Being Creatively Charitable While Reducing Estate Taxes: Not a Bad Thing
Increased Gifting Available for 2011 and 2012

Financial planning offers different strategies to benefit both yourselves and charities in tax efficient ways. Different strategies work depending on the economic times we are in.

Today, there's an excellent opportunity in this difficult, low interest rate environment, to benefit your heirs in a way that minimizes taxes, while at the same time providing substantial charitable value. This strategy is called a Charitable Lead Trust, known as a "CLAT," and has been in use over the last 20 years. Its value is heightened during low interest rate times.

Prior additions of the Taxwise Giver have discussed the use of this strategy, but this month's column discusses the use of the CLAT in the context of a tax benefit that is due to expire at the end of 2012. In fact, it is a tax benefit that Congress would like to eliminate even before then. Stay tuned for whether Congress acts sooner.

Right now, Congress has increased the amount that people can give away during life without gift taxes. For 2011 and 2012, individuals have available to them the use of an additional $4,000,000 lifetime gifting amount. This means that during these years, donors can give away, separate and apart from the $13,000/donee that can be given, up to $4,000,000, without having any of that amount subject to gift taxes.

A strategy that has been in use over the last 20 years is the Charitable Lead Trust, known as a "CLAT." Prior additions of the ______have discussed the use of this strategy, but this month's column discusses the use of the CLAT in the context of a tax benefit that is due to expire at the end of 2012. Specifically, at the end of 2010, Congress increased the amount that people can give away during life without gift taxes. For 2011 and 2012, individuals have available to them the use of an additional $4,000,000 lifetime gifting amount. This means that during these years, donors can give away, separate and apart from the $13,000/donee that can be given, up to $4,000,000, without having any of that amount subject to gift taxes.

That $4,000,000 is scheduled to expire in 2013. Congress could, at its election, continue the $4,000,000 amount, but many planners do not want to take the chance that Congress will let the amount disappear. These planners are advising their clients to use the $4,000,000 currently, if they can afford to give that amount away to their family.

There are Different Ways to Use this Amount

Among the techniques being discussed to use part or all of the new $4,000,000 gifting amount are gifts of partnership interests, payoff of notes that younger family members may have outstanding, gifts of personal residences, and more creative techniques involving sales to grantor trusts.

In the charitable area, planners are also considering using CLATs to give away large amounts of property to both charities and individuals, free of any gift tax.

How it Works

A CLAT is an unchangeable **trust** in which one or more charities receive an annual amount, called an annuity, for a period of years. At the end of the period of years, any amount that remains in the trust is distributed to the children, or others, as the trust prescribes. The terms of the trust are as the creator determines, so the creator can determine the charities to be benefited, the eventual individual beneficiaries, the annuity amount, the type of investments in the trust, and the length of the charitable interest.

The Power of a CLAT with the $4,000,000 Gifting Amount

With the use of the increased gifting amount, a CLAT can be used to give away large amounts without gift tax, while providing charities with a certain amount for a limited time.

For example, if the donor wanted to transfer $10,000,000 to his children, this would be a gift of $10,000,000. Only $4,000,000 would be free of a gift tax payment. Instead, the donor could use a CLAT to transfer that $10,000,000. The donor would place these funds into a CLAT, and provide that the CLAT is to make annual gifts of 7 % of the initial principal,[1] or $70,000 annually, for 10 years to the JUF, or other designated charity or even charities. At the end of 10 years, any amount remaining passes to creditor protection trusts, say, for the benefit of the donor's children.[2]

Because of the 10 year gift to the charities, the donor has not gifted $10,000,000 to his family. Instead, the IRS says that the donor has gifted $10,000,000 less the value of the amount going to charity. That amount is $70,000 times 10 years, and is required to be valued pursuant to IRS rules.

Under those rules, the value of the gift in October, 2011, is approximately $3.8 million. The donor would pay no gift tax because the donor would apply the $4 million m (actually only $3.8 of the $4.0 million) gift tax exemption to the gift.

Assume that the trust returns on average 7 % annually, starting out in the first few years returning more than 7 %, and towards the end earning less than 7 %, but on average 7 %. At the end of 10 years, the full principal, $10,000,000 remains in the trust free of any additional gift or estate tax. These amounts can pass to the family members in specially crafted trusts.

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[1] The exact percentage will depend on the length of the charitable interest in the CLAT, and interest rates then in effect.

[2] The exact math will depend on required interest rates to be used in the calculations at the time the CLAT is set up.

If the donor was more conservative in projections, believing that 5 % was a reasonable return, the same $10,000,000 could be placed into a CLAT. But instead of a 10 year charitable interest at 5 % of initial fair market value annually, or $50,000, the donor would provide this charitable interest for 15 years. Each year designated charities would receive $50,000 from the trust.

The gift taxable amount would be approximately $3.7 million, entirely shielded by the $4 million credit. At the end of 15 years, in excess of $10,000,000 would remain available to the donor's children, assuming at least a 5 % rate of return was experienced.

These calculations are linear. The donor could make a gift to a CLAT of $1,000,000, on the same 7 % terms. There, only $400,000 about of unified gifting credit would be used. Assuming the variables in the above examples, the full $1,000,000 would be available at the end of 10 or 15 years, depending on the length chosen for the CLAT and the rate of return experienced.

Who Wins?

Use of a lifetime CLAT benefits charities currently, as well as a donor's children. The CLAT can reduce gift and estate taxes as to the property transferred.