

# ADMINISTRATIVE PRACTICE LETTER

Section V -D  
Issue 2  
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Effective 7/14/06

## SUBJECT: CHARITABLE GIFT ANNUITIES

### OVERVIEW

A Charitable Gift Annuity (CGA) is an irrevocable contract in which a donor transfers cash or property to a charity in exchange for a commitment by the charity to pay up to two beneficiaries a fixed and guaranteed periodic payment for the remainder of the beneficiaries' lifetimes. The annuity payments can either begin immediately or be deferred for a period specified by the donor. CGAs are available to all campuses and are administered centrally by the University of Maine System (UMS) Office. A charitable gift annuity is considered a general obligation of UMS, and the present value of the future annuity payments to the beneficiaries is recorded as a liability. The difference between the assets transferred from the donor and the related annuity liability is recognized as the contribution. Annuity payments must be made regardless of actual earnings or the remaining principal balance of the gift annuity.

Annuity rates may be negotiated but are generally calculated to net at least fifty percent of the original principal balance to the charity upon termination of the contract. UMS uses the American Council on Gift Annuities suggested rates. The rates offered to the donors depend on the age of the beneficiaries, the date of the gift, and the date income is scheduled to begin. Usually there are no restrictions on the residuum other than to the campus of choice. Should the donor want to restrict the residuum further, the respective campus' administration and the System-Wide Services Office of Finance & Treasurer (OFT) shall be consulted and an addendum shall be attached to the Agreement.

### BENEFITS TO DONOR

- Provides a fixed income stream for the life of up to two beneficiaries.
- Gives an immediate federal income tax charitable deduction to the donor.
- Annuity payments are only partially subject to income tax.
- May result in reduced probate and estate taxes.
- Provides a means to meet charitable objectives. Allows donation of a small gift that may not justify more complicated arrangements.

### GIFT ACCEPTANCE CRITERIA

- The minimum gift shall be \$10,000 for a current annuity and \$5,000 for a deferred annuity. The minimum additional charitable gift annuity (separate contract) from the same donor is \$2,500.
- The Agreement is written for the fair market value of the gift transferred.
- The minimum beneficiary age for a current annuity shall be 60 and for a deferred annuity, 50.

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- For a two-life gift annuity, the younger beneficiary must be at least 60 years of age.
- The annuity contract shall be written for one or two beneficiaries only.
- UMS uses the American Council on Gift Annuities suggested rates, or lower rates, if the donor agrees.
- Acceptable gift assets include: cash, appreciated securities and in rare cases, marketable real property.
- The donor may specify the use of the residuum (gift can be restricted).
- The UMS or one of its universities is the sole remainderman.
- The entire gift shall be invested until the demise of the last income annuitant with a unique account number and contract number.

### TYPES OF GIFT ANNUITIES

**CURRENT** – A current gift annuity begins to make payments to the beneficiaries at the end of the payment period immediately following the date of contribution. The first payment is prorated from the later of the date of the contribution or the date of the signing of the disclosure statement to the end of the first period. This payment will typically be a smaller amount than subsequent payments.

**DEFERRED** – With a deferred gift annuity, the payments to the beneficiaries begin on a future date determined by the donor and set forth in the gift annuity contract. This date must be more than one year after the date of contribution. Because the payments are deferred, the beneficiaries will receive a higher income.

### ADMINISTRATION

Gift annuity gifts are invested as part of the UMS Endowment Fund. The System-Wide Services (SWS) Accounting Department is responsible for making the annuity payments to the beneficiaries by the payment due dates and for issuing the 1099R annual tax forms. Payments to beneficiaries are made no more frequently than quarterly.

The tracking of donor/beneficiary addresses and other maintenance of the donor gift annuity database are performed by staff in OFT. Additionally, OFT staff will prepare the CGA proposals (**Exhibit I**) that development officers provide to donors when discussing CGAs. The OFT staff also prepares the Gift Annuity Agreements/Schedule A (**Exhibit II**) and Disclosure Statements (**Exhibit III**) that are provided to donors after an agreement has been reached.

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Neither the development officers, OFT staff, nor any consultant who may be involved should provide tax, estate or financial planning advice to potential donors or beneficiaries. The development officer should advise the donor to contact a Financial Advisor or attorney prior to engaging in a CGA.

The University of Maine System's Charitable Gift Annuity Program was developed in accordance with Maine law, and is substantially compliant with the regulatory requirements of most other states. Because there is no federal code that regulates charitable gift annuities and the various state laws are varied and evolving, UMS will exert its best efforts to be in substantial compliance with the laws of the various states in which UMS's charitable gift annuity donors are domiciled.

### PROCEDURES

When development officers receive an inquiry from a potential CGA donor, they should complete a Charitable Gift Annuity Application (**Exhibit IV**), which facilitates the collection of the information required for the purpose of preparing a proposal.

If the donor insists on further restrictions on the gift (in addition to having the residuum benefit a specific campus), the development officer should consult with appropriate campus administrators (including the campus President) and the OFT for approval of the requested restriction. Upon approval, a Gift Annuity Addendum should be prepared (see **Exhibit V** for sample). The gift annuity application should then be sent to the OFT for the preparation of a Gift Annuity proposal. Several proposals may be required before the development officer reaches an agreement with the donor.

After the donor has accepted a proposal, copies of the final Charitable Gift Annuity application, and the Addendum (if any) should be sent to the OFT.

If the donor will be using securities to establish the gift annuity, the development officer should contact the donor's broker to transfer the securities to the UMS account at E\*TRADE (see APL #53). The amount of the gift for the purpose of the Charitable Gift Annuity Agreement is the average of the high and the low selling price of the security on the date of transfer. The date of transfer is the date the securities are electronically transferred to the UMS account at E\*TRADE, or the date paper certificates are delivered to the development officer (see APL #53). Development officers should contact the OFT for specific stock trade details (e.g., date of transfer, net proceeds).

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The Office of Finance and Treasurer will send the following to the campus Development Officer:

- The original Gift Annuity Agreement signed by the Chief Financial Officer and Treasurer (if the annuity is to be funded with stock, the Gift Annuity Agreement cannot be prepared until the stock transfer has taken place. This is because the value of the stock on the date of transfer is the value that is used to establish the value of the gift in the Gift Annuity Agreement.)
- Schedule A (which lists the amount and type of assets to be contributed),
- An Addendum (if applicable),
- An unsigned Disclosure Statement
- Two color copies of the CGA proposal.

After the university development officer receives the donor's check or stock transfer, the Development Officer:

- Will give the donor the original Gift Annuity Agreement and Schedule A
- Will have the donor(s) sign the Disclosure Statement and the Addendum (if applicable)
- Provide the donor with a copy of the Disclosure Statement and Addendum.

