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Donation of Income Interest

By Ken Dike

If you are a beneficiary of a charitable remainder annuity trust and are thinking of donating your future income stream to the charity, now is the time. With the Internal Revenue Service (IRS) discount rates at historically low levels, you will receive a charitable income tax deduction exceeding just about anything offered in the past.

IRS DISCOUNT RATES

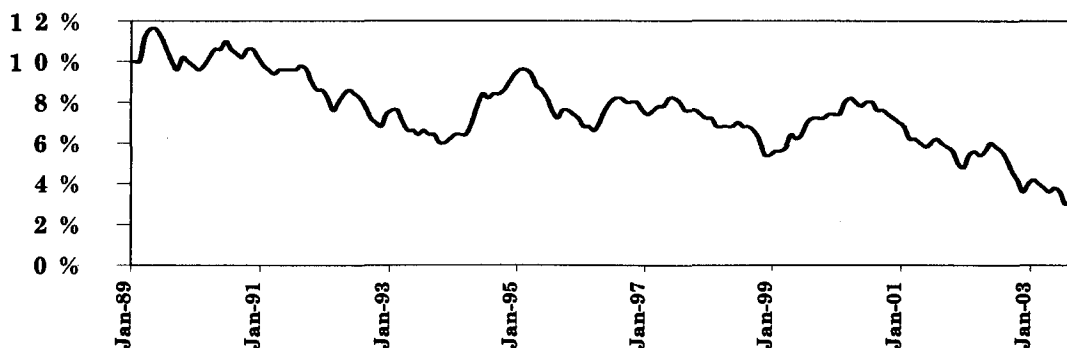
The IRS discount rate changes each month and is based on 120% of the federal midterm rate. The federal midterm rate is the average yield of U.S. government obligations with maturities of three to nine years. Below is a chart that reflects the historical levels of the IRS discount rate. There has been much written about how such low IRS discount rates result in historically low charitable deductions for gifts to

charitable remainder trusts. The flip side of the situation is the affect of low IRS discount rates on the charitable deduction available for gifts of charitable remainder annuity trust *income interests*.

CHARITABLE REMAINDER ANNUITY TRUSTS

Charitable remainder annuity trusts pay a fixed amount to the beneficiary. The beneficiary's right to receive these annuity payments is the *income interest*. Current tax law provides for a charitable deduction, by the beneficiary, for "donations" of this income interest when the beneficiary relinquishes their right to the annuity payments. The amount of the deduction, or present value of the income interest, is directly related to the amount and expected duration of the payments but indirectly related to the IRS discount rate. As the

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IRS discount rate declines the present value of the annuity trust income interest increases.

the income interest for a 5% unitrust and 5% annuity trust over a range of IRS discount rates. Both the unitrust and annuity trust are

assumed to have a 70 year old life beneficiary receiving annual payments of \$5,000 per year.

When calculating the charitable deduction for a gift of an income interest, the donor may use the IRS discount rate for the current month or the prior two months. In order to achieve the highest charitable deduction

Charitable Deductions for Gift of CRAT Income Interest (in thousands of dollars)						
Age	Amount of Annual Annuity					
	\$5	\$10	\$20	\$30	\$40	\$50
60	72	144	288	274	365	456
65	63	125	251	262	349	436
70	53	106	213	245	326	408
75	44	88	175	222	296	370
80	35	70	140	191	255	319

A 70-year old giving \$5000 annual income receives a \$53,000 deduction.

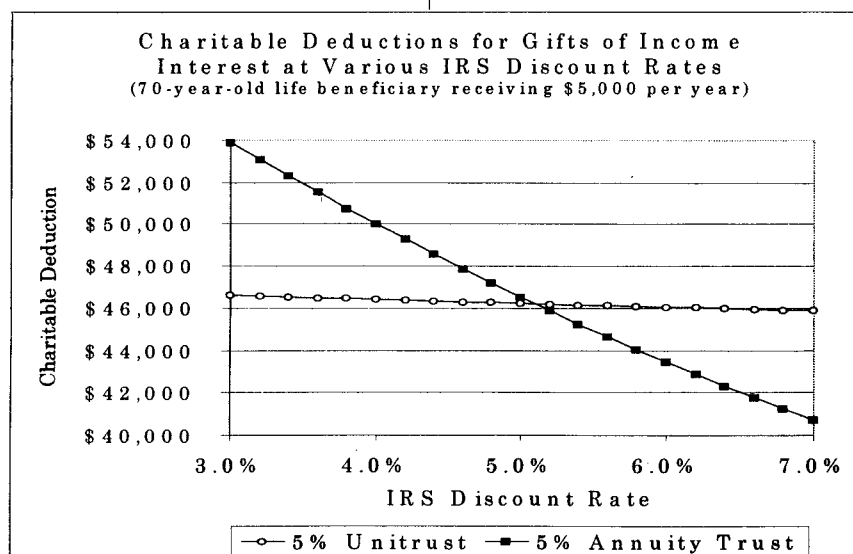
As the graph below shows, there is almost no difference in the present value of a unitrust income interest using a 3% or 7% IRS discount rate. The unitrust income interest present value declines by only 1.5% while the annuity trust income interest present value declines by 24.5% when the IRS discount rate increases from 3% to 7%. In addition, the present value of the annuity trust income interest exceeds the present value of the unitrust income interest when the IRS discount rate is less than the payout rate (5% in this example). When the IRS discount rate exceeds the payout rate, gifts of unitrust income interest will produce the larger charitable deduction.

for an income interest, the beneficiary/donor should use the lowest IRS discount rate for the three months ending with the month of the gift. The following table summarizes the charitable deduction available for gifts of a charitable remainder annuity trust (CRAT) income interest using the 3.2% IRS discount rate for the month of August 2003 (available for gifts made during the months of August, September, and October 2003).

ANNUITY TRUST VERSUS UNITRUST

The advantage of historically low IRS discount rates with respect to gifts of charitable remainder trust income interests is not nearly as significant for unitrusts as it is for annuity trusts. This is because the present value charitable deduction calculation for unitrusts is based primarily on the unitrust payout rate and only slightly affected by the IRS discount rate. The following graph compares the present value of

If you are a beneficiary of a charitable remainder annuity trust and the IRS discount rate is less than the payout rate, as is currently the case, a historically large charitable deduction is available for your contribution of the income interest due to the historically low IRS discount rate.



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