Take Care of Heirs and Charities with a CLT

Key Takeaways:

- Charitable lead trusts help accomplish both philanthropic and estate planning goals.
- CLTs can come with potentially attractive tax benefits.*
- CLTs can be appropriate for many types of people—including executives, entrepreneurs, real estate investors and more

If you're like many investors with significant assets, you may feel you're in a kind of tug-of-war between two goals:

- Leaving money to your heirs
- Benefiting charitable organizations that are meaningful to you

The good news: There's a philanthropic tool that can help you strike the balance you want between those two objectives. It's called a ***charitable lead trust,*** or CLT, and it can enable you to have a major impact on both your family and your favorite causes.

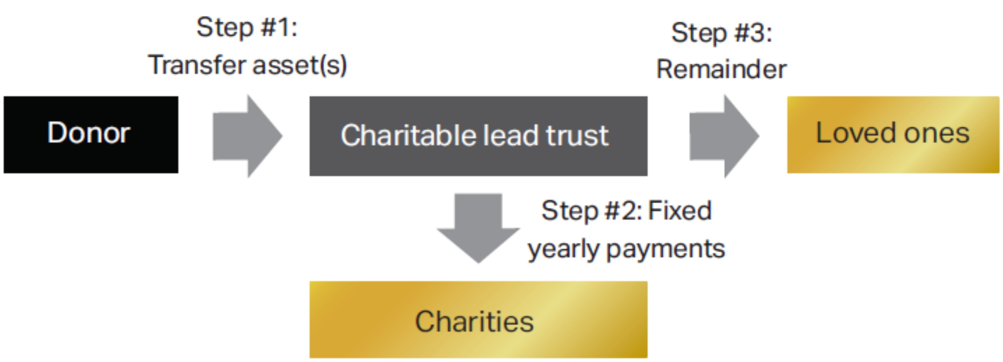
Here's an overview that spells out the ABCs of CLTs—and how to decide whether this powerful approach to charitable planning may be a good option for you.

CLT overview

The basic mechanics of a charitable lead trust are well-established (see Exhibit 1).

EXHIBIT 1

Mechanics of a Charitable Lead Trust



* Disclosure: Tax laws are subject to change, which may affect how any given strategy may perform. Always consult with a tax advisor.

Step #1: Establish a charitable lead trust and fund it. You can establish a charitable lead trust while alive or through your estate plan. To fund it, you contribute assets—such as cash or appreciated securities—to the trust, which invests and manages those assets.

Step #2: The trust sends payments to one or more charities. The trust provides an annual income payment to a chosen charity (or charities, as the case may be). These charitable payments can go on for a fixed number of years, for the life span of an individual or a combination of the two. In addition, the trust can be structured to allow you to replace the chosen charity with another during the term.

Step #3: The remaining assets are distributed to you or your loved ones. At the end of the charitable term, the remaining assets are distributed to your loved ones (typically those who are of your same generation or one generation down, in order to avoid the generation-skipping tax). Ideally, the trust assets have grown over time—leaving a nice amount of wealth left over.

Voila! You've helped fund a favorite cause and also taken care of your heirs.

Tax benefits—and a caveat

Because the government wants to encourage charitable giving, it has attached some serious tax benefits to CLTs. For example:

- **Tax-deferred growth.** The assets in the CLT can be structured to grow tax-deferred, if you utilize proper planning and appropriate investment vehicles.
- **Tax deduction.** When you create and fund the CLT, you get an income tax deduction. There are different tax deductions depending on factors such as the assets being used, the projected payments to charity, and the IRS interest rates that form the basis of the anticipated growth of the money in the trust.
- **Avoidance of other taxes.** The beneficiaries of the trust receive the assets estate- and gift tax-free.

Warning: Charitable lead trusts are irrevocable. That means once you put assets into one, you cannot change your mind later and pull them out. The upshot: Don't even think about creating and funding a CLT unless you're sure you want some of your wealth to go to one or more charities!

What can you put in a CLT?

You can use a wide variety of assets to fund a CLT. Some examples include:

- Cash
- Stocks and bonds
- Partnership interests
- Real estate

As with all wealth planning strategies, a charitable lead trust has advantages and disadvantages (see Exhibit 2).

