



## The Appeal of Step Lead Trusts and Shark Fin Trusts



Date: April 25, 2013  
Time: 1:00 – 2:30 Eastern Time  
Presenter: Bill Laskin  
Vice President, Product Management  
PG Calc



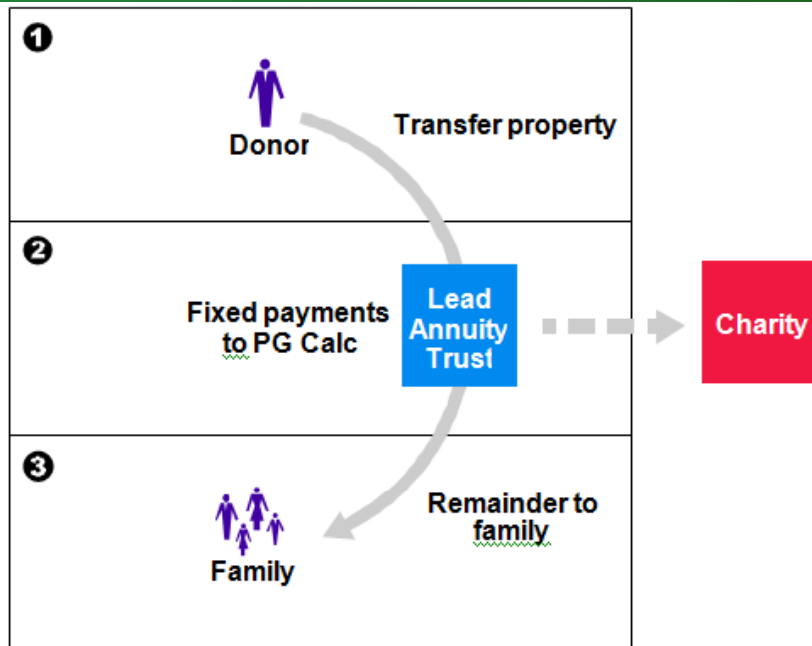


## Agenda

- CLT basics
- IRS statistics on CLTs
- Why an increased interest in CLATs?
- Step lead trusts and shark fin trusts
- CLTs and transfer taxes
- Donor profile and funding options



# How A CLT Works





## Tax Implications of Non-Grantor CLTs

- Gift tax deduction (estate tax deduction if testamentary)
- Asset growth escapes all gift/estate tax
- Income in excess of charitable distribution subject to tax on trust schedule
  - 2013 trust rate is 39.6% on taxable income > \$11,950
  - 2013 married rate is 39.6% on taxable income > \$450,000
- CLT inherits donor's cost basis; heirs inherit CLT's cost basis



## Lead Trust Statistics

Gift vehicle	# returns	Total net assets	Ave net assets
<b>CLTs</b>	6,617	\$20,945,036,000	\$3,165,337
<b>CRATs</b>	15,862	\$7,136,591,000	\$449,917
<b>CRUTs</b>	93,828	\$86,901,148,000	\$926,175
<b>PIFs</b>	1,402	\$1,311,456,000	\$935,418

*Source: IRS Split Interest Trust Statistics from 5227s filed in 2011*



## Lead Trust Statistics

<b>Gift Vehicle</b>	<b># Distributions</b>	<b>Net Distributed</b>
<b>CLTs</b>	17,384	\$1,119,219,000
<b>CRTs</b>	10,084	\$1,905,209,000
<b>PIFs</b>	561	\$40,573,000

*Source: IRS Split Interest Trust Statistics from 5227s filed in 2011*



## Why Is There Increased Interest in CLATs?

- In a word, the incredibly low IRS discount rate (and The Fed says it will keep interest rates low into 2015!)

IRS Discount Rate	Deduction % for 20-year 5% CLAT	100% Deduction Payout Rate for 20-year CLAT
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%



## CLUT Deductions Barely Affected

- Changes in IRS discount rate have little effect on CLUT deductions

IRS Discount Rate	Deduction % for 20-year 5% CLUT	100% Deduction Payout Rate for 20-year CLUT
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





