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a business, tax, and financial newsletter

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The Tax Advantages of Charitable Annuities

Would you like to donate to the causes you care about, while also generating a steady retirement income and saving on your taxes? If doing good, while continuing to work toward achieving your financial and estate planning goals sounds appealing, you may want to consider purchasing a charitable gift annuity.

Many charities have programs that assist donors in purchasing gift annuities, which are designed to provide long-term financial support to both the donor and the nonprofit organization. Essentially, a charitable gift annuity is a contract between the donor and the nonprofit organization that calls for the charity to make fixed lifetime payments to the donor and, in some cases, to his or her spouse. In exchange, the charity receives the remainder of the gift to further its work when the donor, or the donor's spouse, dies.

Recognized by the IRS as a form of philanthropic giving, a charitable gift annuity offers a number of potential tax advantages. The portion of the annuity purchase that is considered a gift can be included as a charitable contribution on your itemized deductions. In addition, a portion of the payments from a charitable gift annuity are tax free until you reach your life expectancy, while another part is taxed at ordinary income rates. If you donate appreciated securities, you will owe some capital gains taxes for the sale portion of the transaction, but the taxes are payable over your expected lifetime, rather than being due immediately.

In addition, purchasing a charitable gift annuity can reduce the size of your taxable estate. You may, for example, wish to donate appreciated property that currently generates little or no income, but which would be taxable if it were sold or passed on to the next generation.

A charitable gift annuity can also be a great option if you want to donate to your favorite charity, but prefer not to make a large gift outright. If you are thinking about purchasing a charitable gift annuity, you should, however, be aware that these annuities are not identical to commercial products, which generally offer higher rates of interest. But the tax savings associated with gift annuities can help to offset the smaller payments. The interest rates paid by all types of annuities are also usually superior to those paid on savings accounts and certificates of deposit.

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Who'll Be in Control When You Can't Be?

One thing is for certain: Life is unpredictable. But it's still important to prepare for the future and whatever it may hold. Have you ever considered what would happen if you were to experience an accident or illness that left you incapacitated and no longer able to make important financial decisions? While this unpleasant prospect may be difficult to think about, you can prepare to establish a measure of control in your life should you become incapacitated. One strategy is to establish a **durable power of attorney**—a legal document that appoints someone you trust to handle your financial decisions.

While an attorney is a licensed professional who has been granted legal authority to conduct business on your behalf, you have the right to provide anyone with this power. If the **power of attorney (POA)** is *limited*, the individual you choose can conduct only that business specified in your agreement. If the POA is *general*, the person's authority is more extensive but still assumes you are competent to review and approve decisions. If the agreement contains what is known as "durable" language (according to the passage of certain state laws), it allows the designated individual, also known as the **attorney in fact**, to make decisions on your behalf in the event of physical or mental incapacity.

The Time to Prepare Is Now

Generally speaking, a durable power of attorney allows you to specify, in advance, the person you want to make decisions regarding your personal finances and business matters, if you ever become incapable of making those decisions for yourself. By contrast, a **health care proxy** allows you to designate an individual to make decisions regarding your medical care and well-being, and a **living will** allows you to specify your preferences regarding the giving or withholding of life-sustaining medical treatments. These documents are known as **advance directives**, and they are essential estate planning tools for all individuals, regardless of age. Without such documents, court intervention—involving a great deal of time, expense, and stress—may be necessary.

In addition to your own advance directives, consider the important role these documents can play in your *parents'* estate planning. For many of us, discussing such matters with a parent may be uncomfortable. Nevertheless, an open conversation about expectations may strengthen familial bonds and help ensure that your loved ones' preferences for the future will be met.

It is important to note that a will, which only becomes operative *at death,* is not the appropriate vehicle for specifying a durable power of attorney, health care proxy, or living will. Rather, these documents should be created separately by a qualified legal professional who is familiar with the language appropriate for your particular state. Taking the steps to designate your durable power of attorney can help ensure that your financial decisions will be handled by someone you trust, in the event that you're unable to do so. ■

Buy-Sell Agreements for Your Business Plan

It's easy to get caught up in the day-to-day tasks of running your business and to put off thinking about the future. But every business needs a plan for the future.

A buy-sell agreement is a great tool to help you and your fellow business owners deal with some difficult issues that may come up. The agreement provides for the sale of an owner's interest in cases of death, disability, retirement, an offer to purchase the interest from an outside party, or the divorce of a partner.

Having a buy-sell agreement assures the departing owner (or the family) of a guaranteed buyer at a fair price. The buying shareholders benefit because the agreement enables them to continue the business without having to negotiate with outside parties. Buy-sell agreements can be drafted to accomplish the following:

- Set a fair price for valuing stock to be transferred.
- Determine the procedure to be followed upon a triggering event (i.e., retirement).
- Give the right of first refusal to the other shareholders to maintain continuity of the business.
- Provide funds or an income stream to the survivors.

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Living Together: Are There Strings Attached?

