# The Boomerang Charitable Gift

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Using a tax tool known as the Charitable Lead Annuity Trust (CLAT), it is possible to make a substantial, essentially tax-free gift to one's children while at the same time making a significant gift to The Denver Foundation or another charity each year for a number of years. This permits one to derive the immediate satisfaction and recognition associated with a charitable gift while at the same time providing for the eventual return of the trust contribution to one's children when the trust terminates. Thus, the original gift becomes a boomerang. It does a good work and then returns to the family.

## The Jackie O. Zero Tax Plan

Although the CLAT has been an accepted tax planning strategy for years, it gained notoriety when it was reported that Jacqueline Kennedy Onassis had included such a trust in her Last Will and Testament to transfer her estimated estate of $120 million to her grandchildren without significant estate tax consequences. However, because of a special tax on generation-skipping transfers, most CLATs today are now designed to pass to children rather than grandchildren.

*Source: Getty*

Here is how the Jackie O. Plan was to work. After some specific gifts to various family members, the balance of Mrs. Onassis' estate was to be transferred to the trustee of a CLAT. The trust was to pay a designated annuity to a family foundation for 24 years. At the end of the trust term, the remaining assets were to be distributed to Mrs. Onassis' grandchildren. The estate taxable value of the grandchildren's share would be reduced by the present value of the charitable annuity.

## Tax-Free Wealth Accumulation

Although the Jacqueline Kennedy Onassis CLAT was created by her Last Will and Testament, these trusts are typically created during the lifetime of the donor. The benefit of a CLAT is greatly magnified when the property transferred to the trust is expected to appreciate in value over the term of the trust. For example, assume an annual annuity payment to the charity of 5% of the initial value of the trust contribution while the trust assets are growing at the rate of 6% annually. The growth of the trust assets over and above the amount paid annually to the charity keeps accumulating in the trust for eventual distribution to the children.

## A Stunning Example

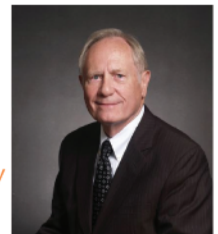
To understand the power of a CLAT, let's examine a 25-year-trust funded with $1,000,000 of assets. The charity is to receive a 5% annuity. It is anticipated that the assets will grow at a rate of 6% (representing the combined income earned on the assets and capital appreciation). Since the IRS will assume the trust will earn only 2.2% (but the rates which the IRS uses to value these trusts change every month, referred to as the 7520 Rate), the gift tax value of the children's remainder interest would be only $46,365. A gift tax return would be filed showing this amount. However, since we have assumed that the assets are growing at a rate greater than the annuity being paid to the charity, the amount that would be distributed to the children at the end of 25 years would actually be $1,548,645. This dramatic difference between the IRS assumed value of the children's remainder interest and the real value results from the difference between what the IRS assumes the trust will earn (2.2%) and the actual investment return (6%). The greater the disparity between the assumed and the actual return, the greater the impact on the children's trust remainder interest. All the children must do is wait until the trust expires in 25 years. Remember, this example is based on a 7520 Rate of 2.2% and this rate is published monthly by the IRS.

## Income Tax Consequences

For income tax purposes, the contributor to a non-grantor CLAT is not taxed on the trust income. Instead, the trust is taxed on the income to the extent such income is not distributed to the charity each year as part of its annuity. There is no income tax charitable deduction for the contribution to a non-grantor CLAT.

## Gift Tax Consequences

A federal gift tax charitable deduction is allowed for the value of the charity's annuity interest. A gift tax return must be filed in the year the CLAT is created to reflect the value of the children's remainder interest. The annual gift tax exclusion may not be applied to reduce the gift consequences.



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