## Why Is This Woman Smiling?





# Step Lead Trust





## Step Lead Trust





## Step Lead Trust

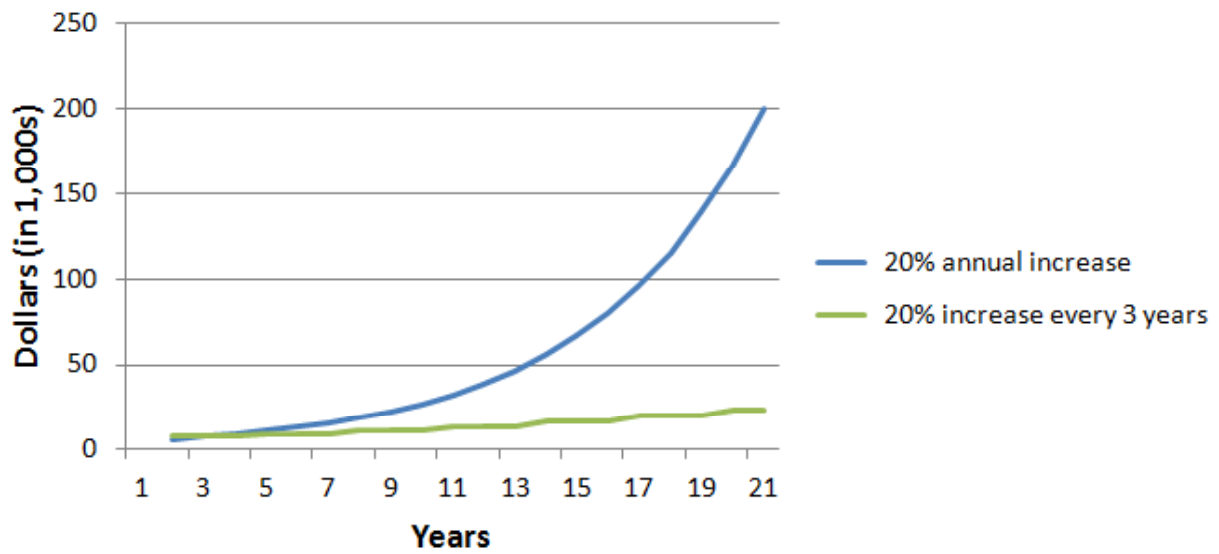
- Also called “accelerated payment lead trust”
- Payments increase by specific \$ amount or % in specific years
- Sample agreement in Rev. Proc. 2007-45 allows for increases in CLAT payments
- PLR 201216045 affirms IRS position





# Step Lead Trust

## Step Lead Trust Payments





## Shark Fin Trust





# Shark Fin Trust





## Shark Fin Trust

- Also called “balloon payment lead trust”
- Payments are same small amount in early years, then very large in final year(s)
- No specific IRS rulings on shark fin trusts
- Some feel 20% increase/year is a safe harbor

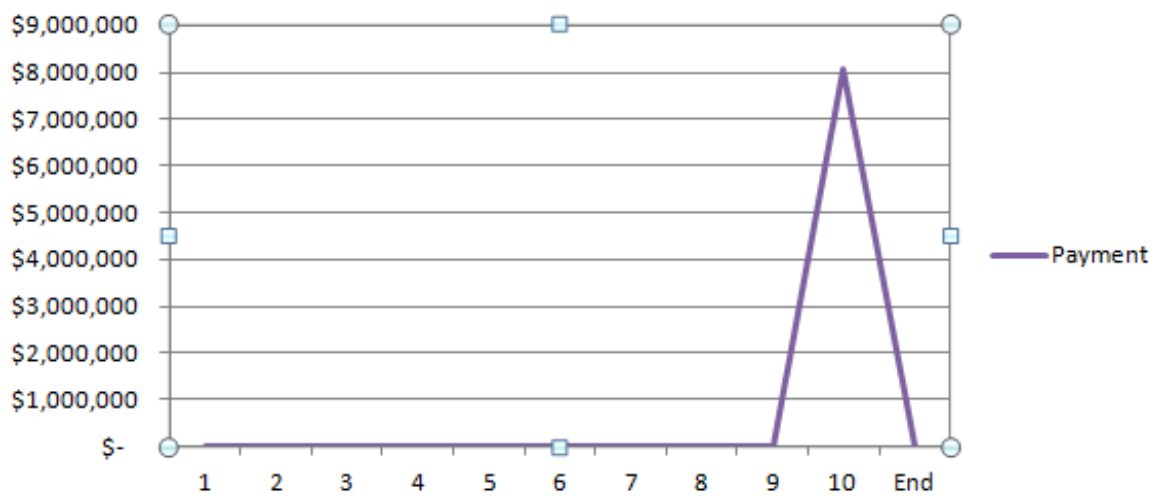






# Shark Fin Trust

### "Shark Fin" or "Balloon" Payment Schedule





## Compared Three CLATs

- Compared standard, step, and shark fin lead trusts under different investment assumptions
- \$1 million funding amount, 20-year term
- 100% deduction (1.0% IRS discount rate)
- Step payments increase 20%/year
- Shark fin trust makes one balloon payment
- All trust income taxable up to 35%

