 donor must file 8283 for personal property gifts
- Over $5,000 donor must file 8283 and have appraisal of personal property but not securities

Case Study Approach to Integrating Charitable Gift Annuities into Wealth Preservation, Wealth Enhancement and Portfolio Diversification