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The monthly IRS discount rate has hovered around 2.0% since August of 2013. Before that there was a stretch of rates that averaged 1.2% for 22 months. Although the rates have been slightly better recently, IRS discount rates have set an historical all time low. How does this effect gift planning?

Deductions and the IRS Discount Rate

Deductions for planned gifts that make fixed payments each year are far more affected by changes in the IRS discount rate than deductions for planned gifts whose payments can vary. As a result, deductions for charitable gift annuities (CGAs) and charitable remainder annuity trusts (CRATs) have decreased far more than deductions charitable remainder unitrusts (CRUTs). Deductions for pooled income fund gifts are not affected by changes in the IRS discount rate.

For charities that follow the annuity rates suggested by the American Council on Gift Annuities (ACGA), the decrease in CGA deductions will be mitigated somewhat by the decrease in ACGA rates that become effective January 1, 2012.

Although retained life estates (RLEs) don't fit neatly into either category, their deductions have also been affected greatly. Unlike the gifts mentioned above, however, RLE deductions are at historic highs rather than historic lows.

The table below compares deductions for a $100,000 gift for a 70 year-old, based on the September 2008 rate of 4.2% and the December 2013 rate of 2.0%.

Gift Type and Payout Rate	**Deduction @ 4.2%**	**Deduction @ 2.0%**
5.70%	$42,672	$31,833
5% CRAT	$49,713	$0*
RLE	$50,676	$65,151
5% CRU	$52,698	$52,288

* A 5% CRAT for a 70 year-old fails the 5% probability of exhaustion test and therefore would not qualify as a CRAT, despite a computed deduction value of $40,916.

These already significant deduction changes are amplified for younger beneficiaries and higher CGA and CRAT payout rates.

Pitfalls in a Low IRS Discount Rate World

Larger planned gifts, especially those that entail creation of a trust, often take many months or even years to complete. The deduction illustrated for a proposed CGA or CRAT just 6 months ago, for example, has decreased markedly since. Keep your prospects abreast of these changes so that they aren't rudely surprised when they contact you to complete their gift.

Now is a time to be especially wary of the 5% probability test and 10% deduction test for CRATs. The possibility of a CRAT failing either of these tests increases as the IRS discount rate falls. For example, using September 2008's 4.2% rate, a CRAT with the minimum 5% payout fails the 5% test for annuitants under 54, but the same trust fails the 5% test for annuitants as old as 71 when using the September 2013 2.0% rate.

As a practical matter, CGAs also must earn a deduction of greater than 10% to qualify as CGAs. The ACGA suggested rates effective January 1, 2012 ensure that all immediate payment CGAs will earn a deduction of greater than 10% for IRS discount rates as low as 2.4%. You may want to reduce the annuity amount you are offering in all instances where an immediate payment CGA fails the 10% test. There may be instances already where a deferred payment CGA that follows the ACGA rates fails the 10% deduction test. In these cases, you will again want to decrease the annuity rate you are offering enough so that the gift earns a deduction of more than 10%.

The consequence of failing any of these tests is disqualification of the gift. PG Calc's Planned Giving Manager conducts each of these tests whenever appropriate and issues a warning if one or more of your chosen gifts fail any of them.

Opportunities

Charitable gift annuities

The news for gift annuities is not all bad. While the income tax deduction available has declined, the tax-free portion of each payment has increased by the same proportion, making the after-tax value of each payment more valuable. For example, if the deduction for a particular CGA has declined 10%, the tax-free portion of all its payments combined has increased by the same amount. Donors who cannot use their entire deduction or consider it unimportant may find this tax benefit of particular interest. In addition, the secure fixed payments CGAs offer should be very attractive to the many donors who are concerned about the volatility of today's financial markets.

Charitable remainder unitrusts

As already demonstrated, the charitable deduction available for funding a charitable remainder unitrust is affected little by gyrations of the IRS discount rate. When the IRS discount rate is extremely low, as it is today, the deduction for funding a CRU looks pretty good in comparison to other life income plans. Furthermore, donors who feel that financial markets are near their bottom and are likely to rise substantially in coming years may find appealing a CRU's promise to make larger payments as its principal value increases. You are most likely to find this point of view with donors who are in their 60s or early 70s and therefore expect to live long enough to benefit from an eventual market recovery.