The development officer then forwards any gift annuity funds to the Office of Finance and Treasurer by certified mail along with the original signed Disclosure Statement and any applicable Addendum.

The university development officer will send an acknowledgement letter to the donor as soon as possible after all paperwork has been completed.

### **ANNUITY PAYMENTS**

Annuity payments will be made no more frequently than quarterly. Payment dates for the UMS charitable gift annuity program are September 30, December 31, March 31, and June 30.

## ADMINISTRATIVE PRACTICE LETTER

### SUBJECT: CHARITABLE GIFT ANNUITIES

Payments for current gift annuities shall begin at the end of the payment period immediately following the date of the contribution. The SWS Accounting Department will ensure that annuity payments are mailed to arrive by the payment due date. The check stub will indicate the annuity number for which the payment is being made. The first payment (usually a prorated amount) for each annuity will be mailed to the respective campus development officer. The development officer should send a letter to the donor along with the payment which explains that the first payment is a pro-rated payment, what the subsequent periodic payments will be (as reported in the Gift Annuity Agreement), and that future payments will be mailed directly to the beneficiaries from the SWS Accounting Department. The prorated amount is computed using the later of:

- the date the Disclosure Statement is signed; or
- the date of transfer and determining the number of days to the end of the first payment period.

Development Officers must communicate any donor address changes to the Finance Office.

When word is received of the annuitant's/beneficiary's death, the development officer should request a death certificate from the family or personal representative. If the income annuitant/beneficiary dies on or after the payment due date, the payment belongs to the beneficiary. If the income beneficiary dies prior to the due date but after the payment has been mailed, insurance regulations require that a reasonable effort must be made to retrieve a refund from the donor's estate. Once a death certificate is received, the remainder of the annuity shall be distributed to the UMS entity so designated in the Agreement.

**Exhibit VI** provides a checklist of steps for establishing a Charitable Gift Annuity.

#### **Related Documents:**

[Policy 706 Acceptance of Gifts, Development Activities and Fund Raising Campaigns](#)

**APPROVED**

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**Chief Financial Officer and Treasurer**

# Charitable Gift Annuity

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**Prepared For**

**Mrs. Sample T. Smith**

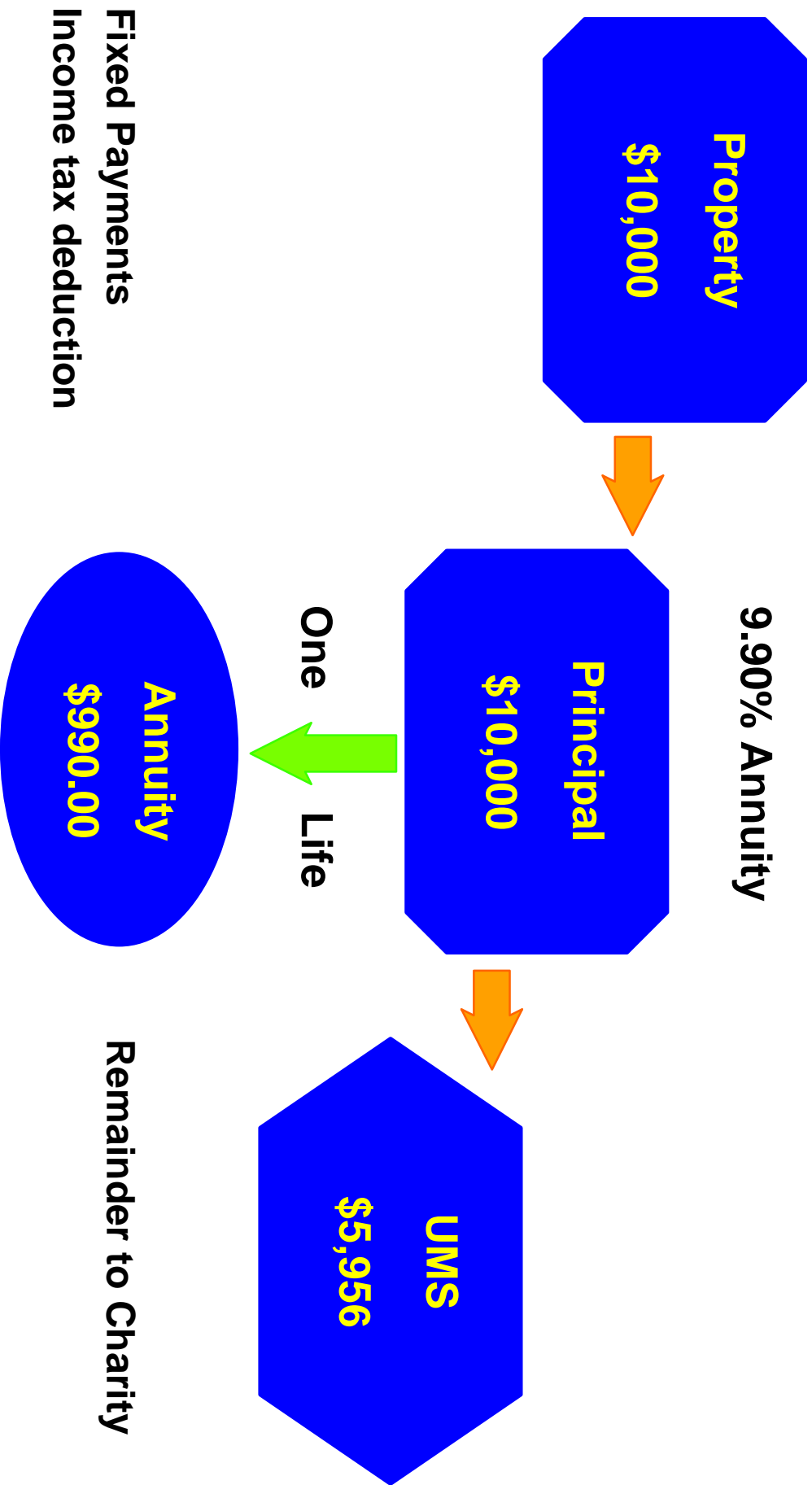
**A SERVICE PROVIDED BY**

**University of Maine System  
Office of Finance and Treasurer  
16 Central Street  
Bangor, ME 04401  
Phone 207-973-3355  
mhh@maine.edu**