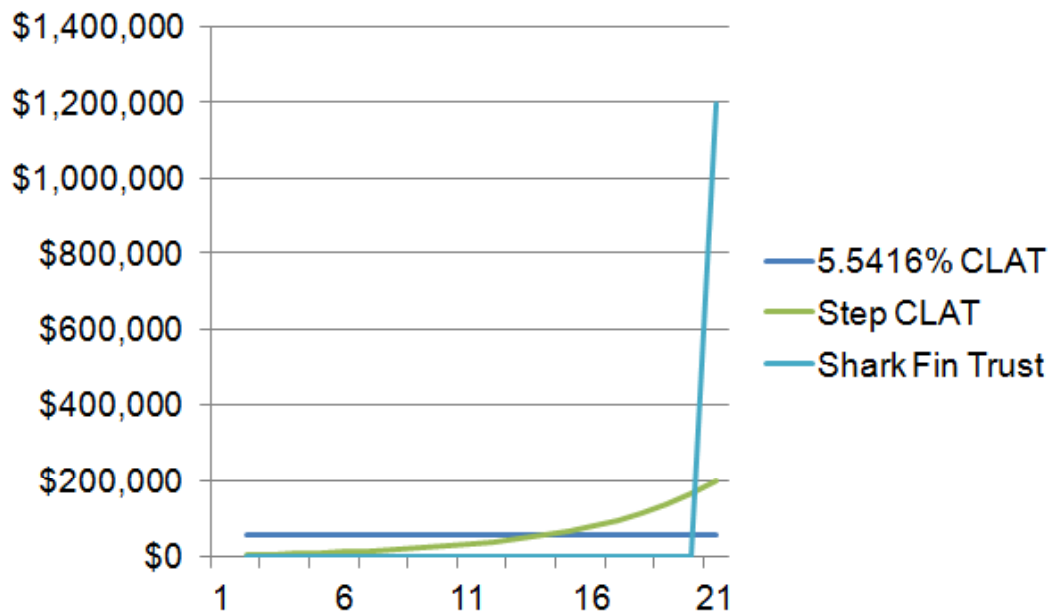


## Pattern of Payments Over Trust Term

Year	5.5416% CLAT	Step Lead Trust	Shark Fin Trust
1	\$55,416	\$6,246	\$1,000
2	\$55,416	\$7,495	\$1,000
3	\$55,416	\$8,994	\$1,000
4	\$55,416	\$10,793	\$1,000
...	...	...	...
20	\$55,416	\$199,548	\$1,199,170
<b>Total</b>	<b>\$1,108,320</b>	<b>\$1,166,056</b>	<b>\$1,218,170</b>



## Pattern of Payments Over Trust Term





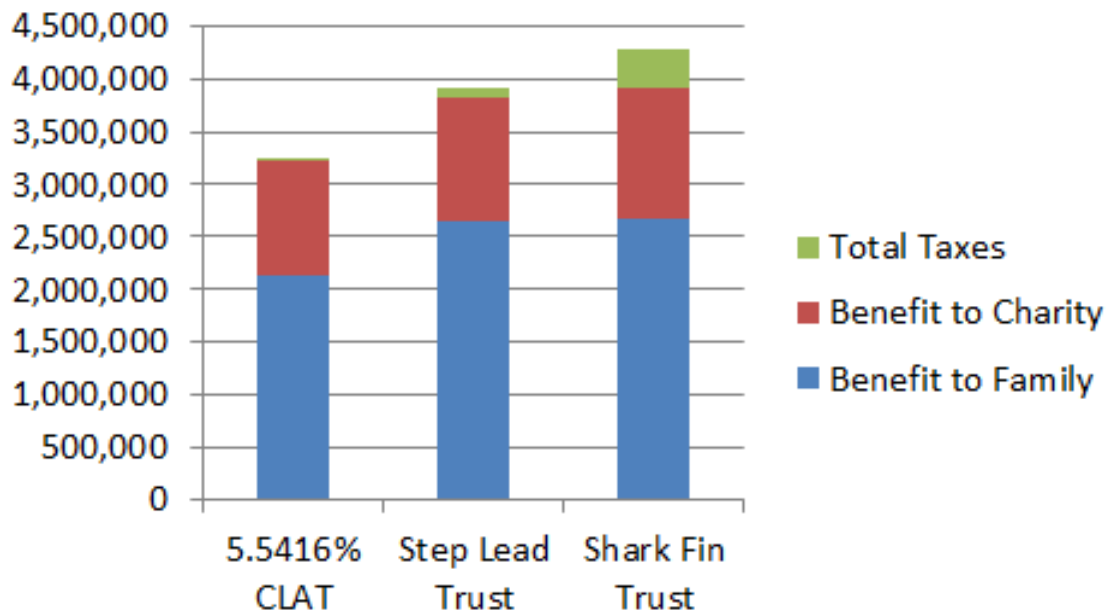
## Real Benefit to Charity

	<b>5.5416% CLAT</b>	<b>Step Lead Trust</b>	<b>Shark Fin Trust</b>
Benefit to Charity	1,108,320	1,166,056	1,218,170
Benefit to Charity (PV @ 1.0%)	1,000,000	1,000,000	1,000,000
Benefit to Charity (PV @ 3.0%)	824,450	743,151	678,275

