What Is the Best Way to Fund a Charitable Gift Annuity?

WHAT IS A CHARIT ABLE GIFT ANNUITY?

By way of review, a Charitable Gift Annuity (CGA) is an arrangement whereby an individual or couple can make a donation to a participating public charity in exchange for a fixed income. A CGA is ideal for supporters age 65 and over. It's a simple tool that allows one to do the following:

- Contribute to the ongoing work of the organization
- Receive a guaranteed lifetime income
- Enjoy a number of tax benefits

WHAT ARE THE OPTIONS FOR FUNDING A CHARITABLE GIFT ANNUITY?

There are three basic options for funding a Charitable Gift Annuity, each with its own unique benefits.

Cash

Cash is the easiest way to fund a CGA. Using cash qualifies donors for an income tax deduction on a portion of the gift. In addition, some of the income is exempt from taxation, allowing donors to realize a greater net return on their funds.

Stock

Another option for funding a CGA is stock. When donating appreciated stock, donors can avoid some of the capital gains tax on the sale of the stock. The rest is spread out over their life expectancy. As with cash funding, donors receive an income tax deduction on a portion of the gift amount and partially tax-free income.

IRA QCD

Since January 1, 2023, a CGA can be funded through a direct transfer of funds from an IRA. This is an extension of the Qualified Charitable Distribution (QCD) provision available to IRA holders ages 70½ and older. Taxpayers may use this provision only once during their lifetime. And for those age 73 or older, the transfer counts toward the Required Minimum Distribution (RMD). The maximum amount allowable for this one-time IRA-to-CGA transfer was $50,000 in 2023 and is $53,000 in 2024.

As with a direct QCD contribution to charity, the IRA-to-CGA distribution is not eligible for an income tax deduction. Furthermore, all income from the CGA is taxable as ordinary income. However, no tax liability accompanies the withdrawal of funds from the IRA. This is one of the few ways funds can be moved out of an IRA without increasing the owner's income tax liability.

HOW CAN I DETERMINE THE BEST METHOD FOR FUNDING MY CHARITABLE GIFT ANNUITY?

So which CGA funding method makes the most sense: cash, appreciated stock, or a QCD transfer from your IRA? As you can see, each option brings unique advantages.

To answer this question, let's look at the following issues:

- Do you itemize deductions?
- Will the entire QCD count towards your RMD?

- Can you fund the CGA with appreciated securities?
- How much appreciation is present in the securities in question?

Do You Itemize?

The IRS allows each taxpayer the option of itemizing various income tax deductions or taking the standard deduction. Itemized deductions may include property taxes, mortgage interest, business expenses, certain medical expenses, and gifts to charity. The standard deduction simplifies the process by allowing the taxpayer to deduct a specified dollar amount, regardless of yearly expenses or donations. Further, this amount could exceed the total amount of any eligible itemized expenses.

The Tax Cuts and Jobs Act of 2017 basically doubled the amount of the standard deduction. (For 2024, the standard deduction is $14,600 for single filers and $29,200 for married filing jointly.) As a result, far more taxpayers (roughly 87%) claim the standard deduction rather than itemizing their deductions.

When taking the standard deduction, the taxpayer receives no additional deductions for charitable donations. (You might say that the deduction is already built into the standard deduction.) Therefore, it is important to consider how best to handle charitable donations in those tax years.

When itemizing deductions, any taxable withdrawals from his IRA could be offset with a donation of an equal or greater amount to a qualified public charity. But if the taxpayer opts for the standard deduction, then taxable IRA withdrawals cannot be further offset through such charitable donations. Therefore, it makes sense to consider taking a Qualified Charitable Distribution in years that the standard deduction is elected, moving funds from the IRA to the charities of choice. This is the only way to move funds out of the IRA without incurring an income tax.

The first question to consider when funding a CGA, then, is this: Do I plan to itemize my deductions or take the standard deduction? Taking the standard deduction creates a strong case for funding the CGA with your IRA, assuming you are age 70½ or older.

Are You Subject to a Required Minimum Distribution (RMD)?

Required Minimum Distributions begin at age 73. (In 2033, the RMD age is scheduled to increase to 75.) If you are below the age threshold, then you have the option of leaving your

funds in your IRA, continuing to shelter them from income taxes. However, if you are 73 or older, the RMD will force you to withdraw funds from your IRA, potentially subjecting those funds to taxes.
If this describes your situation, then you have only a few options for addressing this tax bill. One is to donate some or all of those funds to charity and take an income tax deduction—but only if you itemize. Another is to use the Qualified Charitable Distribution provision to make a tax-free transfer from your IRA to a qualified public charity. This can be an outright custodial transfer, or you can use these dollars to fund a CGA.

If you are subject to a Required Minimum Distribution, then it makes sense to fund the CGA from your IRA, especially if doing so allows you to make full use of your RMD.

Can You Fund the CGA with Appreciated Securities?

Appreciated securities gives you a third option for funding the CGA. The advantages for doing so lie in the fact that some of the appreciation is sheltered from capital gains tax, and some of the gain recognition is spread out over your life expectancy. The greater the appreciation in the securities, the greater the tax savings will be by using those securities to fund the CGA. Securities with a very low basis would be an ideal source of funding when considering a CGA.

The capital gains tax avoidance and deferment can provide significant tax savings. And keep in mind that this option still allows for a partial income tax deduction in the year the CGA is funded, along with partially tax-free income.

CONCLUSIONS

Taking all these matters into consideration, we can propose general guidelines to follow when determining the best way to fund your CGA.

AN IRA QCD is the preferred option if you are age 70½ or older and are not planning to itemize deductions, especially if the entire amount will count toward your RMD.
APPRECIATED SECURITIES make the most sense when you are going to itemize deductions and the cost basis is 50% of the value of the securities or less.
CASH would be a good choice if you do not own appreciated securities and are not yet required to take distributions (RMDs) from your IRA.

Again, funding a CGA with a QCD is a one-time-only opportunity for each IRA owner. This option could make sense for you, but there are also other options to consider. If you are considering a Charitable Gift Annuity and would like assistance deciding how best to fund it, let us know. We'll be happy to work through that decision with you.