Retained life estates

An RLE donor receives an income tax deduction in the year of the gift. The low IRS discount rate has made deductions for RLE gifts especially high, so in this respect it is an auspicious time for suggesting and closing RLE gifts. The real estate market has been badly bruised in many parts of the country, of course, but there are still many donors who own valuable homes or second homes and have no plans to pass them on to heirs. These donors will be pleased to learn they can earn a substantial income tax deduction by giving their home or second home to your charity while retaining the right to live in it for as long as they want.

Non-grantor charitable lead trusts

The deductions for charitable lead annuity trusts (CLATs) are greater than they have ever been, making them a more attractive giving option.

With a non-grantor CLAT, the donor creates a trust that makes fixed payments to your charity each year for the duration of its term, then distributes its remaining principal to whomever the donor chooses. The donor receives a gift tax deduction for the present value of the payments to charity.

Non-grantor CLATs appeal to donors who have excess wealth that they don't need for their own financial security and would like to pass on to heirs. A typical non-grantor CLAT is funded with $500,000 or more and lasts for 10-20 years, although longer or shorter terms are permitted.

The great tax benefit of the non-grantor lead trust is that all growth within the trust passes to the heirs named by the donor free of gift and estate tax. With the IRS discount rate at 2.0%, this means that the donor can earn a substantial gift tax deduction at a relatively low payout rate, maximizing the possibility of trust growth. For example, a donor who funds a $1 million CLAT that pays $50,000/year (5% of the trust's initial value) and lasts 20 years will receive a gift tax deduction of over $800,000 and all investment return the CLAT earns in excess of $50,000/year will ultimately go to the donor's designated heirs tax-free. As with CRUs, then, donors who feel that financial markets are near their bottom and are likely to rise substantially in coming years should find CLAT's especially appealing.

Some CLAT donors feel strongly about choosing a trust term/payout rate combination that produces a 100% gift tax charitable deduction. They will be able to achieve this goal more easily now. The table below shows that the payout rate needed for a 20-year CLAT to produce a 100% gift tax deduction has declined markedly with the discount rate.

IRS Rate	**CLAT Payout for 100% Deduction**
4.20%	7.49%
2.00%	6.12%

Grantor lead annuity trusts

Grantor CLATs may also be especially attractive in the current environment. With a grantor CLAT, the donor creates a trust that makes fixed payments to your charity each year for the duration of its term, then returns its remaining principal to the donor (the "grantor") when the term ends. In this case, the donor receives an income tax deduction in the year of the gift for the present value of the payments promised to your charity. Because the donor receives the entire deduction up front, the donor is responsible for all tax on the income earned by the trust during its term.

Grantor CLATs often are invested in tax-free municipal bonds in order to reduce or eliminate this tax burden on the donor, although this strategy also limits the total investment return potential of the trust.

When the IRS discount rate is well below expected earnings on lead trust assets, as it may very well be today, and the donor can make use of a large income tax charitable deduction, a grantor CLAT can be very appealing. For donors who expect to have especially high income in 2013 -- for example as a result of selling a business, converting stock options, or any other reason -- funding a grantor CLAT can be a great way to earn a substantial income tax deduction in a year when it will be most valuable while providing immediate and sustained support to your charity. A grantor CLAT can also be an efficient way for a donor to fulfill a campaign pledge to your charity in a way that ensures that all pledge payments will be made.

Conclusion

The plunge in the IRS discount rate has changed the tax picture for a number of gift types. Gifts that make fixed payments have been particularly affected. For the gift plans that have been affected negatively - CGAs and CRATs - the security of fixed payments in these days of skittish financial markets may very well trump the disincentive of a low charitable deduction in the minds of many donors. For the gift plans that have been affected positively, especially CLATs, this is an especially opportune moment to be spreading the word to your donors.

It is important to keep IRS discount rate changes in perspective, however. While they may affect the timing of a donor's gift, or perhaps the gift plan chosen, they are unlikely to be the sole or even the primary reason for the gift. Support of a charity's mission is consistently cited by most donors as the most important motivation for making a gift. This will continue to be the case. Keep your donors excited about your organization's mission and the gifts will come.

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