

What is the IRS Discount Rate, anyway?

You know that something is “technical” when it has more than one name or acronym. In the case of the IRS discount rate, it has four!

- The IRS discount rate
- The applicable federal rate (AFR)
- The charitable midterm federal rate (CMFR)
- The section 7520 rate

Yes, these are all one and the same thing. The IRS discount rate is set under section 7520(a) of the Internal Revenue Code, and it is used to calculate the charitable deduction for certain gifts to charities such as gift annuities and charitable remainder trusts.

The IRS discount rate is an important factor because, in order for a gift annuity to qualify under the law, *the remainder value must be greater than 10% of the value of the assets transferred*. If it does not reach this minimum threshold, then the gift annuity cannot be issued. However, in such cases all is not lost. With the knowledge and consent of the donor, we may negotiate a lower payment rate than our published rate which increases the charitable deduction to an amount that satisfies the 10% requirement. While these reduced rates may be less than our normal rates, they are often still higher than those offered by other nonprofit organizations.

Interested in a little more detail? In determining the rate, the IRS uses Treasury bills as the basis for the calculation. The rate is the average annual yield over the past 30 days of Treasury bills with maturities ranging from three to nine years, which is then multiplied by 120% and rounded to the nearest fifth.

Once determined, this rate is a key factor in the calculation of the charitable deduction. For charitable annuities, the deduction is computed by first determining the value of the annuity payments that will be made over the beneficiary’s life expectancy. This is done by using the AFR as a discount factor to account for the change in the value of a dollar that will occur over that time period. Then, this figure is subtracted from the

original value of the assets used to fund the gift. A low AFR results in a relatively higher value for the payments compared with the value of the gift, and therefore a lower charitable deduction. If the deduction doesn’t equal at least 10% of the funding assets, lowering the payment rate solves this problem by increasing the charitable deduction.

You don’t need a law degree to understand the IRS discount rate

The IRS discount rate is published monthly and is announced on or about the 20th of the month that precedes the month to which the rate will apply. For example, the rate for December is announced around November 20. When you are calculating a planned-gift deduction, you may use the discount rate for the month in which the gift is made or for either of the prior two months, whichever is most beneficial to the donor. This is one reason why our illustrations for *Pomona Plan* annuities may fluctuate from month to month and why we sometimes suggest that prospective donors check with us on or after the 20th of the month for updated information.

Sample IRS Discount Rates Over the Past Ten Years: November Rates

2002	3.6%
2003	4.0%
2004	4.2%
2005	5.0%
2006	5.6%
2007	5.2%
2008	3.6%
2009	3.2%
2010	2.0%
2011	1.4%
2012	1.0%



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