The Charitable Lead Trust

How to Give and Pass Wealth to Your Heirs

The charitable lead trust has attracted a lot of attention in the past few years due to the low-interest rate environment. Donors who are looking for both a tax-efficient way to pass wealth to their family and make a generous gift to charity might consider the charitable lead trust. Low interest rates mean the trust grantor can enjoy greater savings in transfer taxes (both gift and estate taxes) and larger gifts for the charity. To be sure, the charitable lead trust is not a plan for everyone, but it can be a win/win opportunity for some major donors and qualified charities.

In this booklet we will answer frequently asked questions about the charitable lead trust. Call us and we will be happy to answer your specific questions about how you might personally benefit from this exciting wealth transfer gift plan.

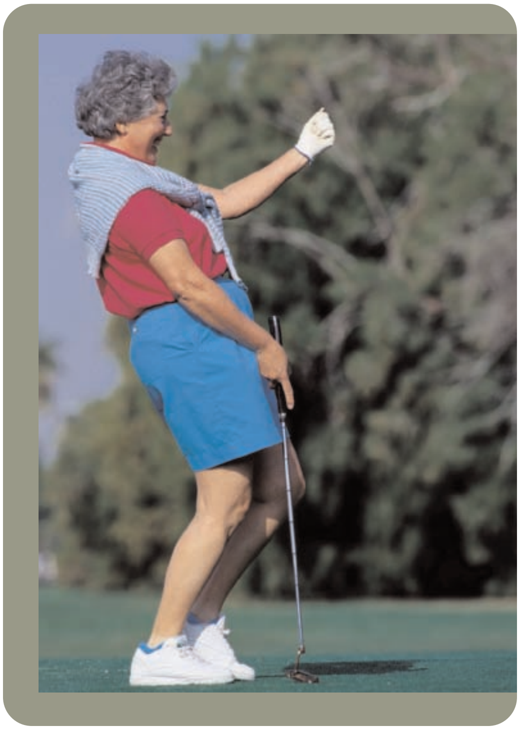
NATIONAL STANDARDS

GREENE COUNTY FOUNDATION

A GENEROUS HAND. A GROWING FUTURE.

How does a lead trust work?

You make an irrevocable transfer of assets to a trust for a term of years or for the life of an individual. At the end of the term, the assets can either return to you or pass to other beneficiaries (usually your children or grandchildren). With careful planning, you can substantially reduce — or even eliminate — estate and gift taxes.



In a sense, the lead trust is the mirror opposite of the popular charitable remainder trust (CRT). Instead of paying an income to individual beneficiaries with the remainder interest going to charity like a CRT, the charitable lead trust pays income to charity for a period of time with the remainder interest going to the individual beneficiaries. While there are different kinds of lead trusts, we will focus on the most popular kind in which the remainder interest goes to the grantor's family rather than reverting to the grantor — the non-grantor or family lead trust.

How do you save transfer taxes?

When you transfer assets to a family lead trust, the IRS calculates the value of the remainder interest to family members at the time the trust is established, not at the time the trust assets actually pass to the beneficiaries. When the trust ends at a time established by you, the assets distributed to the heirs may have appreciated considerably. But regardless of the amount of appreciation, there will be no additional gift tax or estate tax (transfer taxes) on such gain. Given that all appreciation in the value of assets during the term of the trust escapes taxation and transfer taxes can seriously deplete an estate, the tax savings can be huge. Thus, a lead trust can allow you to pass untaxed wealth to loved ones after the charitable interest expires.

How do you determine your charitable deduction?

The size of your deduction for gift or estate tax purposes is based on three factors: the amount to be paid to charity, the length of the trust term, and a federal interest rate called the applicable federal rate (AFR) when the trust is established.

How do interest rates affect the lead trust?

When the AFR is low, the calculated value of charity's income interest is greater, which in turn generates a higher charitable deduction. Moreover, the value of the remainder which goes to the heirs is less. The present value of the remainder is the amount upon which the transfer tax is based. The lower the expected remainder, the lower the gift or estate tax.

Because the AFR (published monthly) has recently been very low, you have the opportunity to maximize your charitable deduction and reduce your transfer tax liability (perhaps, in some cases, even eliminate it). This means you can pass more wealth to your loved ones while making a significant gift to our institution. Equally important, the income we receive can be used to immediately support our charitable mission.

Are you entitled to an income tax charitable deduction?

No, not with the family lead trust. Its primary objective is to minimize or eliminate transfer taxes. That's a highly relevant point since gift and estate taxes can be even more punishing than income taxes.

