



## Charitable Lead Trusts: Why You Should Act NOW!

*Want to pass more on to your heirs, save gift and estate taxes, and benefit your favorite charitable institution at the same time? A big window of opportunity has just opened.*

If you have a large enough estate to worry about estate taxes and are looking for ways to pass more on to your heirs at a substantial tax savings while making a charitable gift, now is the time to consider a Charitable Lead Trust. Why? Because the Section 7520 Rate—the rate the IRS uses to calculate the remainder interest in charitable trusts—has dropped to 3.6% (March, 2008).

That spells “good news” for CLTs. Here’s why.

### **What is a Charitable Lead Trust?**

A Charitable Lead Trust (CLT) is a powerful way to transfer assets to your heirs at a significantly reduced gift and estate tax cost, while supporting one or more charities with income payments for a period of years. During the term of the trust, a CLT makes fixed (annuity) or variable (unitrust) income payments to one or more charitable beneficiaries. When the trust terminates, the assets pass to your heirs (called a Non-Grantor Lead Trust) or revert to you (called a Grantor Lead Trust). Non-grantor CLTs qualify for a gift tax deduction equal to the income payments made to charity, and are a great way to reduce the cost of intergenerational wealth transfers. Grantor CLTs generate a current income tax deduction, and are useful if you wish to accelerate future deductions into the current year. Let’s focus on the non-grantor Charitable Lead Annuity Trust (CLAT) because it is the most common and has the widest application. CLAT’s make fixed annuity payments to your charitable beneficiaries.

### **What Are the Advantages of a Non-Grantor CLT?**

For people who have significant assets (typically, \$5 million or more ), a Non-grantor CLT spells gift and estate tax relief.

1. You receive a charitable gift tax deduction based on the future income payments made to charity. When used in combination with your gift tax credit (\$1 million lifetime per person) and estate tax exemption (\$2 million per person in 2008), this deduction can reduce or even “zero out” your gift and estate tax liability on substantial transfers to your children or grandchildren.

2. The assets you contribute to a non-grantor CLT are removed from your taxable estate, lowering your future estate tax liability.
3. Any growth that takes place in the trust assets during the term of the trust passes tax-free to your heirs. You can even structure your CLT to start with smaller payments to your charity that “build-up” over time in order to enhance asset growth. Take note that a CLT is a taxable trust. CLT income in excess of payments to charity is taxable.
4. Unlike most other kinds of planned giving arrangements, a CLT provides immediate benefits to charitable beneficiaries. Payments from a CLT can be used to fund capital projects as well as endowment.

### So, Why the Fuss About the IRS Discount Rate?

The IRS uses a special discount rate—known as the Section 7520 Rate—to calculate the value of the gift tax deduction for a Non-Grantor CLT. Published monthly, the Section 7520 Rate is based on the federal mid-term interest rate.

