The Boomerang Charitable Gift

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Using a tax tool known as the Charitable Lead Annuity Trust (CLAT), it is possible to make a substantial, essentially tax-free gift to one’s children while at the same time making a significant gift to a charity. For example, the remaining assets were to be distributed to Mrs. Onassis’ grandchildren. The estate taxable value of the grandchildren’s share would be reduced by the present value of the charitable annuity.

**Tax-Free Wealth Accumulation**

Although the Jacqueline Kennedy Onassis CLAT was created by her Last Will and Testament, these trusts are typically created during the lifetime of the donor. The benefit of a CLAT is greatly magnified when the property transferred to the trust is expected to appreciate in value over the term of the trust. For example, assume an annual annuity payment to the charity of 5% of the initial value of the trust contribution while the trust assets are growing at the rate of 6% annually. The growth of the trust assets over and above the amount paid annually to the charity keeps accumulating in the trust for eventual distribution to the children.

**A Stunning Example**

To understand the power of a CLAT, let’s examine a 25-year trust funded with $1,000,000 of assets. The charity is to receive a 5% annuity. It is anticipated that the assets will grow at a rate of 6% (representing the combined income earned on the assets and capital appreciation). Since the IRS will assume the trust will earn only 2.2% (but the rates which the IRS uses to value these trusts change every month, referred to as the 7520 Rate), the gift tax value of the children’s remainder interest would be only $46,365. A gift tax return would be filed showing this amount. However, since we have assumed that the assets are growing at a rate greater than the annuity being paid to the charity, the amount that would be distributed to the children at the end of 25 years would actually be $1,548,645. This dramatic difference between what the IRS assumed value of the children’s remainder interest and the real value results from the difference between the IRS assumed value and the actual investment return (6%). The greater the disparity between the assumed and the actual return, the greater the impact on the children’s trust remainder interest. All the children must do is wait until the trust expires in 25 years. Remember, this example is based on a 7520 Rate of 2.2% and this rate is published monthly by the IRS.

**Income Tax Consequences**

For income tax purposes, the contributor to a non-grantor CLAT is not taxed on the trust income. Instead, the trust is taxed on the income to the extent such income is not distributed to the charity each year as part of its annuity. There is no income tax charitable deduction for the contribution to a non-grantor CLAT.

**Gift Tax Consequences**

A federal gift tax charitable deduction is allowed for the value of the charity’s annuity interest. A gift tax return must be filed in the year the CLAT is created to reflect the value of the children’s remainder interest. The annual gift tax exclusion may not be applied to reduce the gift consequences.

L. William Schmidt, Jr. is currently Senior Trust Officer at First Western Trust. Prior to that, he was most recently an estate planning attorney with Holland & Hart. Mr. Schmidt serves on a number of nonprofit boards, including the Board of Trustees of The Denver Foundation. He has authored six books on the subject of estate planning and is a recognized speaker to professional and lay audiences. Mr. Schmidt received one of The Denver Foundation’s first Philanthropic Leadership Awards.