claimed on Line 16. However, there could be further changes before the final Schedule A for 2018 is released, so estate administrators claiming the deduction should determine the appropriate line on the final draft of Schedule A.

The instructions regarding the applicable line are expected to continue to refer to IRS Publication 529, and this Publication provides that if a retiree dies before his or her entire investment in an annuity contract is recovered, the unrecovered investment may be deducted on the retiree's final income tax return. In addition, IRS Publication 575 provides an example of how to treat the recovery of a husband's and wife's investment in a joint-and-survivor annuity if both spouses die before receiving a return of the entire investment amount. The publication provides that if the wife is the last to die and her death occurs before recovering the entire investment, the unrecovered cost may be claimed as a miscellaneous itemized deduction on the wife's final income tax return. The publication further provides that this deduction is not subject to the two-percent-of-adjusted-gross-income threshold.

Note: In some cases, the unrecovered investment may be so large, in comparison with the annuitant's income for the year in which he or she died, that the deduction can be used as the basis for claiming a net operating loss carry-back (or, in rare instances involving an annuitant survived by a spouse who is not an annuitant, a carry-forward).

See the Appendices to this chapter for copies of (1) Schedule A of Form 1040, (2) instructions regarding Line 28, and (3) an excerpt from Publication 529. For a sample letter a charity can send the personal representative of the annuitant's estate, see Appendix 16 of Chapter 5.

Changing the Frequency of Annuity Payments

Occasionally, an annuitant wants to change the schedule of payments. For example, an annuitant may want to receive quarterly payments rather than the semi-annual payments stipulated in the original agreement. Changing the payment frequency should be permissible so long as the new schedule of payments does not result in a higher present value of the annuity payments.

Whenever payment frequency is changed, whoever is administering the charity's gift annuities should be informed of the change. Moreover, the ideal timing is for the change to take effect with the first payment to be made in a calendar year, in order to simplify preparation of IRS Form 1099-R.

Less Frequent Payments

If payments will be made less frequently – quarterly instead of monthly, semi-annually instead of quarterly, etc. – and the total amount paid each full year remains unchanged, the present value of the payments will be lower. Since the annuitant receives no added benefit, it is unnecessary to change the total amount (though a slightly higher annual amount is supportable). See Figure 20.3.

Figure 20.3

Less Frequent Payments

Mildred N has been receiving monthly annuity payments of $100, and she wants to receive quarterly payments. She and the charity could execute an agreement containing the following wording:

Mildred N and [*Charity*] hereby agree that, effective January 1, 2019, the annual annuity amount of $1,200, currently paid in monthly installments of $100 at the end of each calendar month, shall be paid in quarterly installments of $300 at the end of each calendar quarter. The first quarterly payment under the new schedule shall be made on March 31, 2019.

Figure 20.4

Methodology for Calculating Annuity Amount When Payment Frequency Changes

Margaret, whose date of birth is October 27, 1928, contributed $100,000 for a gift annuity on June 10, 2001. She has been receiving an annual annuity of $7,600 paid in semi-annual installments of $3,800 at the end of each calendar period. On July 1, 2018 she entered into an agreement with the charity to change to quarterly payments, with the first quarterly installment due on September 30, 2018. What is the amount of the quarterly installment she should receive from the charity?

1. Determine the present value of $1 per year, paid in semi-annual payments, over her life expectancy, using the July 2018 CMFR of 3.4%. In Margaret's case that will be 3.9634. (Your planned giving software will show you this number—just enter as the gift date the date the payment frequency change becomes effective. You can also find these factors in IRS Publication 1457.)

2. Determine the present value of $1 per year, paid in quarterly installments, over her life expectancy, again using the July 2018 CMFR of 3.4%. In Margaret's case that would be 3.9804.