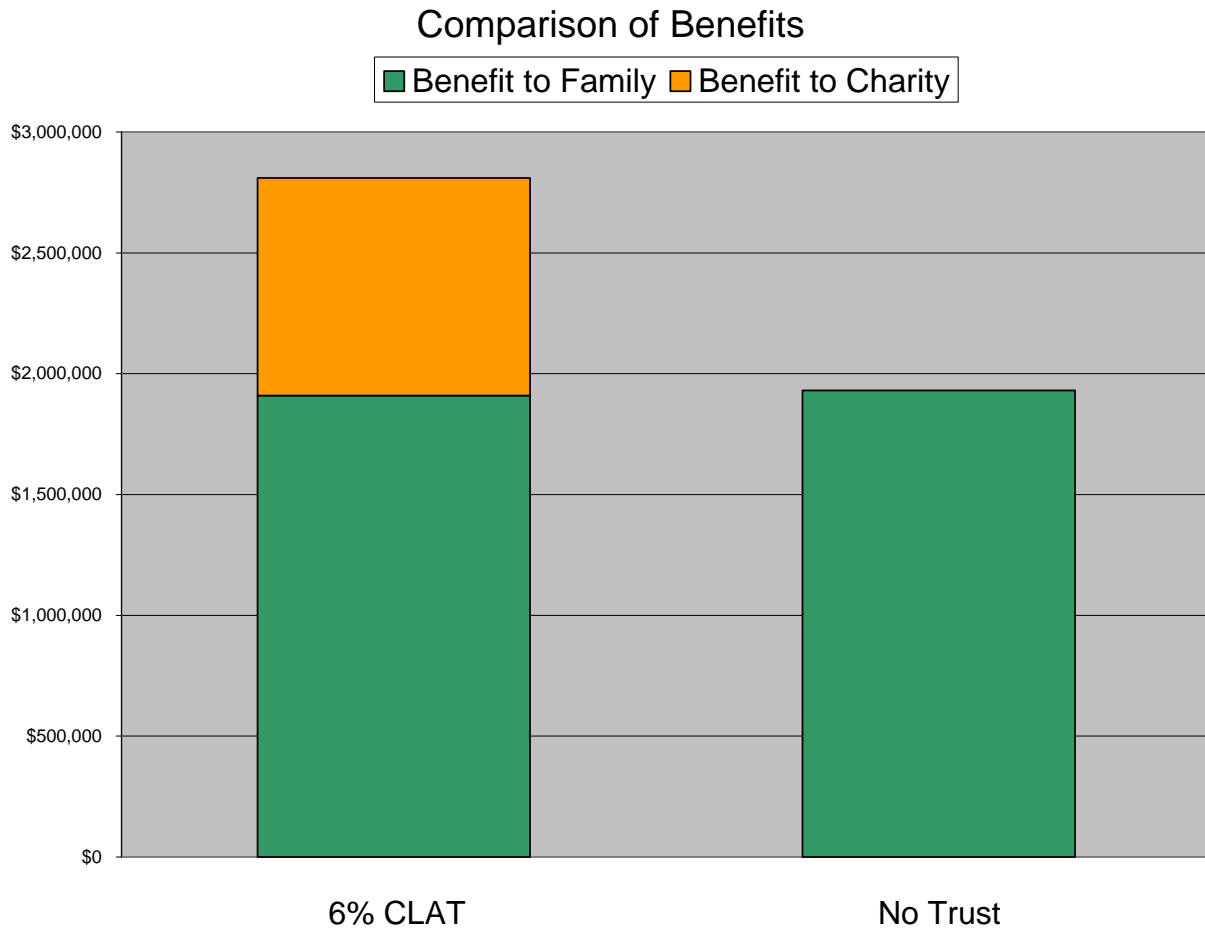
The key is that a lower IRS discount rate translates into lower gift and estate taxes. And, herein resides the good news: the IRS discount rate has recently dropped to historically low levels—3.6% for March, 2008. That means big tax savings for CLT donors as the following example illustrates.

### EXAMPLE

Assume a Non-Grantor CLAT funded with \$1 million in cash that pays a 6% annuity (\$60,000 a year) to one or more charities for 15 years after which the assets pass to donor's children. (Assumption details are provided below.)

	<b>6% CLAT (7520 Rate 3.6%)</b>	<b>6% CLAT (7520 Rate 6.2%)</b>	<b>No Trust</b>
Gross Principal	\$1,000,000	\$1,000,000	\$1,000,000
Annual payments to charity	\$ 60,000	\$ 60,000	\$ 0
State & Federal income taxes	\$ 69,639	\$ 69,639	\$ 418,040
Transfer Taxes	\$ 141,228	\$ 191,165	\$1,579,611
Benefit To Family	\$1,909,622	\$1,859,686	\$1,930,636
Benefit To Charity (15 yrs.)	\$ 900,000	\$ 900,000	\$ 0

**Assumption Details:** Non-Grantor Inter Vivos Trust established in 2008 for 15 years; CLAT makes annual, end of period payments to charity; funding asset is cash i.e. cost basis of 100%; donor's marginal income tax rate is 38.5%, 15% for capital gains; CLAT's combined income tax rate is 38.5% (35% marginal income tax rate plus 3.5% state income tax rate for trusts), 15% for capital gains; value of donor's estate is \$10,000,000; prior taxable gifts are zero; 2009 transfer tax rates are continued in future years; trust investment return assumptions are 3% income and 7.5% appreciation for a total annual return of 10.5%; CLAT management fee is 0.75% and No Trust management fee is 0.35%; annual asset turnover is 10%; and, transfer taxes are paid with cash from principal in 15 years upon termination of the CLAT.



As you can see, the advantages of a CLAT in this case are enormous. It saves \$1.79 million in taxes, leaves virtually the same amount to your heirs, AND provides a gift of \$900,000 to charity.

### **What About the 2001 Tax Act?**

But, you say, doesn't the 2001 Tax Act phase out the estate tax by 2010, making the Lead Trust irrelevant as a wealth transfer device? The short answer is "not likely." The consensus among legal and tax experts is that, for a variety of reasons too numerous to discuss here, Congress will act to freeze income and estate tax rates at pre-2010 levels before the law "sunset" in 2011 and returns to the 2001 rates. If rates were frozen at 2008 levels, for example, the estate and GST exemption would be \$2 million per person with a top federal gift and estate tax rate of 45%, leaving plenty of justification for CLTs in larger estates. More importantly, whatever happens to the estate tax, the gift tax exclusion is scheduled to remain at \$1 million. The bottom line? This is a good time to consider a CLT!

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