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IRS Approves Increasing Payment Charitable Lead Annuity Trust

A just-released IRS private letter ruling (PLR 201216045) authorized a charitable lead annuity trust (CLAT) with an increasing annuity payment. CLATs are trusts which typically provide for an annual annuity amount payable to charity for a period of years, with the remainder of the trust value going to the donor's heirs at the termination of the trust. To qualify for the charitable contribution deduction, the annuity payable to the charity must be a "guaranteed annuity," meaning a "determinable amount" the value of which can be ascertained as of the appropriate date. Unlike charitable remainder trusts, the law does not require that the annual payment be a "sum certain" (i.e., a fixed amount). One of the recent "hot topics" in the gift planning community is whether the CLAT payments can increase over the term of the trust. Actuarially, one can structure a CLAT with increasing annuity payments to have the same present value as one with a fixed annual annuity. However, by back-loading the payments (which leaves more investment assets in the trust in the early years), the trust is likely to have more funds for the heirs at termination, even though the charity gets the same amount on a present value basis (at least using the IRS assumptions). The taxpayer in this ruling asked the IRS to approve a CLAT with annuity payments that increased 20% per year — in other words, each year's payment is 120% of the prior year's — and the IRS said "yes"!

Two notes:

- First, the CLAT in question was a testamentary formula CLAT, which had a 10-year term and essentially said "pick an annuity rate that will result in a present value for the charitable annuity interest equal to 100% of the contribution." It appears that the CLAT was initially formed with a fixed percentage, and was then reformed later to provide for the increasing annuity payments.
- Second, note that the CLAT payments increased at a steady 20% per year. This trust was not a "shark-fin CLAT," in which the payments are very small during the initial years and increase dramatically in the final years. The jury is still out on that one!

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