**This illustration is offered as a service.  
Please feel free to call for further assistance.**

# Charitable Gift Annuity

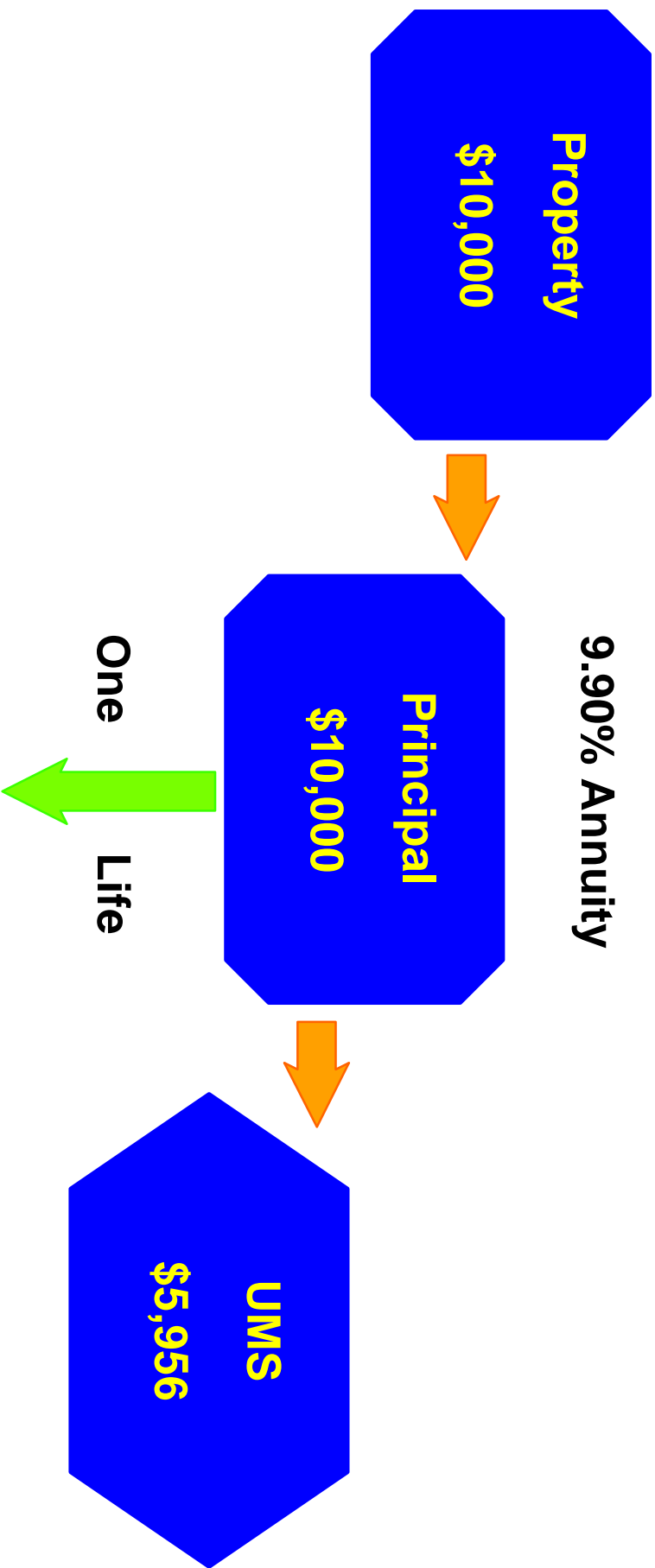
Mrs. Sample T. Smith - Age 86



# Charitable Gift Annuity

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Mrs. Sample T. Smith - Age 86



1. Gift property to charity. Donor receives contract for annuity payments. Income tax deduction of \$5,454 may save \$818.
2. Annuity of \$990.00 for one life. Tax-free amount \$710.82. Estimated one life payout of \$7,029. Effective payout rate 12.1%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.

## CHARITABLE GIFT ANNUITY

FIRST PERSON      Mrs. Sample T. Smith      AGE 86

GIFT AMOUNT	<u>\$10,000.00</u>
CHARITABLE DEDUCTION	<u>\$5,453.52</u>
ANNUITY OF 9.900%	<u>\$990.00</u>
TAX FREE	<u>71.80%</u>
EFFECTIVE ANNUITY RATE	<u>12.1%</u>

### INCOME TAX INFORMATION

	QUARTERLY PAYMENT	ANNUAL TOTALS
Ordinary Income		\$279.18
Capital Gain Payout		\$0.00
Tax Free*		<u>\$710.82</u>
<b>ANNUITY AMOUNT</b>	<u>\$247.50</u>	<u>\$990.00</u>

\* Tax Free Until 2012

# CHARITABLE GIFT ANNUITY

The Charitable Gift Annuity is a combination of a gift to charity and an annuity. For senior persons, annuity rates may be 8%, 9% or even higher. Since part of the annuity payment is tax-free return of principal, the gift annuity may provide the annuitant with a substantial income. The combination of partially tax free income and the initial charitable deduction makes this agreement quite attractive. And after all payments have been made for the life of the annuitant, a favorite charity will benefit from the charitable gift.

## **Partly Tax Free Payments**

A gift annuity is a contract between the charity and the individual. The individual, referred to as the donor, transfers property to the charity and the charity promises to pay a given amount at the end of each selected payment period to one annuitant for life or two annuitants for both lives. Part of the payment is interest earned and is taxable as ordinary income. Part of each payment is return of principal and is tax free. However, if an annuitant survives past his or her life expectancy, all later annuity payments will be ordinary income.

## **Gifted Property**

Cash or appreciated property may be transferred to charity in exchange for a gift annuity. With appreciated property, a portion of the capital gains tax is avoided. Part of the gain is allocated to the charitable gift amount and there is no capital gains tax on that portion. The rest of the gain is allocated to the annuity portion and is taxed each year over the projected life expectancy of the annuitant. Since the tax is spread out over the life of the annuitant, and the annuitant is receiving in part tax free income, the transfer of appreciated property in exchange for a gift annuity can generate very favorable results.

## **Fixed Payments**

Gift annuities are most attractive to senior persons. The annuity amount is fixed and will not change regardless of current investment or market conditions. Since the more senior person is probably more easily able to plan for the future with a fixed payment, the gift annuity seems most appropriate for a senior individual.

