Charitable Lead Trusts: Now Is The Time

Do you have a large enough estate to worry about estate tax? Are you 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 (CLT)**. Why? Because the Section 7520 Rate (the rate the IRS uses to calculate the charitable deduction in charitable trusts) is at an all-time low – .8% for July 2020. While that is not such great news for charitable deductions for most life-income gifts (the lower the discount rate, the lower the deduction for such gifts), it is great news for CLTs. Why? Read on…

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. Non-grantor charitable lead annuity trusts (CLATs) are the most common and have the widest application. CLATs make fixed (annuity) payments to one or more charities over a term of years.

What are the advantages of a non-grantor CLAT?

For people who have significant assets (more than $5 million for single filers or $10 million for joint filers), a non-grantor CLAT 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 unified gift and estate tax credit of $5.25 million per person in 2013, this deduction can "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 CLAT are removed from your taxable estate, lowering your future estate tax liability.
3. Any growth that takes place in the assets during the term of the trust passes tax-free to your heirs. In tough times like these, assets you place in the trust are more likely to experience substantial appreciation as the economy improves. You can even structure your CLAT to start with smaller payments to your chosen charity or charities that "build up" over time in order to enhance asset growth.

4. Unlike most other kinds of deferred giving arrangements, a CLAT provides immediate benefits to your charitable beneficiaries. Payments from a CLAT can be used to fund capital projects as well as endowments.

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 present value of remainder interests left by charitable trusts. Published monthly, the Section 7520 Rate is based on the federal midterm interest rate.

The key is that the lower the IRS discount rate, the lower the calculated remainder value of a trust. In the case of Charitable Lead Trusts, where the remainder value goes to your heirs, a lower discount rate translates into lower gift and estate taxes levied on the transfer. And, herein resides the good news: the IRS discount rate is currently at the lowest levels in history – it has hovered between 1.0% and 1.6% for the last six months, and was 2.4% in October, 2013. That means big tax savings for CLT donors, as the following example illustrates.

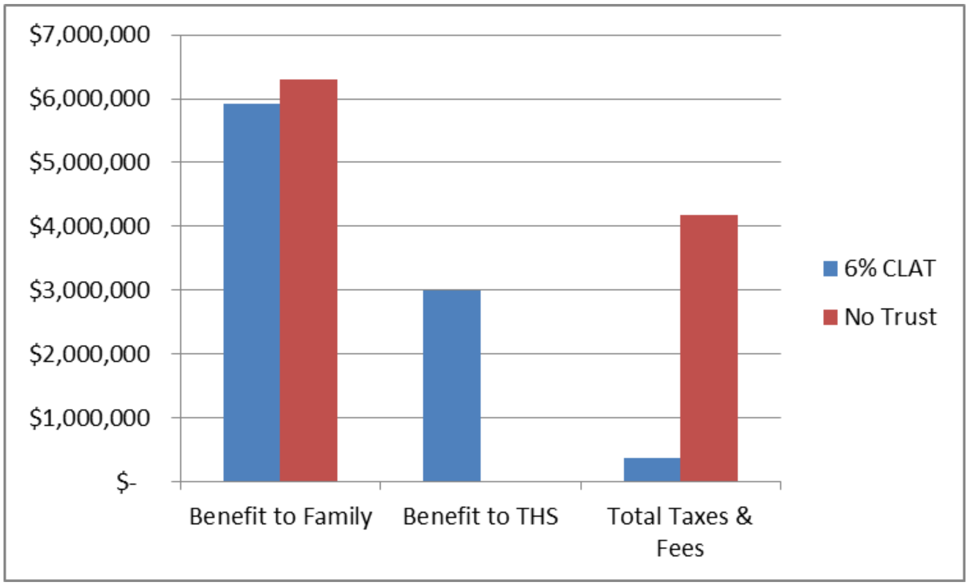
Comparison of Benefits

ASSUMPTIONS:
Non-grantor *Inter Vivos* Trust established in 2012 for 10 years.
Lead Trust makes 6% annual, end-of-period payments to THS.
Original principal of $5 million has a cost basis of 100%.
Donor income tax bracket is 35%, 15% for capital gains.
Beneficiary income tax bracket is 35%, 15% for capital gains.
State income tax for trusts is 3.5%.
Value of donor's estate is $50 million. Prior taxable gifts are $0.
Transfer tax: Continue 2012 tax rates in 2013 and future years.
Average total investment return over term of trust is 8%
Annual investment and administrative fee for CLAT and no trust is 0.65%.

	(1) 6% CLAT (7520 Rate 1%)	**(2) 6% CLAT (7520 Rate 6.2%)**	**(3) No Trust**
Gross principal	$5,000,000	$5,000,000	$5,000,000
Annual payments to charity	$ 300,000	$ 300,000	$ 0
Gift tax deduction	$2,841,400	$2,187,750	$ 0
Total taxes and fees	$ 369,340	$1,353,803	$4,182,686
Benefit to family	$5,919,082	$4,934,619	$6,305,449
Benefit to charity (10 years)	$3,000,000	$3,000,000	$ 0

As you can see, the advantages of a CLAT over no trust in this case are enormous. It saves $3,813,346 in taxes and fees, leaves almost as much to your heirs, AND provides a gift of $3 million over 10 years to The Kiski School. In addition, the drop in the IRS discount rate from a peak of 6.2% in 2007 to 1% (column 2 vs. column 1) further reduces your transfer taxes and increases the benefit to your heirs by $984,463! More importantly, if you fund a lead trust in today's down-market, all of the appreciation that takes place within the trust during the term will go to your heirs tax-free – a significant add-on benefit!

Comparison of Benefits



The bottom line? The time to act is NOW while the Section 7520 Rate is historically low and the market is rising.

Like to learn more?
For a detailed financial illustration, contact Steven Szilagyi, Assistant Headmaster For Institutional Advancement at 877-547-8467 or steven.szilagyi@kiski.org

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