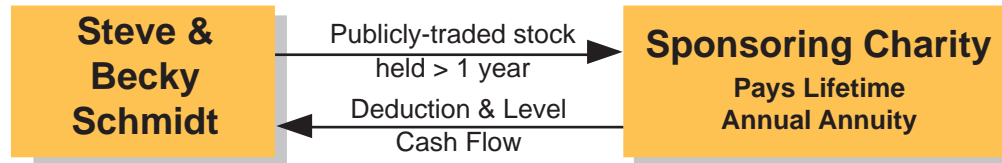


# Case Strategy: *Increasing Future Cash Flow*

SCHMIDT



Steve and Becky Schmidt (both age 70) own a publicly-traded stock valued at \$100,000 with a \$25,000 cost basis. The stock currently pays a 1% dividend but the Schmidts don't need the income. More importantly, they are concerned about market fluctuations and want to make sure the stock can produce a cash flow in the future if their IRA runs out.

Mike Cole, the Schmidts' financial planning professional, describes a way they can put the stock in safekeeping, guarantee a lifetime cash flow that starts in 14 years, get a current income tax deduction and make a charitable gift in the process. Mike says the technical name for this tool is a *Deferred Charitable Gift Annuity (DCGA)*.

If the Schmidts' sold the stock, they would have to pay \$15,000 in capital gain tax on the appreciation. However, by contributing the stock to a charity in exchange for a DCGA, the charity will hold the stock or invest the sales proceeds in return for agreeing to pay the Schmidts a level cash flow of \$12,600 each year for the rest of their lives starting in 14 years. The charity, as a non-tax paying entity, can sell the stock without incurring a tax liability and invest the entire proceeds from the sale of the stock in a diversified portfolio of stocks and bonds. In addition, the Schmidts will receive a \$60,943 income tax deduction this year.

Because CGA recipients are treated as general creditors of the charity, the Schmidts' lawyer and professional advisor both reviewed the charity's financial statements and investment policies to ensure the charity would be likely to be financially able to pay the lifetime payments.

The Schmidts' DCGA allows them to save a substantial amount in immediate capital gain taxes, diversify their portfolio, take advantage of the ability to receive a lifetime retirement income based on all the value of their stock and receive a substantially increased lifetime cash flow that is level and dependable. However, they are most pleased that they have shifted investment risk to the charity, while creating a legacy by leaving money to a charity that will support causes that are meaningful to them.

## Key Features of CGAs

- CGAs pay a level cash flow to the annuitant so it is well-suited for people who desire a continuous, predictable cash flow.
- CGAs can never accept additional contributions after the initial funding. However, since CGAs are so easy to create, many people create multiple CGAs to approximate an additional contribution.
- CGA payments are tax-advantaged through the annuitant's life expectancy. After that, all payments are taxed as ordinary income.
- Investment risk is shifted to the charity. Therefore, investment performance and program expenses do not change the annuity payout.
- Most charities that issue CGAs use the recommended rates published by the American Council on Gift Annuities.
- Immediate CGAs must make a payment to the annuitant each year. Deferred CGAs start the annuity payment in a future year.

Income Tax Deduction

\$ 60,943

Before Tax Lifetime Income

\$ 88,200\*

Charity

\$214,951\*

Immediate Capital Gain Tax

\$0

### Assumptions:

- Combined Federal and state income tax rate of 25%.
- Combined Federal and state capital gain tax rate of 20%.
- 1% dividend yield and 5% capital appreciation (only affects the charity's projected future benefit).
- CMFR = 3.2%. Deduction may be limited. Consult a tax advisor.
- Not all charities are eligible and/or registered to issue CGAs. CGAs are subject to state regulation.

Some charities reinsure their CGA obligations to reduce their risk.

This example is hypothetical and for educational use only. The situations, tax rates or return numbers do not represent any actual clients or investments. There is no assurance that the rates depicted can or will be achieved. Actual results will vary. Please consult with legal and tax counsel about the suitability of this plan before proceeding.

**For more details about this strategy or any other charitable or trust case, please call Renaissance at 800.843.0050.**

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