# CHARITABLE GIFT ANNUITY

## One Life

Election: IRC Sec. 7520(a) election made using May 5.8% AFR

Donor Mrs. Sample T. Smith Gift Amount \$10,000.00 Gift Date 07/03/2006  
 First Person Mrs. Sample T. Smith Birth Date 04/23/1920  
 Date of 09/30/2006  
 Cost Basis \$10,000.00 First Ann. Payment  
 Payment Freq. QUARTERLY (Payments at End of Selected Period)

<b>Annuity %</b>	<u>9.900</u> %																
(A) Annual Annuity Payout	<u>\$990.00</u>	(A)															
Gift Amt. x Annuity %																	
(B) Factor      Age      86	<u>4.4957</u>	(B)															
(IRS Pub. 1457, Table S)																	
AFR of the Month <u>5.8%</u>																	
(C) Adjustment for time of Payment	<u>1.0215</u>	(C)															
(IRS Pub 1457, Table K)																	
	<table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th colspan="3">End of Period</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">1</td> <td style="text-align: center;">1.0000</td> <td style="text-align: center;">Annual</td> </tr> <tr> <td style="text-align: center;">2</td> <td style="text-align: center;">1.0143</td> <td style="text-align: center;">Semi-Annual</td> </tr> <tr> <td style="text-align: center;">3</td> <td style="text-align: center;">1.0215</td> <td style="text-align: center;">Quarterly</td> </tr> <tr> <td style="text-align: center;">4</td> <td style="text-align: center;">1.0263</td> <td style="text-align: center;">Monthly</td> </tr> </tbody> </table>	End of Period			1	1.0000	Annual	2	1.0143	Semi-Annual	3	1.0215	Quarterly	4	1.0263	Monthly	
End of Period																	
1	1.0000	Annual															
2	1.0143	Semi-Annual															
3	1.0215	Quarterly															
4	1.0263	Monthly															
(D) Adjusted Factor	<u>4.5924</u>	(D)															
Line (B) x Line (C)																	
(E) Present Value of Annuity	<b><u>\$4,546.48</u></b>	(E)															
Line (D) x Line (A)																	
(F) Amount Transferred	<b><u>\$10,000.00</u></b>	(F)															
(G) CHARITABLE GIFT VALUE	<b><u>\$5,453.52</u></b>	(G)															
Line (F) less Line (E)																	

7/1/2006 ACGA Rates

# CHARITABLE GIFT ANNUITY

## One Life

(H) Unadjusted Expected Return Multiple (Reg.Sec. 1.72-9, Table V)	6.5	(H)
(I) Adjustment if Not Monthly (Reg.Sec. 1.72-5(a)(2))	-0.1	(I)
(J) Adjusted Expected Return Multiple Line (H) Plus Line (I) Sec. 72 Exp.6.4 -- Uniform Table Expectancy 7.1	6.4	(J)
(K) Expected Return Line (J) Times Line (A)	\$6,336.00	(K)
(L) EXCLUSION RATIO Line (E) Divided By Line (K)	71.8%	(L)
(M) Amt Excluded From Ordinary Taxation Exclusion Ratio Times Annuity Line (L) Times Line (A) (I.R.C. Sec. 72(b)(3))	\$710.82	(M)
(N) Basis Allocated to Annuity Basis Times Line (E)/GIFT	\$4,546.48	(N)
(O) Gain Allocated to Annuity Line (E) Less Line (N)	\$0.00	(O)
(P) Gain Each Year Line (O) Divided By 6.4 (Not to Exceed Line (M); Assumption: Separate Prop. of First Ben.) (Reg.Sec. 1.1011-2(a)(4))	\$0.00	(P)

### SUMMARY OF ANNUITY

CHARITABLE DEDUCTION	\$5,453.52		
EXCLUSION RATIO UNTIL 2012	71.8%		
INCOME	PRO RATA	EACH	ANNUAL
<u>TAX</u>	<u>FIRST PAYMENT</u>	<u>PAYMENT</u>	<u>PAYMENT</u>
Ord.Income	\$68.79	\$69.7950	\$279.18
Cap. Gain	\$0.00	\$0.0000	\$0.00
Tax Free	\$175.15	\$177.7050	\$710.82
Ann. Amt	\$243.94	\$247.50	\$990.00

# CHARITABLE GIFT ANNUITY

First Person Mrs. Sample T. Smith Birth Date 4/23/1920 Gift Date 7/3/2006  
 Date of 9/30/2006  
 Cost Basis \$10,000.00 Gift Amount \$10,000.00 First Ann. Payment  
 Payment Freq. QUARTERLY (Payments at End of Selected Period)

## Effective Equivalent Annuity Rate Calculation

(A) Annual Annuity	<u>\$990.00</u>	(A)
(B) Exclusion Ratio	<u>71.8%</u>	(B)
(C) Excluded Amount	<u>\$710.82</u>	(C)
Line (A) x Line (B)		
(D) Capital Gain Each Year	<u>\$0.00</u>	(D)
Tax Rate 8.00%		
(E) Equivalent Amount of Ordinary Income	<u>\$0.00</u>	(E)
(F) Return of Principal Each Year	<u>\$710.82</u>	(F)
(G) Equivalent Amount of Ordinary Income (Line F / (1-15.00% Tax Rate))	<u>\$836.26</u>	(G)
(H) Total Equivalent of Ordinary Income	<u>\$1,115.44</u>	(H)
(I) Effective Amount Transferred (Gift Amount Less Tax Savings)	<u>\$9,182.00</u>	(I)
(J) Effective Equivalent Annuity Rate (Line H/Line I) (Compared to Taxable Investments)	<u>12.15%</u>	(J)
(K) Effective Equivalent Annuity Rate (Line H * (1-Tax rate)/Line I) (Compared to Tax-Free Investments)	<u>\$1,214.81</u>	
	<u>10.33%</u>	(K)
	<u>\$1,032.59</u>	
<b>Summary</b>	<b>Tax Savings</b>	<b>Effective Rate</b>
Initial Rate		9.90%
Income Tax Savings	\$818	10.78%
Capital Gain Payout	\$0	10.78%
Tax-Free Payout	\$125	12.15%