- Shark fin trust looks like a CRT from charity's viewpoint

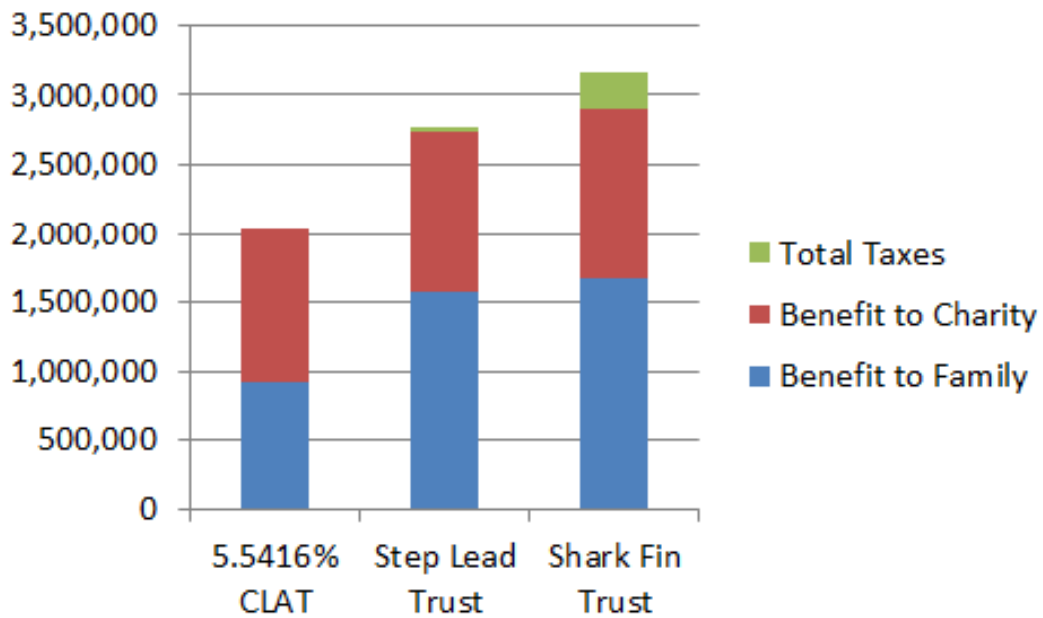


## Model 1: 8% Constant Return



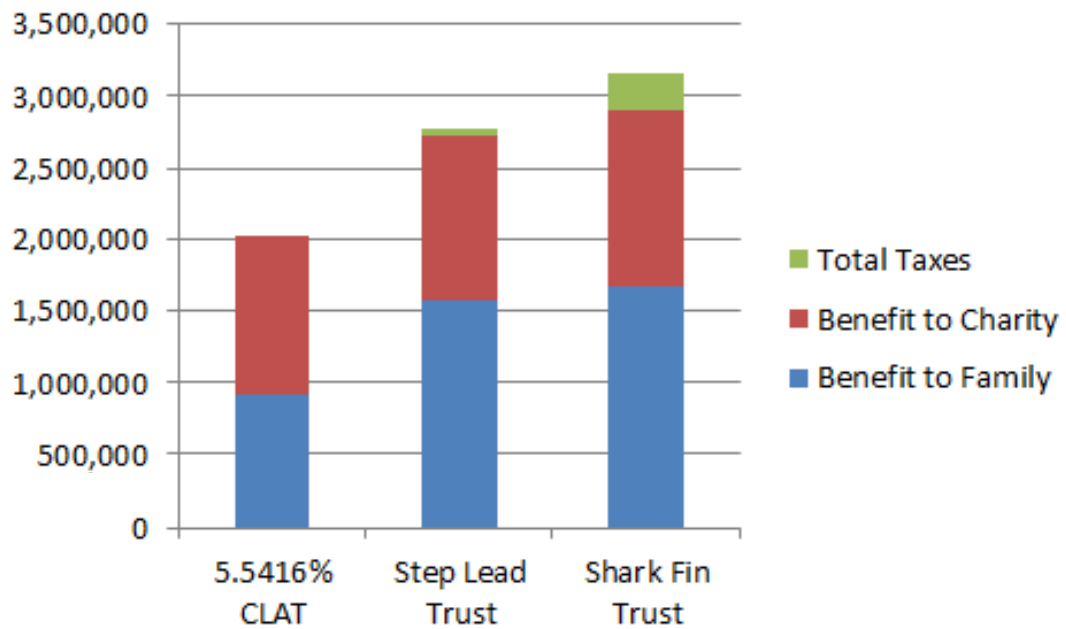


## Model 2: -20% Investment Return in First Year





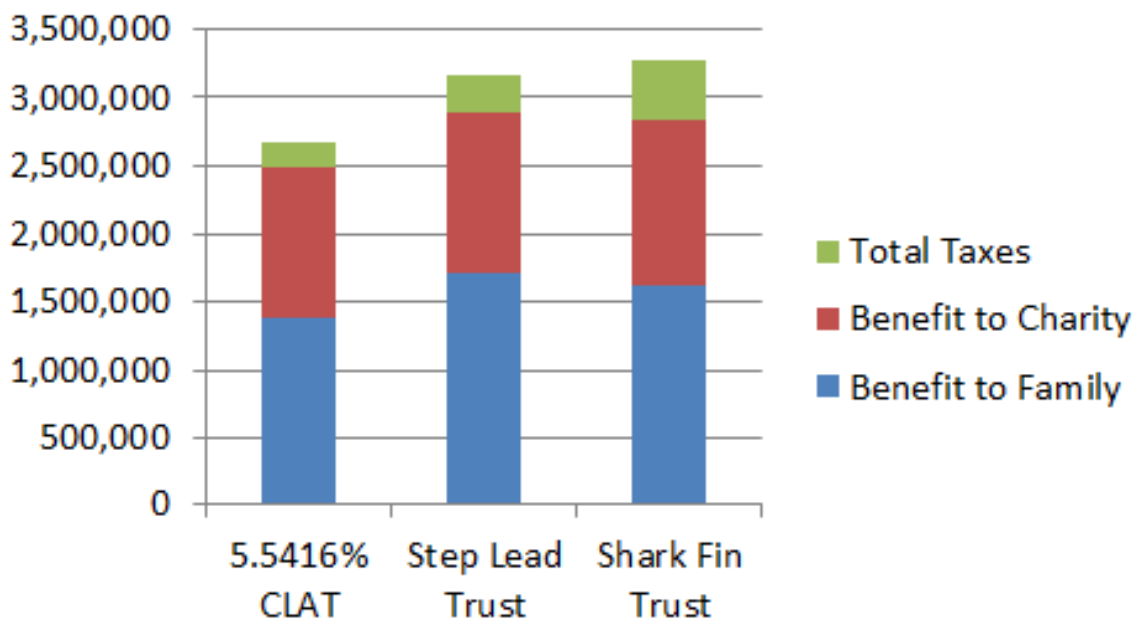
## Model 3: +20% Investment Return in First Year





