

# Taxation of a Charitable Gift Annuity

Payments received from charitable gift annuities are taxed in the same manner as commercial annuities, i.e., using the annuity exclusion ratio. However, many individuals prefer the fixed, predictable income and upfront income tax deduction received when funding a gift annuity. This often gives them an advantage over payments from pooled income funds or charitable remainder trusts, from which the income may be fully taxable.

A portion of each payment from an annuity is considered to be a return of principal and is, therefore, exempt from income tax. Also, when funded with appreciated property, a portion of the payment will be taxed at capital gains rates.

## Payment Allocation

The chart below illustrates the allocation of payments from a charitable gift annuity as various types of income. The examples are based on the following set of assumptions:

Amount contributed: \$100,000

Payout rate: 5.8%

Age of beneficiary: 75

Applicable federal rate (AFR): 2.4%

### Assuming a Cash Contribution of \$100,000

| Years      | Annual Income | Ordinary Income | Exempt Income | Long-Term Capital Gain |
|------------|---------------|-----------------|---------------|------------------------|
| 1          | \$5,800       | \$1,427         | \$4,373       | \$0                    |
| 2-12       | \$5,800       | \$1,427         | \$4,373       | \$0                    |
| 13         | \$5,800       | \$4,051         | \$1,749       | \$0                    |
| Thereafter | \$5,800       | \$5,800         | \$0           | \$0                    |

### Assuming a Stock Contribution with Basis of \$50,000

| Years      | Annual Income | Ordinary Income | Exempt Income | Long-Term Capital Gain |
|------------|---------------|-----------------|---------------|------------------------|
| 1          | \$5,800       | \$1,427         | \$2,187       | \$2,187                |
| 2-12       | \$5,800       | \$1,427         | \$2,187       | \$2,187                |
| 13         | \$5,800       | \$4,051         | \$875         | \$875                  |
| Thereafter | \$5,800       | \$5,800         | \$0           | \$0                    |

**Note:** The donor will also receive a current income tax deduction of approximately \$45,772.

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### Appreciated Capital Assets

Appreciated capital assets held long-term may be exchanged for a charitable gift annuity without taxation of the unrealized capital gain at time of transfer (much like a charitable remainder trust) unless an income beneficiary other than the donor and his or her spouse is named. In such cases, the full, unrealized gain is taxable to the donor/grantor.

### Seek Professional Guidance

Because of the complexity involved, the advice and guidance of appropriate tax, legal, and other financial professionals is highly recommended.