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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



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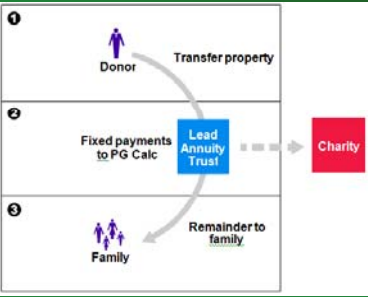
Agenda

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

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How A CLT Works



1 Donor → Transfer property → Lead Annuity Trust

2 Fixed payments to PG Calc ← Lead Annuity Trust → Charity

3 Lead Annuity Trust → Remainder to family → Family

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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
CLTs	6,617	\$20,945,036,000	\$3,165,337
CRATs	15,862	\$7,136,591,000	\$449,917
CRUTs	93,828	\$86,901,148,000	\$926,175
PIFs	1,402	\$1,311,456,000	\$935,418


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



Lead Trust Statistics

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

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


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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%

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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

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Why Is This Woman Smiling?



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Step Lead Trust



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Step Lead Trust




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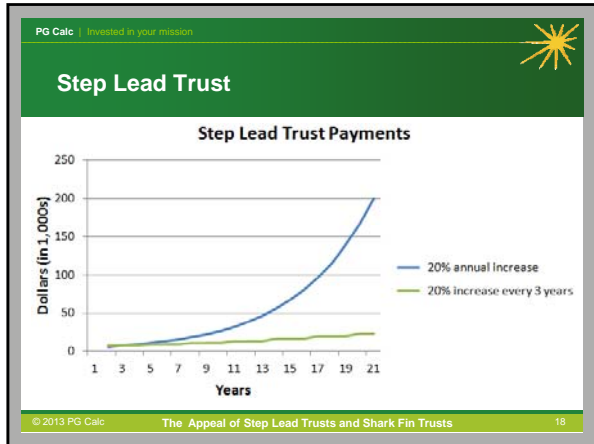
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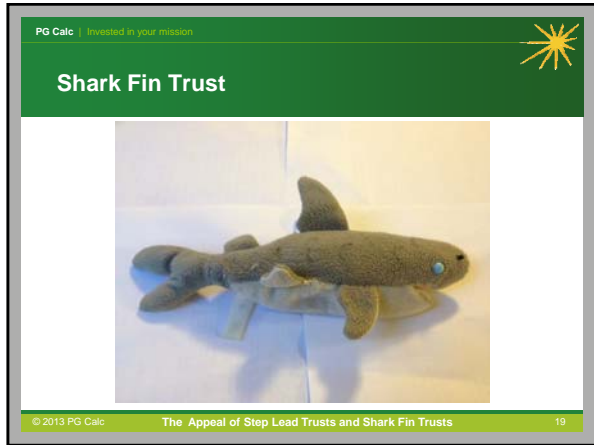
Step Lead Trust

- 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



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Shark Fin Trust

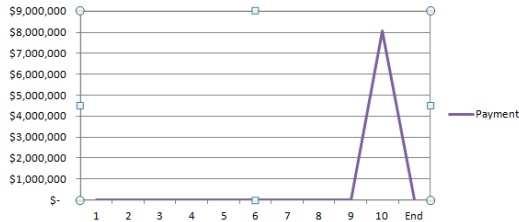
- Also called “balloon payment lead trust”
- Payments are same small amount in early years, then very large in final year(s)
- No specific IRS rulings on shark fin trusts
- Some feel 20% increase/year is a safe harbor





Shark Fin Trust

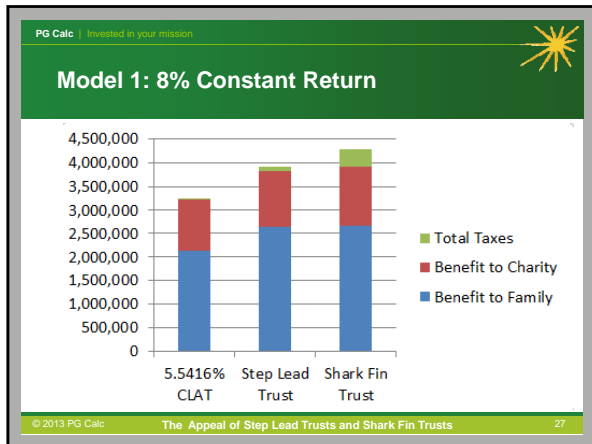
"Shark Fin" or "Balloon" Payment Schedule

