

# Charitable Lead Trusts

How would you like to put your gifts to a favorite charity on autopilot, benefit your children, grandchildren, or other heirs, and gain tax benefits to boot? It's all possible with a charitable lead trust.

Basically, with a charitable lead trust, you place cash, securities, or other assets in an irrevocable trust. The trust then makes payments to a charitable organization for a specified period. At the end of that period, the property remaining in the trust passes to the trust's remainder beneficiary — a child or grandchild, for instance — or the property can be returned to you.

## Two Types

You have considerable flexibility in creating a charitable lead trust. The trust can be created during your lifetime or at your death. You choose the charity that will benefit from the trust, how long the trust will last, and who will eventually receive the trust property. And your trust can be one of two types — either a charitable lead annuity trust or a charitable lead unitrust.\*

**Charitable lead annuity trusts.** With a charitable lead annuity trust, the annuity payment to the charity is a set dollar amount or a percentage of the initial fair market value of the property placed in the trust. Let's say you create a charitable lead annuity trust with \$500,000 in securities and direct that the trust pay 5% of the securities' value to the designated charity each year for ten years. The trust would pay the charity \$25,000 a year for the term of the trust (\$250,000 total) — no matter what the appreciation in the trust assets might be year to year or what income the trust assets generate.

So, if the securities consistently earn annual returns greater than 5%, your remainder beneficiary would receive more than your initial \$500,000 contribution when the trust ends. What happens if the securities earn less than 5%? The payments to the charity would diminish the trust assets below their original value, and your beneficiary would receive less than the trust's original value.

\* A third type of charitable lead trust — a "nonqualifying" trust — is not discussed here.

**Charitable lead unitrusts.** With a charitable lead unitrust, the payments to the charity are based on the fair market value of the trust property, recalculated annually. So they will most likely vary from year to year. Let's say you set up your \$500,000 charitable lead trust as a unitrust. You direct that the trust pay the charity 5% of the fair market value of the trust assets valued annually. The first year, the trust would pay the charity \$25,000. If the value of the trust assets dropped to \$480,000 at the beginning of the second year, the trust would have to pay the charity only \$24,000 for that year. And, if the value of the assets increases, the trust pays the charity relatively more for the year.

As with a charitable annuity trust, the greater the investment return earned by a unitrust, the greater the value of the resulting assets that will eventually pass to the remainder beneficiary. Also, higher investment returns mean greater payments to the charity.

## Tax Advantages

Along with supporting charitable causes and providing an orderly way to transfer assets, charitable lead trusts offer tax advantages. Depending on how you design your trust, you can gain estate-, gift-, and, possibly, income-tax benefits as well.

**Estate- and gift-tax benefits.** Charitable lead trusts are often created as a way to minimize or avoid estate tax on lifetime transfers of property to family members or other loved ones. To secure estate-tax benefits, you must irrevocably transfer the property and most rights in the property to the trust and name some other person as the trust's remainder beneficiary. Then, any future

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appreciation in the property will be removed from your estate for estate-tax purposes.

However, your gift to the noncharitable beneficiary will be a taxable gift when you create the trust. The good news is that the amount of your taxable gift is reduced by the value of the charity's lead interest in the trust.

You may also realize estate-tax savings by creating a charitable lead trust in your will. With a testamentary charitable lead trust, the value of the bequest to the trust's remainder beneficiary will be included in your estate for estate-tax purposes. But any future appreciation in the trust assets will pass estate-tax free. In addition, your estate will be able to claim an estate-tax charitable deduction for the value of the charity's income interest in the trust.

**Income-tax benefits.** If you find yourself in an unusually high income-tax bracket one year because of large capital gains or the sale of a business interest, for example, you might consider creating a charitable lead trust structured to provide immediate income-tax benefits. To gain income-tax advantages, the charitable lead trust has to be a "grantor" trust. The grantor is the person who creates the trust.

For a charitable lead trust to be considered a grantor trust, you, as the grantor, have to keep some interest in or control over the trust property. You will be able to claim an immediate income-tax charitable deduction for the present value of the charity's interest in the trust (within IRS limits). In return for this up-front deduction, you will have to pay income tax on the trust's annual income. In addition, all or a portion of the trust assets will generally be included in your estate for estate-tax purposes.

**Obviously, charitable lead trusts of any type are a sophisticated planning tool. Your professional advisors can help you evaluate how a charitable lead trust might fit in your estate planning.**

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