


PG Calc YOUR PARTNER IN PLANNED GIVING SUCCESS

Lead Trusts: No Time Like the Present



Date: January 28, 2021
 Time: 1:00 – 2:30 Eastern
 Presenter: Bill Laskin
 Vice President,
 Product Management
 PG Calc

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Agenda

- CLT characteristics
- CLTs and the IRS discount rate
- CLTs and taxes
- Funding considerations
- Donor profile
- Cases

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Lead Trust Statistics

Lead trust statistics from the IRS based on Form 5227s filed in 2012

Item	Total	Size of end-of-year book value of total assets (in \$1,000s)				
		Under \$500,000	\$500,000 under \$1,000,000	\$1,000,000 under \$3,000,000	\$3,000,000 under \$10,000,000	\$10,000,000 or more
CLT Number of returns	6,498	2,658	1,406	1,353	757	324
CLT Total net assets	23,705,416	413,545	995,305	2,266,958	4,048,280	15,981,328

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Lead Trust Statistics

Total Charitable Distributions, by Type of Trust, Filing Year 2011
[Estimates based on samples—money amounts are in thousands of dollars]

	All Trusts		CRTs		CLTs		PIFs	
	Num	Amount	Num	Amount	Num	Amount	Num	Amount
Total	27,992	\$3,065,001	10,084	\$1,905,209	17,348	\$1,119,219	561	\$40,573

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How a Lead Trust Works

1. Give assets

2. Fixed payments to Charity

3. Remainder to family

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Types of Charitable Lead Trusts

- Qualified CLTs
 - ✓ CLATs – pay fixed amount to charity
 - ✓ CLUTs – pay fixed % of value to charity
 - ✓ Grantor – donor is owner of trust assets
 - ✓ Non-Grantor – trust is owner of trust assets
- Non-Qualified CLTs

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Characteristics of Qualified CLTs

- Irrevocable
- *Inter vivos* or testamentary
- Annuity trust or unitrust
 - ✓ No net income or flip provision allowed
 - ✓ No lower or upper % limit on payout
- Permissible durations
 - ✓ Typically, a fixed term; no 20-year limit
 - ✓ Life of lineal relations to donor

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Characteristics of Qualified CLTs

- Permissible beneficiaries
 - ✓ Individuals, typically children (non-grantor)
 - ✓ Another trust (non-grantor)
 - ✓ Donor (grantor)
- Trust additions
 - ✓ CLUT = yes, CLAT = no
- Private foundation rules
 - ✓ No self-dealing, taxable expenditures
 - ✓ If lead interest > 60%, no excess business holdings

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Characteristics of Qualified CLTs

- Sample IRS agreements – Rev. Procs 2007-45/46 and 2008-45/46
 - ✓ *Inter vivos* and testamentary CLATs
 - ✓ *Inter vivos* and testamentary CLUs
- Knowledgeable attorney should draft trust

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Non-Grantor Lead Trust Offers Double Leverage

Non-grantor charitable lead trust

1. Generous gift tax deduction in year lead trust created (CLAT)
2. Growth within CLT escapes all transfer tax

- CLT pays tax on income in excess of payments to charity
 - ✓ Character of income taxed proportional to income earned
- CLT inherits donor's basis, remaindermen inherit CLT's basis
- If grandchildren, GST applies; GST planning much easier with CLUT than CLAT

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Federal Gift and Estate Tax Basics

- Federal gift and estate are unified
- Gift and estate tax rate is 40%
- Lifetime exemption is \$11.7 million in 2021
 - ✓ Indexed for inflation
 - ✓ Portability means \$23.4 million for a married couple
 - ✓ About 0.1% of estates pay federal estate tax
- Exemption scheduled to decrease by ~half in 2026
 - ✓ Biden has proposed decrease to \$3.5 million (2009 level)

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Federal Gift and Estate Tax Example

- \$800,000 gift in 2000. Paid \$47,250 gift tax
- \$15 million estate settled in 2021

Estate in 2021	\$15,000,000
Prior taxable gifts	+ \$800,000
Taxable estate	\$15,800,000
Tentative tax (2021 estate tax table)	\$6,265,800
Less 2021 estate tax credit and prior gift tax paid	- \$4,625,800 - \$47,250
Estate tax paid 2021	\$1,592,750

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Elements that Affect CLT Deduction

-] Funding amount
-] Term length
-] Lead trust type
-] Payment %
-] Payment frequency
-] Payment timing
-] **IRS discount rate**
 - ✓ Extremely low = extremely high CLAT deductions