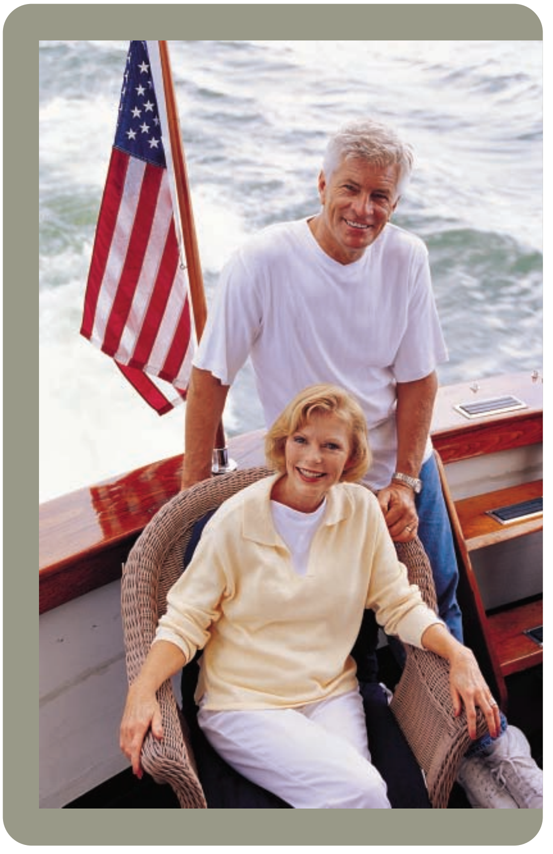
How do you fund your lead trust?

Marketable securities are often used to fund a family lead trust. The best choice is to select an asset with strong potential for growth for the benefit of your remainder beneficiaries. But there are other considerations. Since it is not tax-exempt, the lead trust must pay taxes on its income and realized gains. Even though the trust can claim tax deductions annually for the dollar amounts paid to charity, careful management is necessary to offset the trust's tax liabilities and ensure sufficient income and liquidity to make the required annual payments to charity.

How do you arrange your income payments to charity?

To qualify for a charitable deduction, the lead trust must make income payments to a qualified charity either in the form of a fixed dollar amount (the lead annuity trust); or a fixed percentage of the trusts assets as revalued annually (the lead unitrust).

Which is better for you? That depends on your objectives. If you expect the assets to grow substantially and you want charity to share in the growth, then you would select the unitrust version. Both the income payments and remainder interest grow as the trust assets increase in value. On the other hand, if the object is to pass more wealth to the family, then you may prefer the lead annuity trust. Since annual payments to charity are fixed, any growth in the trust assets would inure to your family. Also, your administrative expenses would be minimized since annual valuations are not required as with the unitrust option.



Whichever you select, keep in mind that there are no minimum or maximum annual payout requirements as with a charitable remainder trust. Still, the payout should be in line with the trust's ability to generate the required income payments to charity.

When should you establish a lead trust?

A lead trust can be established either during your lifetime or in your will (many lead trusts are created by will). However, while the AFR is at or near a historic low, there is an incentive to create and fund a lead trust during life rather than risk much higher rates and a lower charitable deduction when the trust comes into existence at some uncertain time under a will.

A lead trust created during life also would reduce the size of your taxable estate. Equally important, all appreciation in the value of the trust properties occurring after funding the trust would be completely free of gift and estate taxes.

cf NATIONAL STANDARDS℠

GREENE COUNTY FOUNDATION

A GENEROUS HAND. A GROWING FUTURE.

An important consideration is the loss of income from the trust assets used to fund the charitable lead trust. Also, the beneficiaries do not receive a stepped-up basis in the transferred assets (in contrast to a trust created by will). But, if the trust were funded with assets that had a relatively high cost basis, it may be preferable to pay long-term capital gain taxes rather than to lose value in the estate due to transfer taxes.

In brief, you need to look at all your overall financial and estate planning objectives before deciding on how and when to establish your lead trust. We will be happy to work with you and your advisors to help you map out your best plan of action.

Can you designate your gift?

Yes. Gifts designated for a specific purpose are most welcome and provide you with the opportunity to help shape our future. But we also are grateful for unrestricted gifts which allow us to direct support to areas of greatest need as those needs change. Whether restricted or unrestricted, the income from your lead trust gift can be used immediately to further our good work. And, you have the satisfaction during your lifetime of seeing the fruits of your philanthropy.

Does the lead trust make sense for you?

There are many factors to consider before answering this question. Certainly, the charitable lead trust is not for everyone. It requires a substantial financial commitment from the donor over a long period of time. But for affluent donors who want to make an immediate impact with their giving and pass more wealth to heirs, the charitable lead trust may well be worth exploring.

cf NATIONAL STANDARDS℠

GREENE COUNTY FOUNDATION

A GENEROUS HAND. A GROWING FUTURE.

Your community foundation has agreed to adhere to the Indiana Ethical & Operational Standards for Community Foundations. In partnership with the Community Foundation Committee of the Indiana Grantmakers Alliance, your community foundation is pleased to provide this information to you.

Figures in our examples are based on average interest rates, and may be different at the time of a gift. Tax information provided herein is not intended as tax or legal advice and cannot be relied on to avoid statutory penalties. Always check with your tax and financial advisors before implementing any gift.

Greene County Foundation

Cam Trampke
Executive Director

4513 W. St Rd 54
Bloomfield, IN 47424

Phone & Fax: 812-659-3142

ctrampke@greenecountyfoundation.org

www.greenecountyfoundation.org