## CHARITABLE GIFT ANNUITY - INCOME TAXATION

Mrs. Sample T. Smith

Annuity	\$990.00
Char. Gift	\$5,453.52
Capital Gain	\$0.00
Basis	\$4,546.48

TOTAL AMOUNT \$10,000.00

Years	ORDINARY INCOME	CAPITAL GAIN PAYOUT	TAX FREE RETURN	CUMULATIVE CAPITAL GAIN	CUMULATIVE TAX FREE
2006	\$138.59	\$0.00	\$352.85	\$0.00	\$352.85
2007	279.18	0.00	710.82	0.00	1,063.67
2008	279.18	0.00	710.82	0.00	1,774.49
2009	279.18	0.00	710.82	0.00	2,485.31
2010	279.18	0.00	710.82	0.00	3,196.13
2011	279.18	0.00	710.82	0.00	3,906.95
2012	350.47	0.00	639.53	0.00	4,546.48
2013	990.00	0.00	0.00	0.00	4,546.48
2014	990.00	0.00	0.00	0.00	4,546.48
2015	990.00	0.00	0.00	0.00	4,546.48
2016	990.00	0.00	0.00	0.00	4,546.48
2017	990.00	0.00	0.00	0.00	4,546.48
2018	990.00	0.00	0.00	0.00	4,546.48
2019	990.00	0.00	0.00	0.00	4,546.48
2020	990.00	0.00	0.00	0.00	4,546.48
2021	990.00	0.00	0.00	0.00	4,546.48
2022	990.00	0.00	0.00	0.00	4,546.48
2023	990.00	0.00	0.00	0.00	4,546.48
2024	990.00	0.00	0.00	0.00	4,546.48
2025	990.00	0.00	0.00	0.00	4,546.48
2026	990.00	0.00	0.00	0.00	4,546.48
2027	990.00	0.00	0.00	0.00	4,546.48
2028	990.00	0.00	0.00	0.00	4,546.48
2029	990.00	0.00	0.00	0.00	4,546.48
2030	990.00	0.00	0.00	0.00	4,546.48
2031	990.00	0.00	0.00	0.00	4,546.48
2032	990.00	0.00	0.00	0.00	4,546.48
2033	990.00	0.00	0.00	0.00	4,546.48
2034	990.00	0.00	0.00	0.00	4,546.48
2035	990.00	0.00	0.00	0.00	4,546.48
2036	990.00	0.00	0.00	0.00	4,546.48
2037	990.00	0.00	0.00	0.00	4,546.48
2038	990.00	0.00	0.00	0.00	4,546.48
2039	990.00	0.00	0.00	0.00	4,546.48
2040	990.00	0.00	0.00	0.00	4,546.48
2041	990.00	0.00	0.00	0.00	4,546.48
2042	990.00	0.00	0.00	0.00	4,546.48
2043	990.00	0.00	0.00	0.00	4,546.48
2044	990.00	0.00	0.00	0.00	4,546.48
2045	990.00	0.00	0.00	0.00	4,546.48

Note: Tax-Free return of basis not recovered by date of death may be deducted on last income tax return. See IRC Sec. 72(b).

With 5.06% adjusted return and 9.9% payout, \$5,956 remainder after 7.1 years. Present value at 4.20% of \$4,447.

# CHARITABLE GIFT ANNUITY

## Explanation for the Professional Advisor of Mrs. Sample T. Smith

### A. Flow Charts

The first flow chart for the gift annuity includes three boxes. The first indicates the initial circumstance for the property valued at \$10,000. After transfer from the donor to the charity for the gift annuity contract, the charity is obligated to make payments of the annuity amounts for one life. When all income payments have been completed, the balance of the value is available to the charity for its charitable purposes. As time passes, the boxes move progressively lower to show a change of ownership from the donor to the charity.

Under the first box in the second flow chart, the \$10,000 is transferred to charity in the gift annuity contract. A gift annuity is a contract that obligates the charity to make the payments. While charities may be required by state insurance commissioners to maintain a reserve fund, the contractual obligation is against not only any reserve fund, and also the entire assets of the charitable organization. This feature makes gift annuities a very safe agreement for parties dealing with responsible charities, since most charitable entities have substantial assets.

When a gift annuity is created, the value of the annuity contract is determined under Sec. 72 of the Internal Revenue Code and the tables thereunder, and the other portion of the value is treated as a current charitable gift. The value of the contract is based upon the amount of the annuity, the projected number of years of annuity payments, and an assumed earnings rate by the charity.

In this illustration, subtracting the annuity contract value determined under Treasury tables from the total gift results in the charitable value. This charitable income tax deduction is \$5,454 and, at a marginal tax rate of 15.00%, the income tax savings are \$818. Since this is a cash type deduction, this amount may be used up to 50% of adjusted gross income (AGI) in the year of the gift. Any amount in excess of the 50% of the AGI limitation may be carried forward for as many as five years.

The center section of the chart shows the annuity payout percentage of 9.9%. Multiplying this number by the value of the property produces an annuity of \$990.00 payable in proportionate quarterly payments to the annuitant for one life.

Because a portion of the value of the property is allocated to the annuity and this portion is returned under the Sec. 72 rules to the annuitant over one lifetime, part of the annuity payment represents nontaxable return of principal. The tax free amount in this case is \$710.82 per year. Over the one life the basis allocated to the annuity will be recovered tax free.

Using the Treasury Uniform Table for this annuitant, this contract will last 7.1 years, and should pay out approximately \$7,029. This payout, considering the income

tax savings from the deduction and the partly tax free payments, is comparable to receiving a taxable payout of 12.1%.

The third box shows the eventual distribution to the charity of approximately \$5,956. This property will be transferred with no probate cost.

## **B. Gift Annuity Summary Sheet**

The summary sheet is intended to be a simple outline of the major tax benefits for this agreement. It lists the name, the age, the gift amount and the charitable income tax deduction. The annuity of 9.90% is based upon age and total projected return, and an exclusion ratio of 71.8% is calculated. Once again, considering income tax savings and the partially tax-free payments, the effective rate compared to a taxable investment is equivalent to a return of 12.1%.

The lower portion of this form details the income tax information for each payment and for the full year. An annual annuity payment is divided into the portion which represents the ordinary income earned on the investment in the contract, any capital gain amount prorated over one life, and the tax-free return of basis.

The asterisk adjacent to the tax-free entry notes that the tax-free amount continues only until the projected expectancy of an annuitant in the year 2012. If an annuitant lives past that year, then all basis will have been recovered and the balance of all payments will be ordinary income.

## **C. Deduction Calculation**

The deduction calculation for the gift annuity includes three different sections. The first section determines the value of the annuity and the charitable gift amount. The second section determines the expectancy and total payment to calculate the exclusion ratio. A third section calculates the anticipated capital gain for any exchange of an appreciated asset for a gift annuity. Finally, there is a summary of the annuity.

In the upper section are listed an annuitant's name, birth date, gift date and date of first annuity payment. The date of first annuity payment must be within the first period under the payment frequency. Since this annuity pays quarterly, the date of first payment must be within three months of the funding date.

The remaining sections of the calculation follow lines "A" through lines "P".

- |                                      |   |
|--------------------------------------|---|
| A. Annual Payout:                    | The gift annuity value times the annuity percentage produces the annual payout. This amount is rounded up to the nearest two, four or twelve cents, in order to insure that all period payments, whether semiannually, quarterly or monthly, will be of exactly the same amount to the exact cent, thus simplifying administration. |
| B. Deduction Factor<br>IRS Pub. 1457 | The deduction factor from table S is subtracted from one and then divided by the AFR.   |