Unlike marriage, which involves numerous legal obligations and rights, a couple living together outside of marriage may be unaware of concerns unique to their domestic partnership, and could possibly face the following challenges over the course of their relationship: What happens when property is purchased together, or when one partner financially supports the other and then both individuals go their separate ways? What about assets accumulated while the couple lives together? Does a former partner have a right to such property? Suddenly, cohabitation could become more than a mere living arrangement and turn into an issue of asset protection or lifestyle preservation.

Untying the Knots of Obligation

Perhaps the most significant problem facing unmarried domestic partners is a potential claim to property, if and when the relationship ends. The issue of property rights can sometimes create major disagreements that, in some states, have resulted in **palimony** lawsuits.

"Palimony," which means the division of property and/or support payments as a result of the break-up of two unmarried individuals, does not have its origins in the law. The media coined the term in the 1970s amid several high-profile celebrity lawsuits. Although palimony suits generally occur in a limited number of states, unmarried couples could learn valuable lessons from such cases when planning a life together. In states where palimony suits are prevalent, **cohabitation agreements** are an increasingly popular method for unmarried couples to clarify their expectations and obligations. The parties can determine how comprehensive the contracts need to be, taking into consideration their combined assets. When properly drafted, these agreements may be enforceable in a number of states.

A carefully written agreement can outline everything from how jointly owned property will be distributed to what support will be provided by one partner to the other, in the event the relationship terminates. Like any contract, a written cohabitation agreement should be prepared with the assistance of legal counsel to ensure that both parties' wishes are equally and fairly represented.

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buy-sell agreements for your business plan

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A buy-sell agreement, however, does not guarantee the other shareholders or key employees will have the means to purchase the stock. So, you may want to fund your agreement with life and disability insurance. Either the company purchases life insurance on all of the shareholders or the shareholders purchase life insurance on each other. The proceeds, which are generally tax free, are used to purchase the decedent's stock. Unfortunately, the business cannot deduct the life insurance premiums.

If you operate as an S corporation, it's even more critical to have a buy-sell agreement, which can prevent an owner from selling an interest to a nonqualifying shareholder that would nullify the "S" election. It's important to make sure that your buy-sell agreement treats all owners equally and that its provisions are followed. Preferential rights, both within the agreement or as a deviation from it, could constitute a second class of stock and, thus, nullify the "S" election.

Buy-sell agreements can help ensure a smooth transition when a partner departs from a closely held business. As you think about your plan, structure an agreement that meets the needs of the company, the shareholders, and their heirs.

the tax advantages of charitable annuities

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Purchasing an annuity can be especially attractive at more advanced ages, as the payments will be higher. If you are younger and do not yet need the income, you can select an annuity that allows you to defer payments until reaching a specific age. If you are interested in buying a charitable gift annuity but do not yet know when you might wish to start collecting payments, you can opt for a flexible annuity, which does not require you to choose the payment starting date at the time of purchase.

To set up a charitable gift annuity, the donor typically makes a donation of cash, stock, or other assets for a set amount—usually no less than $5,000. Under a "single life" agreement, the charity commits to making payments to one person for the course of his or her lifetime, while under a "two lives in succession" agreement, the charity makes payments first to one person, and then to a designated survivor. If you are married, you may prefer to enter into a "joint and survivor" agreement, in which the organization splits the payments between spouses during their lifetimes, and makes the full payment to a surviving spouse.

Remember, however, that annuities are irrevocable, and you will not be able to extract your funds or property once the donation has been made. Keep in mind, too, that charitable gift annuity payments are not inflation-protected, and your income from this type of annuity will not go up even if the cost of living rises. On the other hand, the annuity payments become a general obligation of the charity, and the annuity is backed by the organization's entire assets, not just by the property donated. The charity is therefore committed to continuing payments throughout the lifetime of the donor, regardless of whether the funds used to purchase the annuity have been exhausted.

Even if you are already familiar with the charity from which you are purchasing the annuity, it is nonetheless advisable to investigate the financial stability of the organization to ensure that it will be able to make payments well into the future. If the charity becomes insolvent, the funds will be lost and annuity payments will stop. Charitable gift annuities are not insured, but some states regulate this type of annuity, generally requiring charities to maintain sufficient reserves to meet its obligations to annuitants.

It is usually best to choose a charity that has an established charitable gift annuity program, as they will be able to guide you through the process of purchasing an annuity, and will be able to help you resolve any issues that might arise. ■

living together: are there strings attached?

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For whatever reasons, one or even both partners may not wish to enter into a formal agreement. If one party is of substantial means, a personal asset protection plan may be an option for that individual to explore in further detail. However, there are other ways to help avoid potential problems. For example, it may be unwise to purchase significant assets together, title assets in joint names, regularly give money to a partner (unless it is made as a "gift" using the annual gift tax exclusion), place money into a joint account, or use a partner's last name.

In today's tax environment, estate planning for unmarried partners is complex. Although such planning can be challenging, it may be less difficult if both individuals have a realistic understanding of their rights regarding asset protection and lifestyle preservation. ■