



Charitable GRAT

We all know that Grantor Retained Annuity Trusts (GRATs) have been all the rage in gift planning for wealthy individuals and families due to the low interest rates we have experienced for many years. But are those same individuals aware that they can combine their charitable giving and the GRAT concept and create a fantastic combination that reduces the major risk in a GRAT? Enter the Charitable GRAT, also known as the Charitable Lead Annuity Trust or CLAT.

Are you fond of the time value discounted gift that a GRAT provides? Do you like the fact that you can discount the gift tax value down to zero, even though it is likely that the heir will receive a substantial sum? If you could make a big gift with little or no gift tax consequence while giving to charity what you normally give annually anyway, would you be willing to combine the two techniques? Sadly CLATs have been underutilized while their GRAT sibling has stolen the show.

How does a CLAT work? Like all split-interest trusts, a CLAT has a present and future interest. In this case, the present interest is a fixed sum of money, paid annually to the charity, or charities, of your choice. This may be the amount you give to charity annually or an amount you would otherwise pledge on an annual basis for a fixed period. The distinction here is you would set aside an amount of money, all at once, sufficient to pay that annual payout and it must be irrevocable, that is, you can't change your mind and alter the agreement once it is started. What is the advantage of an irrevocable agreement, you ask? It is the ability to make a future interest gift of the remainder to your family at a substantially discounted value. Irrevocable means that the IRS will count the dollars today, rather than what transfers. Thus, all future growth transfer to your family is gift tax free. We have to assume that the assets will grow by more than a modest rate, 2.2% for October 2017. So, if you believe that your sum invested a fixed period or for the rest of your life will earn more than 2.2% per year, everything over that amount will pass to your family free of gift or estate tax. This is not a loophole, nor a new or aggressive technique; in fact, it was passed by Congress in 1969. As long as you are willing to bet that the assets will grow by more than the Applicable Federal Rate, or AFR, (again, 2.2% at the time of this presentation) the technique works. That means Charitable Lead Trusts shine in low interest rate environments and lose their shine when interest rates are high. What happens to rates over time is unimportant, as the only rate considered is the rate in effect for the month in which the trust is created or either of the previous 2 months if they are better for you.

Let's consider an example. A couple, ages 65 and 66, gives \$150,000 annually to charity. So they set aside \$3,000,000 in a CLAT and instruct the trustee to make a \$150,000 annual payout to their chosen charity every year for the balance of their lives. After they both pass away the trust will terminate and pay the balance to their family. The calculations would show a life expectancy of approximately 25 years and value the present value of the stream of gifts to charity at about \$2,350,000 gift tax free since that is destined for charity, and the present value of what the family is expected to receive at about \$650,000. (These numbers are approximated at a 4% AFR to be conservative, and rounded off for educational purposes only.) That \$650,000 gift to the family is counted against the over \$5,000,000 amount the U.S. lets us transfer gift and estate tax free, so no tax is due. The trust makes the annual charitable gifts and can take a charitable deduction against its income each year. If the trust earned 8% a year, approximately \$9,500,000 would pass to the family estate tax free. Not bad for a \$650,000 gift. In addition \$3,750,000 would have been passed out to their favorite charity.

Another opportunity is to reduce the value of one's estate dramatically. Here I will use a fact pattern from Jacqueline Onassis' own will. Ignoring all the other things she bequeathed and people she benefited, she used several CLATs as part of her will. Following her death, a CLAT was created for each of her sister's children and the residue of her estate was to fund a CLAT as well. Again, ignoring the rest of her estate plan to focus on this one technique she utilized, and without knowledge of the actual values, let's pretend her estate was worth \$100,000,000 dollars. That means her estate tax bill would be about \$40,000,000. But by utilizing a CLAT granting an \$8,000,000 annual payout to a charitable Private Foundation run by the family, the calculation would show that everything would be paid out to charity and zero would be left for the family, thus creating a taxable estate of zero. No estate tax would be paid. Again, this is simply the math required by the IRS. In reality, if the trust earned a total return of 8% a year, her heirs would receive \$100,000,000 estate tax free in 24 years.

These are two examples of the potential power of a Charitable Lead Annuity Trust. If you:

1. have a potentially taxable estate,
2. annually give money to charity, and
3. desire your estate to pass to your family

Talk to your advisor about the application of a CLAT as a part of your estate planning. Do well, while doing good.



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