C. Adjustment for Time of Payment:	If the annuity is paid semiannually, quarterly or monthly, the annuitant has received the value of interest earnings during the year and this is the adjustment for that interest.
D. Adjusted Factor:	Initial factor times the adjustment for the period of payment.
E. Present Value of Annuity:	The actuarial value under Treasury tables for an annuity contract payment, paying the annuity on Line (A).
F. Amount Transferred:	Value of property exchanged for annuity.
G. Charitable Gift Value:	Subtracting the contract value from the property value results in the gift value. This is the IRS's assumed value of the contribution to charity, measured in present value terms.
H. Unadjusted Return Multiple:	The approximate number of years that the annuitants are expected to live.
I. Adjustments If Not Monthly:	A correction for quarterly, semiannual or annual payments.
J. Adjusted Expected Return Multiple:	The unadjusted multiple adjusted for the selected period. The next line shows both the Sec. 72 Return Multiple and the Treasury Uniform Table expectancy of 7.1 years.
K. Expected Return:	Multiplying the multiple of Line (J) times the annuity payout produces an estimate of the total anticipated payment to the donors.
L. Exclusion Ratio:	The Line (E) value of the contract divided by the Line (K) total payout enables allocation of return of principal on an annual basis. This allocation is expressed as a percentage and multiplied by the annual payout to determine the return of principal portion. The return of principal portion is then further divided into the part that is capital gain prorated over one life and the part that is tax free return of basis.
M. Amount Excluded From Ordinary Taxation:	The Line (M) value is Line (L) times the annual annuity and represents the return of principal each year.
N. Basis Allocated to Annuity:	The basis is prorated proportionately between the Line (E) contract value and the Line (G) gift value.
O. Gain Allocated:	The Line (E) contract value less the prorated basis is the gain to be recognized pro rata over one life.
P. Gain Each Year:	Dividing the total gain by the adjusted multiple of Line (J) illustrates the amount to be recognized each year. With a two-life annuity and separate property, the divisor will be the one-life multiple rather than the two-life.

The Summary of Annuity section repeats the above information in a more organized format. The charitable deduction is \$5,454. Since the exclusion ratio until year 2012 is 71.8%, the lower portion of this spreadsheet allocates the payments accordingly.

The annual payment is allocated 71.8% to the tax-free return of contributed principal. Based upon any gain recognized on Line (P), the balance of the 71.8% is tax free. All remaining payment is ordinary income. Amounts in this contract are thus \$279.18 of ordinary income, \$00.00 of prorated gain and \$710.82 of tax-free return.

Since the payout amounts to the precise cent are reported by the charity to the donor and a recipient may not receive exactly a full year's payments the initial year of the agreement, there is also a division into prorata first payment and a payment for each period, in this case the quarterly amounts.

If the donor creates an agreement less than one full period before the desired payout date, then there can be a prorated first payment for the short period. In addition, if the agreement is not funded in January of a given year, there may be fewer than the normal number of payments in the first year for all except annuities with annual payments. The breakout between ordinary income, capital gain and tax-free return is thus calculated taking into account potential partial payments.

#### **D. Equivalent Annuity Rate**

The equivalent rate form details the calculation necessary to determine equivalent return rate in order to compare a gift annuity with other types of taxable payouts. This calculation starts with the annuity amount and determines the excluded amount on Line (C). Line (D) lists any prorated gain amount reported each year. Since gain can potentially be subject to a different tax rate (in this case 8.00% as opposed to 15.00% on ordinary income) the capital gain amount in Line (D) represents an equivalent value of \$00.00 if it were ordinary income.

The return of principal on Line (F) is the equivalent of a tax-free payment and equates to \$836.26 on Line (G). Adding Line (G) and Line (E) to the annual ordinary income portion of the annuity, total equivalent ordinary income is \$1,115.44.

Since the contribution of \$10,000 results in an income tax deduction of \$5,454 and the anticipated tax savings are \$818, the actual net investment is reduced by the tax savings from \$10,000 to \$9,182.00. Dividing \$1,115.44 on Line (H) by \$9,182.00 on Line (I) produces an effective equivalent annuity rate of 12.15%. In addition, multiplying the Line (H) value by 1 less the tax rate and then dividing it by Line (I) results in the equivalent tax free rate of 10.33%. These rates are usually helpful in illustrating the benefits of the gift annuity agreement.

#### **E. Income Taxation**

The final spreadsheet is a detailed form that lists the exact amount of ordinary income, capital gain and tax-free return to be reported to the IRS each year that the annuity is in existence. At the top center are listed the annuity payment, the gift value and the capital gain and cost basis allocated to the annuity. This capital gain and cost basis will be prorated and recovered during the life of the donor.

In 2006, there is recovery of ordinary income of \$138.59, prorated gain of \$00.00 and tax free return of \$352.85. The fifth column shows the cumulative capital gain recovery and the sixth column shows the cumulative tax free. In the second and later years of the agreement, the full annual amounts are displayed for the ordinary income, gain and tax free return. Once again, columns 5 and 6 display the cumulative recovery of prorated gain and cumulative recovery of tax free payments. By the year 2012, the prorated gain and tax-free amounts at the top of the spreadsheet are nearing completion of recovery and there may be a partial recovery of the final amounts of prorated gain and tax-free payments

in that year. After all gain and tax free portions have been recovered, then any future payments are fully ordinary income.

Three additional gift annuity rules should be noted. First, if the gift annuitant dies prior to the full recovery of the tax free portion, then under Sec. 72(b) the unrecovered amount is a permissible tax deduction on the final year tax return. Second, if appreciated property is given by a donor-annuitant, recognized annual gain is limited to annual return of principal. Third, a married couple may prorate their gain amounts evenly over the two life expectancy. However, if separate property is used to fund a two life agreement, the prorated gain is recognized during the first life and the return of principal amount may be totally capital gain until all gain has been recognized. Following the recovery in subsequent years of all return of principal, the annuity payments eventually become fully ordinary income as before.

## **F. Program Options**

Several options are available with the gift annuity. One can select reinsurance if the annuity contract specifies that the annuity must be reinsured. This reinsurance plan then enables one to use the exact amount paid for reinsurance to value the annuity, with the remaining value equaling the charitable gift.

The options also enable one to select either separate or joint property for a two life gift annuity. With a husband and wife, joint property is the common selection. However, with a gift annuity for parent and child, separate property is usually selected. Finally, if the standard payment period is within two or three days of the actual time prior to the selected payout date, the program does not automatically select a prorata payment. However, there is an option that can be used to mandate a prorata payment if desired in a particular illustration.

There is also an option to calculate the end of contract value to charity. Most charitable organizations leave the end of contract value in the default position and show an approximate value to the charity equal to the initial contribution. This is a marketing solution that simplifies the illustration. However, it is possible to calculate, based on the estimated return rate of the annuity reserve fund and the actual payout over the projected one life, the exact projected benefit to the charity. This calculated amount will accurately reflect projected increases or decreases in the principal amount distributed to charity at the end of the agreement.

