Can You Fund a Gift Annuity With a Sandwich?

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Almost every organization, both non-profit and for profit, has some tale that becomes part of the mythology of the organization, often shared at parties and other celebratory events. PG Calc is no exception. A PG Calc client support staff member announced to her colleagues one morning, “Last night I had a dream that a charity client asked if they could fund a gift annuity with a sandwich?” Laughter ensued followed by erudite discussion. Would it make a difference if it was a peanut butter and jelly sandwich or a sandwich rich with Beluga caviar? A sandwich from a neighborhood deli or a restaurant with a five-star rating? The broader question is just what assets can be used to fund a charitable gift annuity?

Typical Funding Assets

Most gift annuities are funded with either cash or marketable securities. However, a charity may miss opportunities for some significant gifts if it refuses to consider non-traditional assets. The charity must always be cognizant about state law restrictions, reserve requirements, and good business decisions when accepting assets that may have considerable value but may also expose the charity to greater risk.

The Risks of Funding CGAs With Non-Traditional Assets

Funding gift annuities with non-traditional assets in most cases will require review by the Gift Acceptance Committee and possibly finding an outside expert on the type of asset being offered. The donor’s tax considerations can be tricky, as the IRS may have given little or inconclusive guidance for many of these assets. In almost every case a qualified appraisal will be required to substantiate the donor’s income tax charitable deduction and to provide guidance to the charity for the value to use in issuing the gift annuity. The donor should always be counseled to seek the advice of tax and financial advisors.

Non-Traditional Funding Assets (Other Than a Sandwich)

Life Insurance

Some donors have life insurance policies that are no longer needed and that are either paid up or have accumulated considerable cash value. In exchange for a gift annuity, the donor can either surrender the policy to the insurer and contribute cash or transfer the policy to the charity. If surrendered for cash, the donor will be taxed in the year of surrender for any excess of surrender value over the cost basis of the policy. If the policy is transferred to the charity, the donor will not be taxed in the year of the gift on the gain in the policy, but the deduction may be reduced and the gain in the policy will be ratably reported over the life expectancy of the annuitant, assuming the donor is the primary annuitant. The donor is best served by having expert advice for this type of gift.

Commercial Annuity

Some donors have purchased commercial annuity contracts, and in the years since purchase considerable gain has accrued. In using the contract to fund a gift annuity, the donor will be taxed on the gain regardless of whether they contribute the contract or surrender it and contribute cash. However, the charitable tax deduction may partially or totally offset the taxable gain, resulting in little or no tax cost for the gift. While there's no tax difference to the donor, from the charity's perspective having the donor surrender the annuity contract to the issuing company and contribute cash is simplest way to fund the gift annuity. If the charity will be surrendering the policy, it will want to know in advance if there will be a surrender charge.

Savings Bonds

Savings bonds have historically been a favored investment, especially with older donors. Their savings bonds may be a forgotten asset. In some cases, the bonds have stopped paying interest, probably to the surprise of the bond holder. Savings bonds can be transferred to a charity, but the process is complicated and requires establishing an account with the U.S. Treasury. Also, even if transferred to charity the accrued interest is taxed to the donor just as if the bonds were redeemed for cash. There is no advantage for the holder of savings bonds to transfer the bonds to charity rather than redeeming the bonds and contributing cash for a gift annuity.

Partnership or LLC Interest

It is possible to fund a charitable gift annuity with a partnership or limited partnership interest if the governing agreement allows for a transfer to a non-profit organization. In some cases, the approval of other partners or holders of interests may be required. The tax consequences of such a transfer to both the donor and the charity are determined by the underlying assets owned by the entity. Also, if the assets are mortgaged or there is debt-financed income there could be taxes due from the donor and/or the charity. The charity will want to be sure that the interest can be liquidated within a reasonable time, so that the charity has sufficient liquid assets to make the annuity payments. Both the charity and the donor will want to consult tax counsel.

Gold and Silver

Investments in gold and silver usually take the form of gold coins such as Krugerrands and American Eagles, bullion, or shares in an ETF which represent ownership of bullion that is stored in a bank. Contributions of gold or silver mining stocks are treated the same as contributions of any other stock. The key tax question is whether coins, bullion, and ETFs in gold bullion are considered tangible personal property (rather than currency). If so, the charitable deduction would be the lesser of market value and cost basis because in most cases the gift would be an unrelated use. This is a situation where the donor should be advised to consult their tax advisor. That said, there are markets for these assets and they are customarily liquid and can be used to fund a charitable gift annuity.

Tangible Personal Property

Tangible personal property such as stamp and coin collections and works of art can be viable finding assets for charitable gift annuities. A donor might prefer this, over using the asset to fund a charitable remainder trust, so that they will more precisely know the timing and amount of the payments. A qualified appraisal would be needed to substantiate the donor's charitable deduction and as a guide to the charity for the value of the gift. The charity must determine the marketability and liquidity of the asset, as the annuity payments must begin when stated in the annuity contract. The amount of the charitable deduction depends, in part, on whether the donated items are retained by the charity and used for its exempt purposes (related use) or sold and the proceeds invested to cover the annuity obligation (unrelated use).

And About That Sandwich

What about the PG Calc client question (albeit in a dream), "Can a gift annuity be funded with a sandwich?" The gift of a sandwich may pose some unique challenges to the charity: marketplace and speed for liquidation (standing outside a local convenience store?), who is a qualified appraiser (deli counter person?), cost basis (how much did two slices of bread cost, unless it's a club sandwich in which case the cost of three slices of bread), gift acceptance policy relating to donor recognition, and even more issues that you might identify not thought about by this author.

Conclusion

Don't overlook non-traditional assets to fund charitable gift annuities. As for that sandwich – don't suggest that as a funding option the next time you meet with a donor. Just have it for lunch.

For more detailed information about non-traditional assets that can be used to fund a charitable gift annuity, refer to the PG Calc publication *Charitable Gift Annuities: The Complete Resource Manual*.