

[Jen Wickham](#) - Mon, 6/22/2015 - 10:50

It's definitely a new day for gift planners and possibly even the dawn of a new era, if the current economic climate persists. Significantly, that climate features not only depressed stock values but also low interest rates, which translate into the low monthly IRS discount rates used in calculating the tax aspects of various planned giving vehicles. Still, many donors continue to have the motivation and capacity to make large charitable gifts. The challenge is to maximize their options, including – when appropriate – acquainting them with novel approaches. In certain situations, one such approach in particular can be especially “gratifying.”

Combining a GRAT with Annual Outright Gifts

With a Grantor Retained Annuity Trust (GRAT), the grantor (effectively the “donor”) contributes assets to a trust and agrees to receive a fixed-dollar amount for a term of years. At the end of that term, whatever is left in the trust passes to one or more non-charitable beneficiaries, typically one or more heirs. At the time the trust is established, the grantor makes a taxable gift to the heir(s) equal to the value of the assets transferred to the trust less the present value of the annuity payments to be made back to the donor.

It is possible to set the trust term and payment amount so that there is no taxable gift. Then, whatever remains in the GRAT when it terminates will pass to the heir(s) free of gift tax. If the grantor dies prior to the end of the trust term, all of the remaining trust assets are included in the grantor's estate. However, this would also have been the case if the trust had never been established.

GRATs are appealing when the IRS discount rate is low for the same reason that a charitable lead annuity trust (CLAT) is appealing. In both cases, the value of the income interest is calculated using the IRS discount rate. If the GRAT can generate a return in excess of this rate, the donor can pass the increase in value on to heir(s) without incurring any gift tax. Note that the gift tax deduction available for establishing a GRAT must be calculated using the IRS discount rate for the month in which the trust is established; the grantor does not have the two-month “look-back” option that is available when computing the charitable deduction for a CLAT and

many other planned giving vehicles.

Indeed, a GRAT is not a charitable instrument, but it can be a way simultaneously to pass property to one or more heirs and support one or more charities if the grantor uses a portion of the trust payments to make charitable gifts. This is the strategy followed by Sandy when she transfers stock valued at \$1,000,000 to a GRAT that will pay her \$215,000* per year for five years, and then distribute the trust remainder to her children. Each year while the trust is in existence, she makes charitable gifts totaling \$150,000 to different charities.

Amount transferred to	the GRAT	\$1,000,000
	Annual payment to Sandy	215,000
	Total payments to Sandy over five years	1,075,000
	Taxable gift to children (2.4% IRS discount rate)	-0-
	Presumed value of trust assets at the end of five years	250,000
	Amount passed to children free of gift tax	250,000
	Total charitable gifts	750,000
	Tax savings from charitable gifts (35% tax rate)	262,500
	Payments to Sandy less charitable contributions and estimated tax on her payments	approx. 250,000

Summary:

Total benefit to Sandy (\$262,500 + approx. 250,000)	approx. \$512,500
Total wealth passed to children	250,000
Total charitable gifts	750,000
Total benefits to all parties combined	approx. \$1,512,500

* \$215,000 is the annual payment - rounded up to the next thousand dollars and made at the end of each year - that reduces Sandy's taxable gift to \$0. Thus, all of

Sandy's gift and estate tax exemptions are preserved for other taxable transfers.

GRAT vs. CLAT

As noted earlier, both GRATs and CLATs are attractive when a low discount rate helps to minimize or even eliminate the value of the transfer potentially subject to gift tax. This assumes that the CLAT in question is a non-grantor CLAT, i.e., one that distributes its assets to persons other than the donor upon termination of the trust. In the case of a non-grantor CLAT, however, only certain classes of persons can be remainder beneficiaries, whereas a GRAT can be established for the ultimate benefit of any individual, regardless of his or her relationship to the donor.

Of course, a CLAT can also be structured as a grantor CLAT, which typically results in the trust's assets being returned to the donor when the CLAT terminates. Such a trust features no gift tax benefit but does produce an income tax charitable deduction. (It is also possible to combine elements of both a grantor and non-grantor CLAT, but this is seldom done in practice.) Because the payments made to charity each year by a grantor CLAT are "for the use of" charity, the income tax charitable deduction the donor receives upon creating the trust can be used up to a limit of only 30 percent of the donor's adjusted gross income (AGI). For some donors, this can delay or dilute the value of the deduction. By contrast, in a situation such as Sandy's in the example above, if a donor uses cash received from a GRAT to make an outright charitable gift, the associated deduction can be used up to a limit of 50 percent of the donor's AGI.

Obviously, you will prefer to have your donor establish a CLAT of one type or another, rather than a GRAT, because your institution will then be a direct beneficiary of the CLAT and will not be dependent on your donor to decide each year what portion - if any - of the payments received from the GRAT he or she will actually contribute to your charity. Nevertheless, you should not hesitate to mention both a CLAT and a GRAT, trusting that if the connection between your donor and your charity is strong enough, your charity will benefit either way.

Look to PG Calc for Assistance

The foregoing represents just one of the ideas about how to adapt your planned giving program to the new economic reality that were covered by PG Calc Senior Advisor Frank Minton in his January 29, 2009 PG Calc Webinar entitled “Gift Planning Strategies in a Down Economy.” You can purchase a recording of Frank’s webinar, along with his written materials, by visiting www.pgcalc.com/training/webinar1317.asp.

[Print](#)

[Categories](#)

[PG Calc Featured Articles](#)