## CHARITABLE GIFT ANNUITY

Rate of Month	<u>May 5.8%</u>	First Paydate	<u>9/30/2006</u>
Donor Name	<u>Mrs. Sample T. Smith</u>	Income Tax %	<u>15.00%</u>
First Person	<u>Mrs. Sample T. Smith</u>	Cap. Gain %	<u>8.00%</u>
		(Income and capital gains rates are assumed.)	
Birth Date	<u>4/23/1920</u>	Property Amount	<u>\$10,000.00</u>
		Cost Basis	<u>\$10,000.00</u>
		Current Return	<u>0.00%</u>
Frequency	<u>QUARTERLY</u>	Annuity %	<u>9.90%</u>
Gift Date	<u>7/3/2006</u>	Amount to Charity	<u>\$5,956</u>

Options:

**Gain Reported Over One Life**

## GIFT ANNUITY - Deduction vs. Tax Free Income

May 5.8%    June 6.0%    July 6.0%

<b>Char. Deduction</b>	<b>\$5,453.52</b>	<b>\$5,487.38</b>	<b>\$5,487.38</b>
<b>Exclusion Ratio %</b>	<b>71.8%</b>	<b>71.2%</b>	<b>71.2%</b>
<b>Capital Gain Pmts</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>
<b>Tax Free Income</b>	<b>\$710.82</b>	<b>\$704.88</b>	<b>\$704.88</b>

**ONE-LIFE GIFT ANNUITY AGREEMENT**

**Annuitant:** Sample T. Smith  
**Birth Date:** April 23, 1920  
**Age:** 86 **Annuity No. UMS-UMF1001**  
**Social Security #:** 000-00-0000  
**Address:** 4 Main Street  
Bangor, ME 04401

The University of Maine System, in Bangor, Maine (the "System"), agrees to pay to Sample T. Smith of Bangor, Maine (hereinafter called the "Annuitant"), for her life an annuity in the annual sum of **NINE HUNDRED NINETY** Dollars (\$990.00) from the date hereof, in equal quarterly payments of **TWO HUNDRED FORTY SEVEN AND 50/100** Dollars (\$247.50) on the last day of March, June, September and December. **The amount of the first payment will be made on a pro-rata basis, based on the number of days between the date of the transfer of securities and September 30<sup>th</sup>, the date the first payment will be made.** This annuity shall be non-assignable, except in the case of a voluntary transfer of part or all of such annuity to the System.

**After all required annuity payments under this agreement are completed, any annuity remainder amount shall be distributed to System's member organization, the University of Maine at Farmington, for its general uses and purposes (see Addendum).**

The obligation of the System to make annuity payments shall terminate with the payment preceding the death of the Annuitant.

The System certifies that the Annuitant, as evidence of her desire to support the work of the System and to make a charitable gift, has this day contributed to the System the property listed in Schedule A attached hereto, receipt of which is acknowledged for its general charitable purposes. This gift is made in the State of Maine, and the terms of the agreement are governed by Maine law.

This charitable gift annuity is not insurance under the laws of Maine and is not subject to regulation by the Maine Superintendent of the Bureau of Insurance or protected by an insurance guaranty association.

**IN WITNESS WHEREOF**, the System has executed this instrument this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

University of Maine System

By: \_\_\_\_\_  
Joanne L. Yestramski  
Chief Financial Officer & Treasurer

SCHEDULE A

**Sample T. Smith**

**Charitable Gift Annuity Asset contributed:**

**Stock = 350 Shares of Pieinthesky, Inc. valued at \$6,000.00**

**Cash = Four thousand and 00/100 dollars (\$4,000)**

**Total Donor Value = \$10,000.00**

**Date Received: \_\_\_\_\_**

**CHARITABLE GIFT ANNUITY DISCLOSURE STATEMENT****DESCRIPTION OF CHARITY****University of Maine System****YOUR GIFT**

A charitable gift annuity is a popular planned giving vehicle that allows you to receive a fixed income stream for your life and to make a significant contribution to the University of Maine System ("System"). In return for your gift, the System promises to pay you (and/or beneficiary of your choice) a fixed sum, for life. This promise is a general obligation of the System and is not backed by any particular assets of the System. Payments to you under your gift annuity contract may begin shortly after you make your gift, or, if the gift annuity is one providing for deferred payment, at a later date specified by you.

The minimum contribution to fund a current gift annuity is **\$10,000** and the minimum amount to fund a deferred gift annuity is **\$5,000**. The minimum amount for an additional gift annuity from the same donor is **\$2,500**. Your gift may be in the form of cash or appreciated securities held by you for more than one year. **As a general rule, the annuitant must be at least 60 years old at the time a current gift annuity is established, and at least 50 years old at the time a deferred gift annuity is established.**

**FEDERAL TAX CONSEQUENCES**

*Income Tax.* A gift annuity provides you with an immediate income tax deduction equal to the difference between the amount of your contribution and the present value of the annuity (the income stream) to be paid to you or other individual annuitants. The value of the annuity is based upon the size of the annuity payments, the age of the annuitant(s) and the interest rate (published monthly by the IRS) in effect at the time of the contribution. A higher interest rate increases the amount of your charitable deduction.

If you use cash to fund your gift annuity, you can deduct the value of the charitable portion of your contribution, together with your other cash gifts made during the taxable year, in an amount up to 50 percent of your adjusted gross income. If the value of your total cash gifts to public charities exceeds 50 percent of your adjusted gross income, you can carry over the excess to offset income for up to five years.

If you use appreciated securities (held by you for more than one year) to fund your gift annuity, the value of your contribution and the resulting income tax deduction is based on the full fair market value of the securities on the date of the gift. Your current year deduction for all gifts of appreciated assets may not exceed 30 percent of your adjusted gross income, with a five-year carryover for any excess.

Unlike other life income gift vehicles, a transfer of appreciated assets to the System in exchange for a gift annuity will result in the recognition of some taxable gain. If you are the only, or the first, annuitant, and the annuity is nonassignable, you may be able to defer the gain, however, and recognize it proportionately over the course of your lifetime, instead of being taxed on the entire amount at the time of the gift.

The annuity will ordinarily be made in quarterly payments and will be constant over the lifetime of the one or two annuitants. A portion of each payment will be taxable as ordinary income. If you fund the annuity with appreciated assets and you are eligible to defer the gain as described above, a portion of each payment will be taxable as capital gain to you. Finally, a portion of each annuity payment may be tax free, representing a return of the investment in the contract. If the annuitant outlives his/her life expectancy as projected by the IRS, the entire annuity payment will become taxable as ordinary income.

*Gift and Estate Tax.* If you name other individuals as either current or future annuitants and you do not reserve the right to revoke their interests, the value of their interests will be a taxable gift at the time the annuity is established. If the only annuitant named is your spouse, his or her interest may be qualified for the gift and estate tax marital deduction. If the annuitant is your grandchild, or a person who is treated as being two generations or more removed from you, your gift may be subject to the generation skipping transfer tax.

*Acknowledgment.* You will receive a separate acknowledgment from the System detailing the value of your gift in compliance with the charitable deduction substantiation rules for purposes of your charitable income tax deduction.