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Effect of AFR on CLAT Deduction

20-year CLAT

IRS Discount Rate	Deduction % for 5% CLAT	100% Deduction Payout Rate
0.6%	94.0%	5.32%
1.0%	88.4%	5.54%
2.0%	81.8%	6.12%
3.0%	74.4%	6.72%
4.0%	68.0%	7.36%
5.0%	62.3%	8.00%
6.0%	57.3%	8.72%

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Effect of AFR on CLAT Deduction

CLAT: Percent of Contribution Deductible @ 0.6%

Payout Rate	Trust Term in Years			
	10	15	20	25
5%	48%	72%	94%	100%
6%	58%	86%	100%	100%
7%	68%	100%	100%	100%
8%	77%	100%	100%	100%
9%	87%	100%	100%	100%
10%	97%	100%	100%	100%
11%	100%	100%	100%	100%

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Effect of AFR on CLUT Deduction

20-year CLUT

IRS Discount Rate	Deduction % for 5% CLAT	100% Deduction Payout Rate
0.6%	63.9%	n/a
1.0%	63.8%	n/a
2.0%	63.4%	n/a
3.0%	63.0%	n/a
4.0%	62.7%	n/a
5.0%	62.3%	n/a
6.0%	62.0%	n/a

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Donor Profile – Non-Grantor CLT

- Net worth in excess of gift and estate tax exemption
 - ✓ \$15 million? \$30 million? \$60 million?
- Goals
 - ✓ Pass assets to heirs at low tax cost and give to charity
- Typical donor ages
 - ✓ 30s – 50s: entrepreneurs, hedge fund, Wall Street
 - ✓ 60s +: accumulated wealth to pass to kids/grandkids
- Own assets expected to appreciate exceptionally

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Non-Grantor CLAT Example

- Mr. Timothy: \$10 million estate
 - ✓ Leave portion of estate to two children in their 20s
 - ✓ Make charitable gifts
- Solution: \$2 million 20-year CLAT
 - ✓ Set payout rate to earn 100% deduction: 5.321%
 - ✓ Assume 3% income, 5% appreciation
 - CLAT benefit to heirs depends on investment performance
 - ✓ IRS discount rate = 0.6%

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Standard CLAT Example

If 2017 exemption amount applies:

	5.321% Non-Grantor Lead Annuity Trust	No Trust
Estate Tax on No Trust (paid 2041)		\$2,968,677
Benefit to Family (ending principal less taxes)	\$4,440,183	\$4,453,015
Total Distributed to CHARITY	\$2,128,400	\$0
Total Benefit	\$6,568,583	\$4,453,015

- Leverage: 166:1

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Standard CLAT Example

If current exemption amount applies:

	5.321% Non-Grantor Lead Annuity Trust	No Trust
Estate Tax on No Trust (paid 2041)		\$1,488,677
Benefit to Family (ending principal less taxes)	\$4,440,183	\$5,933,015
Total Distributed to CHARITY	\$2,128,400	\$0
Total Benefit	\$6,568,583	\$5,933,015

- Leverage: 1.43:1

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Standard CLAT Example

If current exemption amount applies and estate = \$20 million:

	5.321% Non-Grantor Lead Annuity Trust	No Trust
Estate Tax on No Trust (paid 2041)		\$2,968,677
Benefit to Family (ending principal less taxes)	\$4,440,183	\$4,453,015
Total Distributed to CHARITY	\$2,128,400	\$0
Total Benefit	\$6,568,583	\$4,453,015

- Leverage: 166:1

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Step Lead Annuity Trust

- CLAT payments can increase over time – “step” lead trust (see Rev. Proc. 2007-45)

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Step Lead Trust Options

- Step lead trust protects trust value in early years.
 - ✓ Appealing to donors worried about investment performance in near term
 - ✓ In some situations, can be used to pass value of closely-held business to heirs
 - Dividends in early years can accumulate and be used to make payments to charity in later years
 - Can minimize taxes by reducing closely-held stock gradually
 - Pass growth in value tax-free
 - Beware of rule against excess business holdings

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Step Lead Trust Example

If current exemption amount applies:

	Step Lead Annuity Trust	No Trust
Benefit to Family (ending principal less taxes)	\$5,399,539	\$5,933,015
Total Distributed to CHARITY	\$2,194,028	\$0
Total Benefit	\$7,593,567	\$5,933,015

- Leverage: 4.11:1 (compare to 1.43:1)

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"Shark Fin" Lead Trust

- "Shark fin" trust - extreme form of step lead trust
 - ✓ Makes minimal payments until final year, then one very large payment