EXHIBIT 2

Advantages and Disadvantages

Advantages	Disadvantages
• Make a meaningful charitable gift. • Gift and estate tax deductions. • Potential income tax deductions.	• Irrevocable. • "Grantor trust" so the trust income is taxed to the grantor unless the contributions are properly structured. • The value of the assets can fluctuate, potentially leaving heirs less money than expected.

Case studies: CLTs in action

To see how CLTs can work for some types of investors, consider these case studies:[†]

Case study 1: The high-income corporate executive

A corporate executive in his late 50s will generate $2 million of income this year, due to the exercise of vested options. In the long run, the executive wants to benefit his wife and children. But he also has consistently been giving to several charities for years, and he is interested in establishing some type of planned giving strategy.

The executive and his advisors devise a 20-year-term charitable lead trust with zero gift tax due. The executive, who is highly liquid, places $2 million of cash into the CLT. The trust will distribute an annuity among the charities selected by the trustee, with the annuity increasing 20 percent annually.

This results in a relatively small distribution (approximately $17,000) in the early years, which will allow for more of the assets in the CLT to grow tax-deferred. The executive will receive an upfront $2 million charitable deduction, which will help offset the income recognition. The 20 annuity payments to charities will add up to approximately $3.2 million (with the final payment of about $553,000). Assuming that the charitable lead

[†] Disclosure: Examples are calculated with an IRS required interest rate, under Internal Revenue Code Section 7520, of 3.20 percent and are zeroed out to avoid use of gift tax exemption.

trust assets grow at an annualized rate of 6 percent, the remainder left over after 20 years to benefit his spouse and children will be approximately $2.1 million.

Case study 2: The real estate investor

A real estate investor in his late 40s wants to donate annually to his alma mater. Working with his advisors and the school, he establishes a charitable lead trust with a 20-year term and places $1 million of real estate with high growth potential and a strong rental stream into the trust.

The charitable lead trust is structured so zero gift tax is due and so the annuity increases 20 percent every year. At the end of the 20-year term, the real estate investor would like to benefit his younger niece and nephew who work with him in the business.

The real estate investor will receive an upfront $1 million charitable deduction that will help offset his income. The 20 annuity payments to the school will add up to approximately $1.6 million. Assuming the real estate in the charitable lead trust grows 7 percent per year, the remainder to his niece and nephew will be worth approximately $1.6 million. To the extent the real estate throws off depreciation and other deductions, the real estate investor will still be able to use the CLT deductions on his personal 1040.

Case study 3: The entrepreneur

A business owner in her 30s sold a number of shares of her company after an initial public offering, and she expects a significant upside on her remaining shares. She speaks with her wealth manager about a way to minimize her tax bill this year.

Her wealth manager discovers that the business owner has been consistently donating to a number of nonprofits based in her hometown that empower inner-city youth. The business owner decides to use $5 million of cash to fund a 15-year term charitable lead trust, which will provide an annuity (increasing 20 percent every year) to the nonprofits. The remainder assets will then revert back to her.

The charitable lead trust produces zero gift tax. She will receive an upfront $5 million charitable deduction. The 15 annuity payments to the nonprofits will add up to approximately $7 million. Assuming the assets grow at 8 percent per year, the remainder to the entrepreneur will be $5.9 million.

Next steps

Clearly, charitable lead trusts can be extremely useful and powerful wealth planning tools if you’re philanthropically minded and have significant assets. They can allow you to have a major impact on a charity you value—potentially a much bigger impact than you could have otherwise—while also benefiting your bottom line significantly in the form of lower taxes and enabling you to help heirs financially.

If you are considering making charitable giving part of your wealth plan, you'll want to talk with the financial professionals you work with to determine the best vehicle and strategy for your situation. You also should consider discussing your goals with your family.

Best bet: Make sure your advisor is a professional with expertise in the areas of charitable giving and philanthropic wealth planning—or that he or she has access to such a professional via a network of experts.

Contact your financial professional to discuss your charitable goals and how you might position your wealth to best pursue them.

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