## **INVESTMENT INFORMATION**

*Commingling.* Your gift may be commingled, or pooled, for investment purposes with the System's endowment funds, with the assets of charitable trusts in which The System has an interest, and/or with other charitable gifts made to the System. The purpose of commingling is to permit the collective management of the System's investment assets and the collective administration of its investment activities.

*Investments.* It is expected that the pool will invest in a diversified portfolio of assets which may include both debt and equity securities in such proportions as seem advisable from time to time in light of current market and economic conditions, as well as other real and personal property and cash to the extent deemed advisable. There are no limitations or restrictions on the investments of the pool.

There are no specific limitations or restrictions on the types of investments that the pool may make, but the System, in managing the assets of the pool directly and/or in selecting the pool's professional investment managers, has an obligation to exercise ordinary business care and prudence under the facts and circumstances prevailing at the

time of the action or decision considering long-term and short-term needs of the the System. **Note that Maine charities are subject to this standard of care, and, to the extent UMS acts as a charity, it may also be subject to this standard.**

Investment in securities and other assets necessarily involves risk, which can be substantial, and it is expected that the value of the pool's assets will fluctuate over time. If such value were to decrease significantly, and if the value of the System's other assets also decreased (or such assets were subject to senior claims), it is possible that the System would be unable to make the payments required under your gift annuity. While such a situation is not expected to arise, it is a risk that you should take into account in deciding whether or not to establish a charitable gift annuity.

A charitable gift annuity is not insurance under the laws of Maine and is not subject to regulation by the Maine Superintendent of the Bureau of Insurance or protected by an insurance guaranty association.

#### **INDIVIDUAL INFORMATION**

The consequences of a charitable gift are dependent in significant part on the individual donor's particular circumstances. The general discussion of charitable gift annuities set forth above does not address every issue, nor does it take into consideration the type of assets you are contributing in exchange for your charitable gift annuity, the particular terms of your annuity, your individual tax situation or your estate and gift tax planning objectives. Additionally, there are other factors, such as state and local taxes, which may be relevant to your gift. With respect to these considerations, as well as for a description of other ways to structure charitable gifts, you should consult with your tax and estate planning advisers.

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Donor Signature

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Date of Receipt

**Application for Charitable Gift Annuity with the University of Maine System**

**Campus:** \_\_\_\_\_

**Name of Donor:** \_\_\_\_\_

Domiciled in State of: \_\_\_\_\_

Mailing Address: \_\_\_\_\_

Town: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

Home Phone: \_\_\_\_\_ Business Phone: \_\_\_\_\_

Email: \_\_\_\_\_

Social Security Number: \_\_\_\_\_ Date of Birth: \_\_\_\_\_

**Name of First Annuitant:** \_\_\_\_\_

Address: \_\_\_\_\_

Home Phone: \_\_\_\_\_ Business Phone: \_\_\_\_\_

Social Security Number: \_\_\_\_\_ Date of Birth: \_\_\_\_\_

**Name of Second Annuitant:** \_\_\_\_\_

Address: \_\_\_\_\_

Home Phone: \_\_\_\_\_ Business Phone: \_\_\_\_\_

Social Security Number: \_\_\_\_\_ Date of Birth: \_\_\_\_\_

(please fill in back of form)

**Application for Charitable Gift Annuity (continued)**

**Amount of Gift:** \_\_\_\_\_ **Date of Gift:** \_\_\_\_\_

**Type of Gift:** **Cash \$** \_\_\_\_\_ **Securities:** \_\_\_\_\_ **Other:** \_\_\_\_\_

If Securities: Name of Stock(s): \_\_\_\_\_

Number of Shares: \_\_\_\_\_

Cost Basis: \_\_\_\_\_

Name of Stock Broker: \_\_\_\_\_

Name of Brokerage Firm: \_\_\_\_\_

Address of Brokerage Firm: \_\_\_\_\_

Phone # of Brokerage Firm: \_\_\_\_\_

**Annuity Type:** One-Life \_\_\_\_\_

Two-Life: \_\_\_\_\_

Deferred: \_\_\_\_\_ Payments to Begin on: \_\_\_\_\_

**Income Tax Rate:** \_\_\_\_\_%

**Property Value:** \_\_\_\_\_

**Payment Frequency:** Quarterly: \_\_\_\_\_

Semiannual: \_\_\_\_\_

Annual: \_\_\_\_\_

**Gift Annuity Payout Rate:** \_\_\_\_\_% (See website: <http://www.acga-web.org/giffrates.html> )

**Descriptive Information regarding Assets being Gifted:**

**Description Regarding Use of Residuum (e.g., Gift is Unrestricted):**

**ADDENDUM TO CHARITABLE GIFT ANNUITY**

**JOHN P. SMITH GEOLOGY FUND  
UMF1001**

The John P. Smith Geology Fund was established at the University of Maine at Farmington in 2006 with a gift of a charitable gift annuity from John P. Smith. The fund shall be used for support of the Geology Department.

The fund shall be administered by the Vice President of Administration. Should it ever become impossible or impractical to carry out the purposes of this fund as described above, an alternative purpose which best fits the donor's intent and wishes shall be designated by the President of the University of Maine at Farmington, in his/her sole discretion.

Date: \_\_\_\_\_ Signed: \_\_\_\_\_

**Checklist After Establishing a Charitable Gift Annuity**

- Has Donor received a Crescendo Pro Proposal from the System?\_\_\_\_\_
- Has Gift Annuity Agreement been drafted?\_\_\_\_\_ Signed by System?\_\_\_\_\_
- Has original Gift Annuity Agreement been given to the Donor?\_\_\_\_\_
- Has Donor signed Disclosure Statement?\_\_\_\_\_ Received Copy?\_\_\_\_\_
- Has System received copy of signed Disclosure Statement? \_\_\_\_\_
- Has System received Gift Annuity Asset? \_\_\_\_\_
- Has Donor been acknowledged by Gift Planning Officer of respective campus?\_\_\_\_\_
- Has Donor been acknowledged by other individuals? \_\_\_\_\_ Who?\_\_\_\_\_ When?\_\_\_\_\_
- Has Program Number for Gift been established?\_\_\_\_\_ Program Number\_\_\_\_\_
- Has Gift Amount been entered into Benefactor?\_\_\_\_\_ Amount of Present Value?\_\_\_\_\_
- When will first pro-rated annuity payment be sent to PGO for the donor?\_\_\_\_\_
- Did letter to donor explain pro-rated payment and inform donor that subsequent checks of the quarterly amount will be arriving directly from the System?\_\_\_\_\_
- Was 1099R sent to PGO for forwarding to donor with letter of appreciation?\_\_\_\_\_