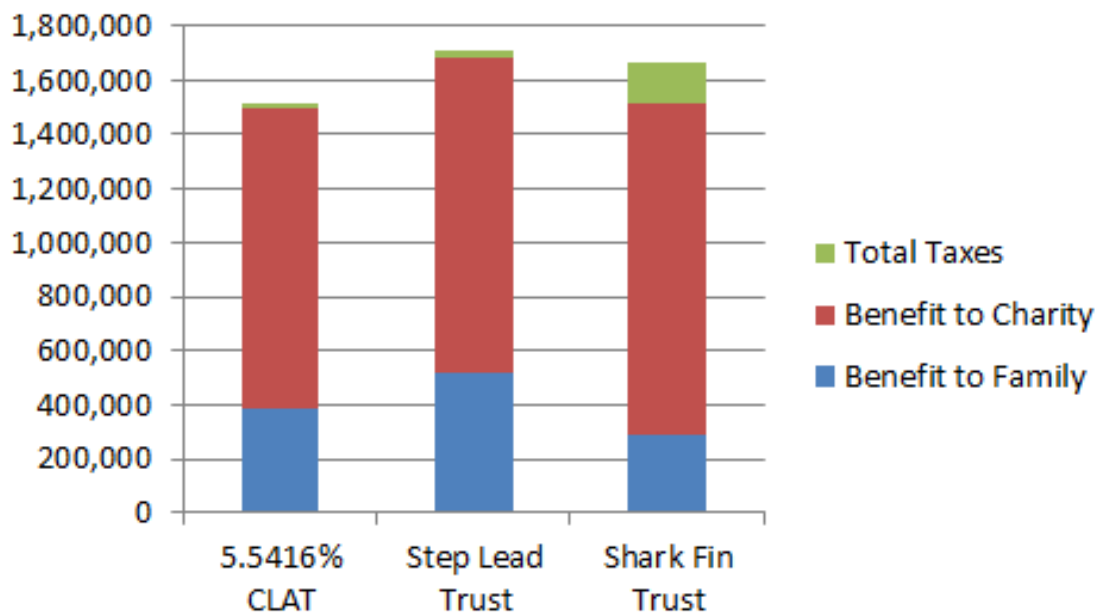


## Model 4: -20% Investment Return in Last Year





## Model 5: 4% Return, -20% in Last Year





## Model 6: Monte Carlo Simulation

- Uses random numbers and repeated solving of the same problem to reach a solution
- Wide range of uses, including financial analysis
- Can be used to estimate likelihood of outcomes within a specified range



## Model 6: Monte Carlo Simulation

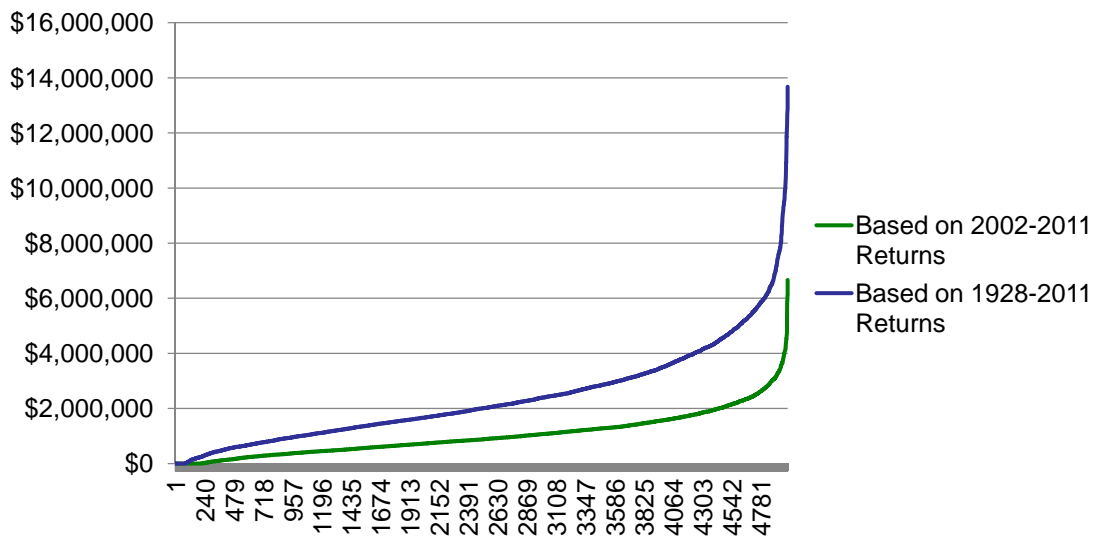
- Two sets of means and std deviations
- Portfolio: 60% S&P 500, 40% Treasury Bonds
- 5,000 simulations for each trust

