

[Jen Wickham](#) - Fri, 11/1/2013 - 13:54

We hear regularly from puzzled clients who want to understand why a charitable remainder annuity trust (CRAT) they have just calculated fails to qualify as a CRAT, but a charitable remainder unitrust (CRUT) with the same payout rate doesn't also fail.

The answer boils down to today's extremely low IRS discount rate of 1.4%. Changes in the IRS discount rate affect the deduction for a CRAT far more greatly than the deduction for a CRUT. When the rate is very low, as now, so is the deduction available for a CRAT. What's more, if the calculated deduction is below 10%, then under current tax law the CRAT (or CRUT) is not considered a qualified charitable remainder trust and loses all of its tax benefits.

The low IRS discount rate means that it is also easier for a CRAT to fail a second test, the 5% probability of exhaustion test. This test applies to CRATs, but not to CRUTs. The test asks if there is a 5% or greater likelihood that the CRAT will last long enough to run out of funds (by its nature, a CRUT can never exhaust all of its funds). When the IRS assumes the trust will earn only 1.4% in investment return, which is what the 1.4% IRS discount rate means, the income beneficiaries don't have to live very long before a typical CRAT becomes exhausted. That means that the income beneficiaries have to be quite old in order for them to have less than a 5% chance of living long enough to exhaust the CRAT. CRATs usually fail the 5% probability test at older beneficiary ages than they fail the 10% deduction test.

For example, at today's 1.4% IRS discount rate, a 1-life CRAT paying quarterly the minimum distribution of 5% will fail the 5% probability test unless its income beneficiary is at least 75 years old, even though it would pass the 10% deduction test down to a beneficiary age of 51. If the IRS discount rate were to rise to 3.0%, the income beneficiary would need to be at least 67 years old to pass the 5% test, but just 47 years old to pass the 10% test. If the IRS discount rate were to rise to 5.0%, the income beneficiary could be as young as 29 years old without disqualifying the CRAT, and that's because at age 28 the CRAT would fail the 10% deduction test, not the 5% probability test.

[Print](#)

Categories

[Charitable Remainder Annuity Trust](#)