3. Divide the factor for semi-annual payments by the factor for quarterly payments and multiply the result by $7,600. The answer will be the total annual annuity Margaret will receive once the payment frequency is changed to quarterly.

$$\frac{3.9634}{3.9804} \times \$7{,}600 = \$7{,}567.54$$

4. Divide the new annual annuity amount by the number of installments under the new frequency arrangement (4 in the case of Margaret).

$$\$7{,}567.54 \div 4 = \$1{,}891.89$$

This is the amount of the quarterly payment that Margaret will receive.

Note: The lower the CMFR, the smaller the reduction in the annual annuity when payments become more frequent.

More Frequent Payments

If payments will be made more frequently, the present value will be higher if the total amount paid each full year remains unchanged. This is not permitted because it would result in a smaller charitable deduction than originally claimed. Consequently, when the annuity payments become more frequent, it is necessary to reduce the total annual amount to maintain an equivalent present value. See Figure 20.4 above and 20.5.

In calculating the equivalent present values, use the CMFR for the month in which the change in frequency becomes effective.

Timing of Payments

If an annuitant wants to alter the timing of payments – for instance, receive monthly payments on the 15th rather than the end of the month – it would again be necessary to reduce the total annual payment to maintain an equivalent present value if the annuitant receives payments at an earlier date than the date specified in the agreement, which was used in calculating the original charitable deduction.

However, if the annuitant and the charity agree to have payments made on a later date than the date specified in the agreement – for example,

Figure 20.5

Change to More Frequent Payments

Harold J, age 74, has been receiving quarterly installments of $3,922.50 from his annuity. In the future he wants to be paid in monthly installments. Currently, payments total $15,690.00 per year ($3,922.50 × 4). To maintain an equivalent present value, the total payments made each year must be reduced to $15,646.81. Thus, monthly installments will be $1,303.90. To make the change, Harold and the charity could execute an agreement containing the following wording:

> Harold J and *[Charity]* hereby agree that, effective July 1, 2018, the annual annuity amount paid to Harold J shall be $15,646.81, and it shall be paid in equal monthly installments of $1,303.90 at the end of each calendar month. The first monthly payment under the new schedule shall be made on July 31, 2018.
>
> They further agree that this adjustment in the annual annuity amount and payment frequency does not change the present value of the annuity, because the present value of an annual annuity of $15,646.81 paid in monthly installments of $1,303.90 at the end of the month is equal to the present value of an annual annuity of $15,690.00 paid in quarterly installments of $3,922.50 at the end of the quarter. The calculations are based on the July 2018 IRC Sec. 7520 rate (CMFR) of 3.4%.

quarterly payments on March 31, June 30, September 30, and December 31, instead of on March 15, June 15, September 15, and December 15, as stipulated in the agreement – then no reduction in the annual payment should be necessary. That is because the annuitant would not be accelerating receipt of money, which would slightly increase the present value of the payments.

Taxation of Payments

When the payment frequency is changed and, as a consequence, the annual annuity is somewhat smaller, reduce the ordinary income (interest) portion of the annual annuity by the amount of the reduction. The portion that is a tax-free return of capital and the portion (if any) that is capital gain do not change. See the example in Figure 20.6.

Contributing the Right to Annuity Payments to the Charity

Some annuitants, discovering that they do not need the annuity payments, are willing to forfeit permanently their future right to them. This is to be contrasted with the option an annuitant has to instruct the charity to retain on a temporary or indefinite basis each regular payment as it comes due. That option is discussed in Chapter 5.

Once an annuitant assigns his or her right to payments, the charity's obligation under the contract will terminate, and it will be free to use the residuum. An assignment of an annuity interest raises several questions, and the answers to some of them are not entirely clear.

As indicated in Chapter 2, a gift annuity agreement will typically include language such as the following: "This annuity is irrevocable and non-assignable, except that it may be assigned to the charity." Clearly, this wording would allow an annuitant to assign his or her interest to the charity. If, however, the agreement were to say simply, "This annuity is irrevocable and non-assignable," then an assignment likely would not be possible, unless legal counsel for the annuitant and for the charity concluded that an exception permitting assignment of the annuity interest to