	<b>Year Range</b>	<b>Growth Rate</b>	<b>Income Rate</b>
Mean	1928-2011	4.41%	4.34%
Std. Deviation	1928-2011	12.07%	1.38%
Mean	2002-2011	3.07%	2.60%
Std. Deviation	2002-2011	9.12%	0.28%



## Model 6: Monte Carlo Simulation

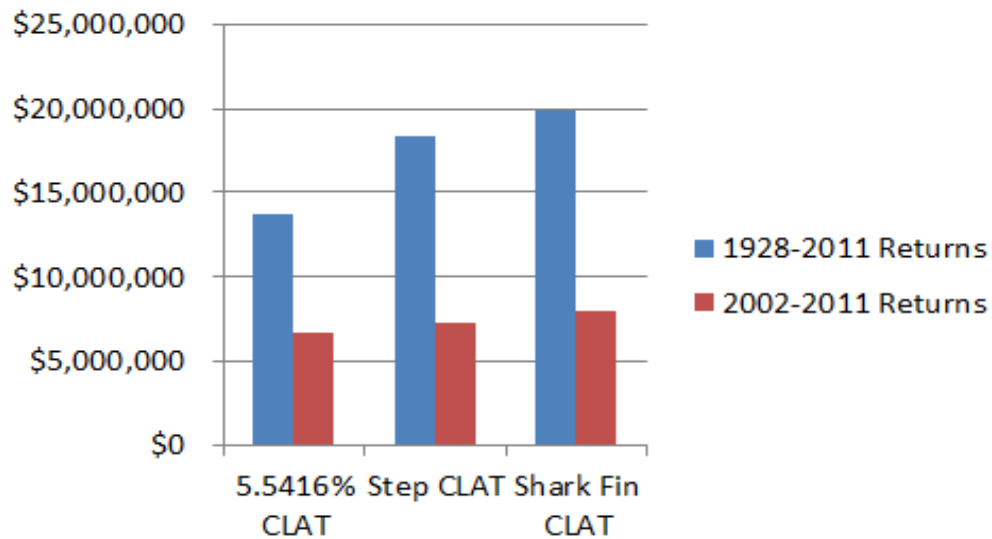
### 5.5416% CLAT Principal in 20 Years





## Model 6: Monte Carlo Simulation

### Greatest Principal Value at End of 20-Year Trust Term





## Model 6: Monte Carlo Simulation

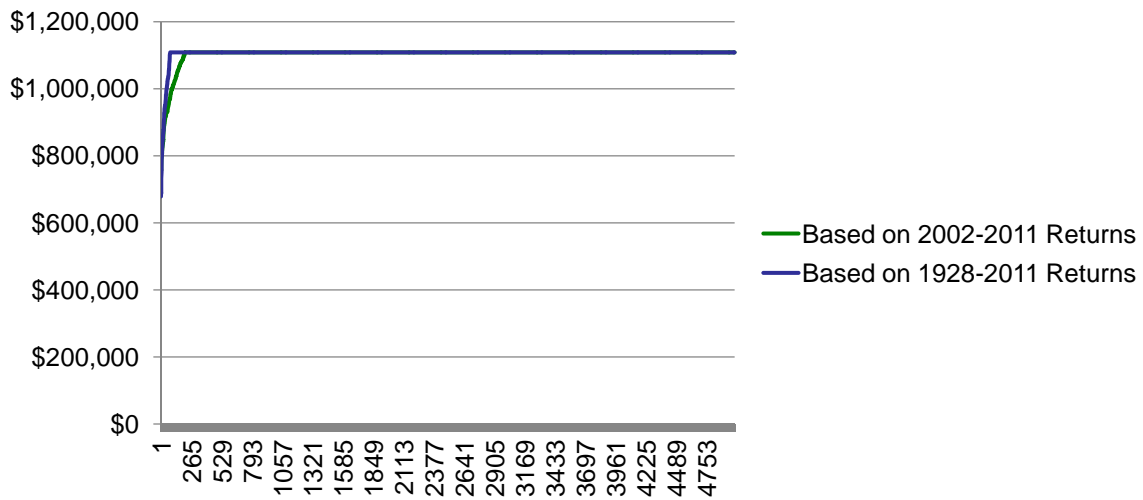
### # Simulations Resulting in Principal Exhaustion

Trust Type	1928-2011 Returns	2002-2011 Returns
5.5416% CLAT	77	206
	1.5%	4.1%
Step CLAT	53	161
	1.0%	3.2%
Shark Fin CLAT	87	192
	1.7%	3.8%