"Shark Fin" or "Balloon" Payment Schedule

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"Shark Fin" Lead Trust

- "Shark fin" trust can be used in same situations as step lead trust
 - ✓ Give assets maximum time to grow before significant payment to charity
 - ✓ Can time sale of closely-held stock to coincide with year of balloon payment – shelter large capital gain

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"Shark Fin" Lead Trust Example

If current exemption amount applies:

	Shark Fin Lead Annuity Trust	No Trust
Benefit to Family (ending principal less taxes)	\$5,335,355	\$5,933,015
Total Distributed to CHARITY	\$2,253,033	\$0
Total Benefit	\$7,588,358	\$5,933,015

- Leverage: 3.77:1 (compare to 1.43:1)

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Grantor CLT to Pay Pledge

- Grantor lead trust
 - ✓ Donor earns income tax deduction for present value of lead trust payments
 - ✓ Deduction limited to 30% of donor's AGI, whether funded with cash or long-term capital gain ("for the use of," not "to")
 - ✓ Deduction limited to 20% when funded with Itcg and payments go to private non-operating foundation
 - ✓ All income earned during trust term is taxable to donor
 - ✓ Remaining assets returned to donor (grantor) at end of trust term

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Donor Profile – Grantor CLT

- Top federal income tax bracket
- Enough wealth to "loan" gift asset for trust duration
- Goals
 - ✓ Offset income in specific year and gift to charity
 - ✓ Fulfill multi-year pledge
- Donors of wide age range
 - ✓ Significant cash event – sell business, big bonus, stock sale
 - ✓ Major gift donors

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Grantor CLT to Pay Pledge

- Mr. Watson solicited for \$500,000 campaign gift
- Willing to make pledge of \$100,000/yr x 5 years
- Wants income tax deduction
- Solution:
 - ✓ \$1 million grantor 5-year CLAT paying 10%

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Option #1: Grantor CLT to Pay Pledge

Mr. Watson wants to fulfill pledge and receive income tax deduction in year of gift

Funding amount in February 2021	\$1,000,000
Annuity to Charity	\$100,000
Income Tax Deduction	\$491,120
Income Tax Savings (37% bracket)	\$181,714
Total Income Tax Paid by Donor	\$69,994
Principal Returned to Donor ⁽¹⁾	\$882,668
Total Distributed to Charity	\$500,000

⁽¹⁾ Assumes an investment return of 3% income and 5% appreciation.

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Option #2: Non-Grantor CLT to Pay Pledge

- Mr. Watson wants to fulfill pledge and transfer assets to children

Funding amount in February 2021	\$1,000,000
Annuity to Charity	\$100,000
Gift Tax Deduction	\$491,120
Taxable Gift	\$508,880
Gift Tax	\$0
Principal to Family ⁽¹⁾	\$882,668
Total Distributed to Charity	\$500,000

⁽¹⁾ Assumes an investment return of 3% income and 5% appreciation.

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"Super" Grantor CLT

- Defective grantor lead trust, aka Super Grantor Lead Trust
 - ✓ Grantor trust for income tax purposes, non-grantor trust for transfer tax purposes
 - ✓ Donor earns gift tax deduction and income tax deduction for present value of lead trust payments
 - ✓ All income earned during trust term is taxable to donor
 - ✓ Remaining assets go to heirs at end of trust term; all growth inside trust is tax-free
 - ✓ Various ways to achieve, none without some risk

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Option #3: "Super" Grantor CLT to Pay Pledge

- Mr. Watson wants to fulfill pledge, get income tax deduction, and transfer assets to children

Funding amount in February 2021	\$1,000,000
Annuity to Charity	\$100,000
Gift Tax and Income Tax Deductions	\$491,120
Taxable Gift	\$508,880
Gift Tax	\$0
Income Tax Savings (37% bracket)	\$181,714
Total Income Tax Paid by Donor	\$69,994
Principal to Family ⁽¹⁾	\$882,668
Total Distributed to Charity	\$500,000

(1) Assumes an investment return of 3% income and 5% appreciation.

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Conclusion

- Non-grantor CLTs:** tax-efficient way for wealthy donors to make big charitable gifts and transfer assets to heirs
- Grantor CLTs:** an attractive way for major donors to fulfill a pledge
- Extremely low IRS discount rate:** makes CLATs especially attractive right now
- Possible reduced estate tax exemption / increased estate tax rate:** could motivate lead trust donors to act in 2021

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Questions?



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Still Have a Question?

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