Grow Your Assets Without Growing Your Heirs' Tax Bills

The Charitable Lead Trust

If you want to put your donation to work right now and also provide an inheritance for your family, consider setting up a charitable lead trust.

Doing so will provide immediate support to benefit a charitable organization such as ours. Meanwhile, you will have reduced your taxable estate and property kept by your family, often with reduced gift and estate taxes, and provided a means for your heirs to receive future financial benefits. Here's how it works:

1. You give assets to an irrevocable trust that pays a charitable organization a fixed payment for a term of years you select or for a person's life.
2. When the trust term ends, individuals ("remainder beneficiaries") receive whatever remains in the trust ("remainder interest").
3. You select the charity, determine how much it receives and choose the remainder beneficiaries.

Two Types of Trusts

Generally, if you structure the trust as a **grantor trust** for income tax purposes, you receive an income tax charitable deduction for the present value of the charitable payments upon funding the trust. In future years, however, you must report the trust income on your personal income tax return. You or your spouse receive the remainder interest or retain certain controls over the trust. The property and appreciation on it may also be included in your taxable estate. *Unless you have unusually high income in one year and can benefit from this deduction, you probably will not use this type of lead trust.*

More often, the trust is drafted as a **nongrantor trust** for income tax purposes, meaning, among other things, that the remainder interest passes to individuals other than you or your spouse, and you do not receive an income tax deduction when funding the trust. Because the trust provides for a charitable organization at a potential cost to your family, you should use the lead trust only if you are charitably inclined. *The rest of this guide discusses a qualifying nongrantor lead trust naming your descendants as the remainder beneficiaries.*

Nongrantor Lead Trust

When Funded During Your Life
- Benefits charity now and family later
- May provide transfer tax benefits
- May reduce the initial outlay for gift taxes

When Funded at Death
- Benefits charity immediately after your death and your family sometime thereafter
- Allows heirs to obtain a stepped-up cost basis in the trust's assets
- Provides your estate with an estate tax deduction

Important note: Regardless of when it is funded, heirs must wait to receive the trust property.

Types of Charitable Payments

Your transfer to the trust is treated as two separate gifts. The first gift is to us in the form of an annual payment. The second gift is the remainder interest that your family will ultimately receive.

fair market value

the price a willing buyer and a willing seller can agree on

To receive a transfer tax deduction for the charitable payment, it must be either:

1. An annuity payment—we receive the same amount annually whether the trust assets appreciate or depreciate.

2. A unitrust payment—we receive a variable amount based on a specified percentage of the fair market value of the trust assets, valued annually. You set the percentage upon creating the trust. The payments fluctuate with trust appreciation or depreciation. If the trust income is insufficient, the trustee uses principal to make up the difference.

Example: *You transfer $500,000 to a nongrantor charitable lead annuity trust that will pay us 5 percent annually for 20 years and then give your children the remainder interest. Assume the trust's net return is 6 percent annually, and the applicable IRS valuation rate, which changes monthly, is 1.4 percent. This chart illustrates the approximate results.*

20–Year Charitable Lead Annuity Trust

For more information, please call us or your estate planning attorney to discuss a gift plan that best suits you.

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