Legal Brief

Charitable Giving in a Low Interest Rate Environment

With the economy still recovering and state budgets being cut, charities need assistance from private individuals more than ever. Following is a brief discussion of common strategies that charitably inclined individuals may want to consider and the current advantages/disadvantages of each.

CRATs and CRUTs

CRATs (and CRUTs) — Charitable Remainder Annuity Trusts and Charitable Remainder Unitrusts, respectively — are trusts in which the grantor reserves an annuity (or a unitrust) payment for a period of years. At the expiration of the term, the remaining balance of the CRAT (or CRUT) is distributed to charity. With the currently low Internal Revenue Code Section 7520 Rate ("7520 Rate") — 1.2 percent for June 2012 — the value of the remainder interest can be quite low. Therefore, the charitable deduction the grantor is permitted to take is currently much lower than in periods where the 7520 Rate is high.

Further, in order to qualify as a CRAT, the Trust must meet two standards. First, the remainder value must have an actuarial value of at least 10 percent of the property transferred to the CRAT. When the 7520 Rate is as low as it currently is, this standard becomes quite difficult to achieve. Second, at funding, there can be no more than a 5-percent probability that the CRAT will be exhausted before the charitable remainder vests. When you are calculating the remainder value based on a 1.2-percent interest rate, there becomes a much higher probability that the Trust will exhaust prior to vesting. For these reasons, a CRAT (or CRUT) is not ideal in a low interest rate environment.

Charitable Lead Annuity Trust ("CLAT")

A CLAT is a trust that provides for an annuity payment to a charity for a period of years, with the remainder being gifted to children or another designated beneficiary. The value of the gift over at the termination of the CLAT is determined by valuing the remainder interest on the date of the gift. The remainder is valued by reference to the 7520 Rate. Therefore, if the CLAT's investment performance over the term exceeds the 7520 Rate, you will be gifting such excess to your designated beneficiary free of gift tax.

Gift of Remainder Interest in Residence

An individual may want to consider reserving the use of their personal residence for the remainder of his or her life and gifting the remainder to charity. The remainder interest is again valued by reference to the 7520 Rate. The lower the 7520 Rate, the higher the remainder value of the gift, which the individual is permitted to take as a charitable deduction on his or her income tax return.

Private Foundation

If you are interested in setting aside a large sum of money for charitable purposes, a private foundation may be of interest. A private foundation allows your family members to maintain control over the investment of the funds while at the same time permitting them to select charitable beneficiaries each year. The primary drawback to a private foundation is that administrative costs can be high, so it should only be considered for large gifts.

Donor Advised or Donor Directed Funds

Donor advised or donor directed funds are typically administered by a local community foundation. The community foundation invests your gift and applies the principal and income from it to the causes that you direct. These funds can last for an extended period of time.

Gift of IRA at Death

If you plan on making a large charitable gift at death, you may want to consider naming a charity as a beneficiary of all or part of an IRA, rather than making a specific charitable bequest under your will. By naming the charity as beneficiary, neither death taxes nor income tax will be paid on the portion of the IRA designated for charity.

Even in periods of slow economic growth, there are estate-planning strategies available for the charitably inclined individual.

For more information about these strategies, contact James E. Spoden at MacDonald Illig at 814/870-7710 or jspoden@mijb.com.

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