## Model 6: Monte Carlo Simulation

### 5.5416% CLAT Payments Over 20 Years

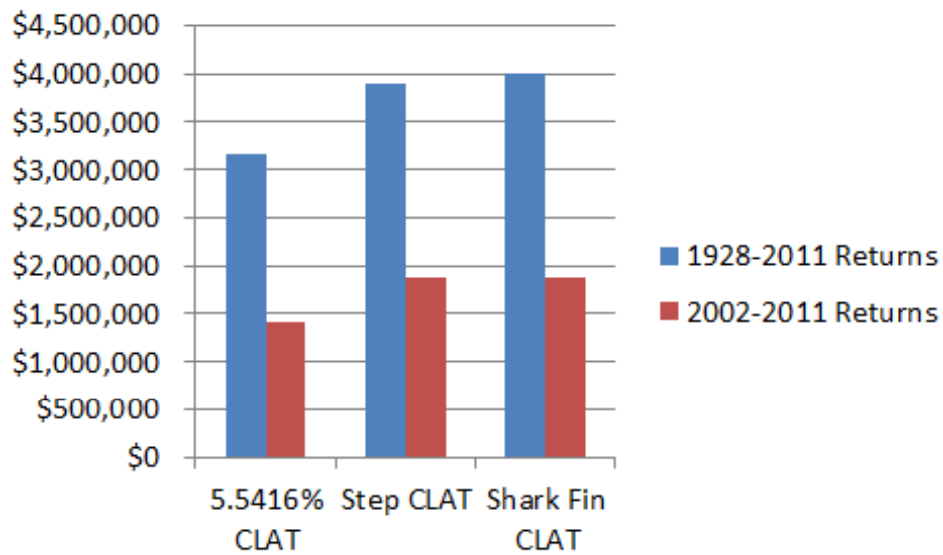






## Model 6: Monte Carlo Simulation

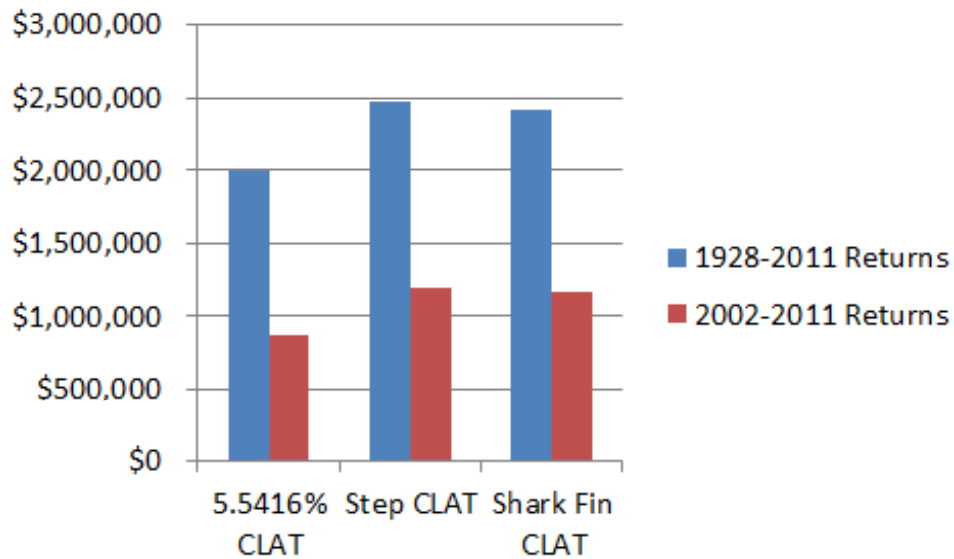
### 25% Confidence Interval for Principal at End of Term





## Model 6: Monte Carlo Simulation

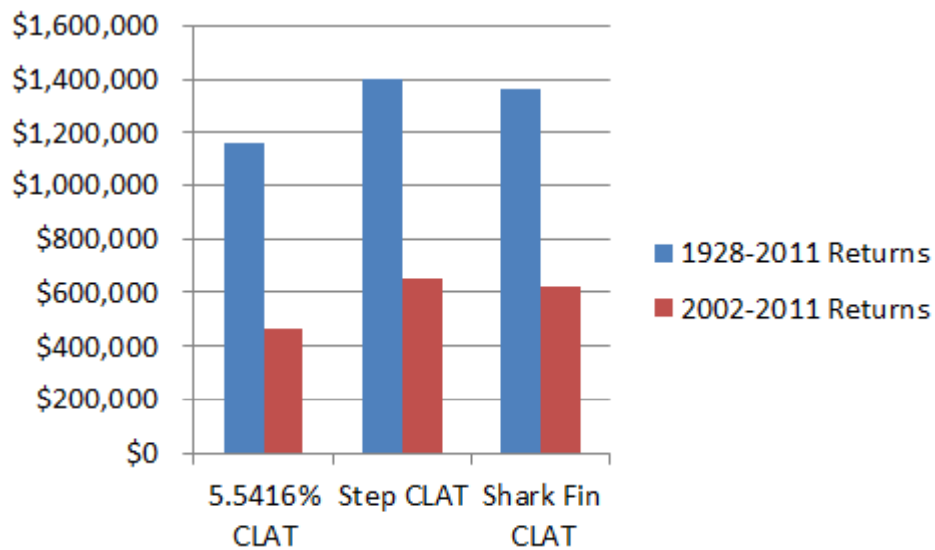
### 50% Confidence Interval for Principal at End of Term





## Model 6: Monte Carlo Simulation

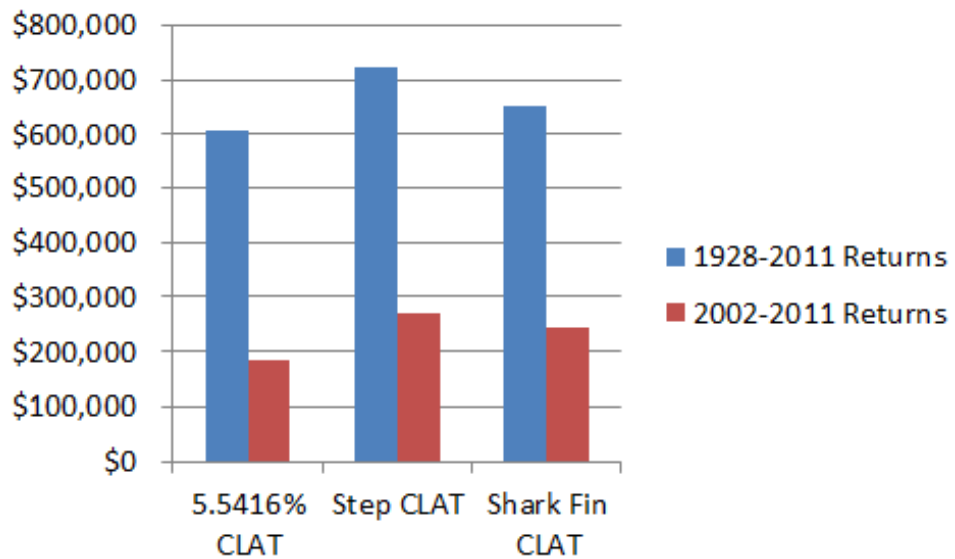
### 75% Confidence Interval for Principal at End of Term





## Model 6: Monte Carlo Simulation

### 90% Confidence Interval for Principal at End of Term





## Basics of Gift and Estate Taxation

- Transfers during life subject to gift tax
- Transfers at death subject to estate tax (and pullback)
- ATRA 2012 made \$5 million exclusion (plus indexing) and 40% top rate permanent



## Basics of Gift and Estate Taxation

### Gift tax

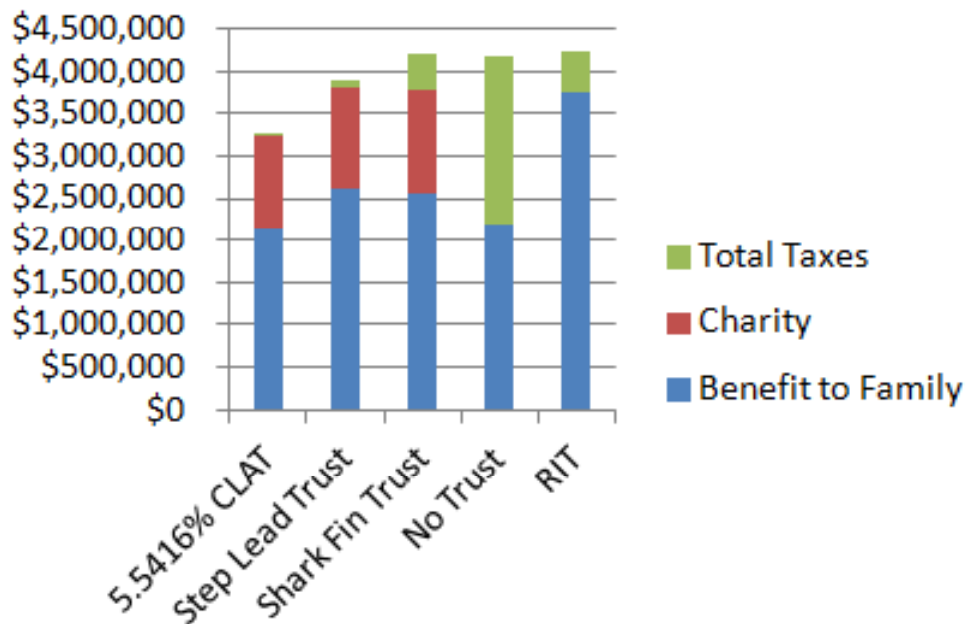
Year	Top Bracket	Exemption
2013	40%	5,250,000
After 2013	40%	5,250,000 + indexing

### Estate tax

Year	Top Bracket	Credit
2013	40%	5,250,000
After 2013	40%	5,250,000 + indexing



## Model 7: Transfer By Will or RIT Vs. Lead Trust: 8% Constant Return





## Profile of Typical Lead Trust Donor

- Wealthy; really no exceptions
- Heirs, typically children
- Planning or reviewing estate
- Already a major supporter
- Usually in 60s or older, but don't count out younger donors





## Possible Funding Assets

- Cash and/or publicly traded securities
- Closely-held stock
- Family business
- Considerations
  - Sufficient income or liquidity to make payments to charity; step or shark fin lead trust can help
  - Self-dealing
  - Excess business holdings



## A Lesson From Wolfenschiessen





## Summary

- Passion for your mission is essential
- It is an opportune time to fund a CLAT (likely to continue for next several years)
- Appeal of shark fin trusts and step lead trusts: they tend to transfer more to family than a standard CLAT
- From charity's perspective, standard CLAT is best
- It takes just one CLT to make a year or more of effort worthwhile – just ask The George School



# Questions and Answers





## Still Have a Question?

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