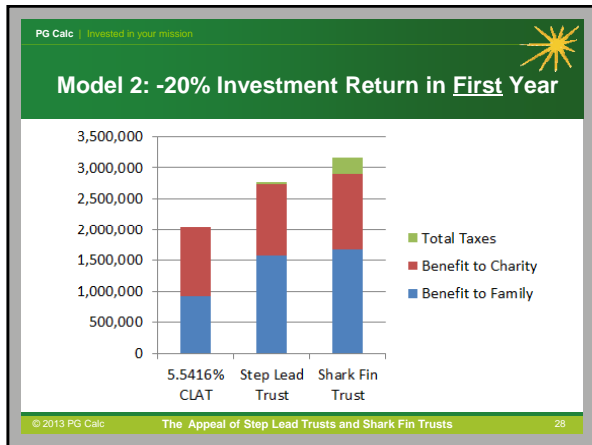


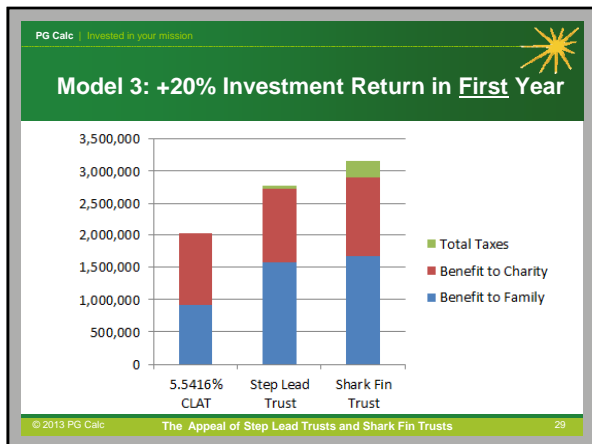


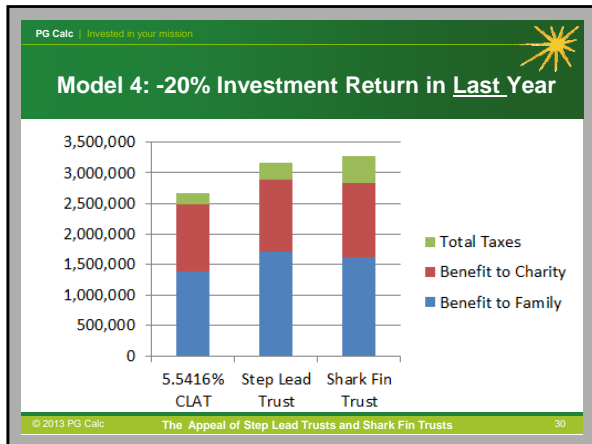
Compared Three CLATs

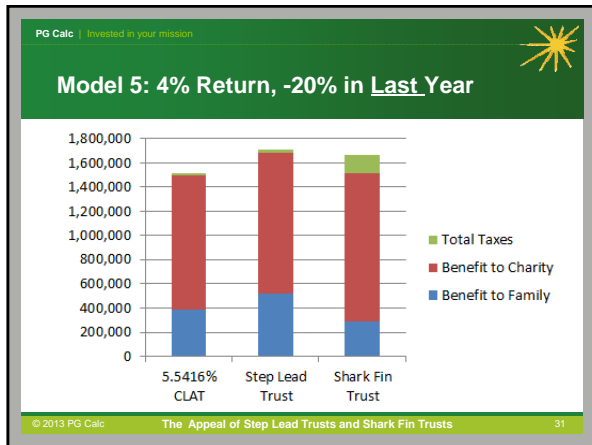
- Compared standard, step, and shark fin lead trusts under different investment assumptions
- \$1 million funding amount, 20-year term
- 100% deduction (1.0% IRS discount rate)
- Step payments increase 20%/year
- Shark fin trust makes one balloon payment
- All trust income taxable up to 35%











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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

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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

	Year Range	Growth Rate	Income Rate
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%

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Model 6: Monte Carlo Simulation

5.5416% CLAT Principal in 20 Years

Based on 2002-2011 Returns
Based on 1928-2011 Returns

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Model 6: Monte Carlo Simulation

Greatest Principal Value at End of 20-Year Trust Term

■ 1928-2011 Returns
■ 2002-2011 Returns

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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%

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Model 6: Monte Carlo Simulation

5.5416% CLAT Payments Over 20 Years

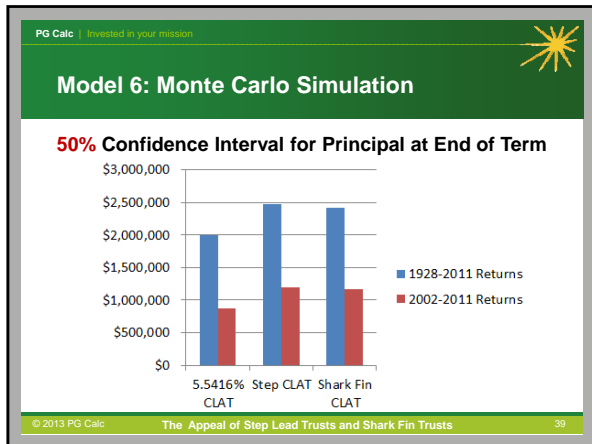
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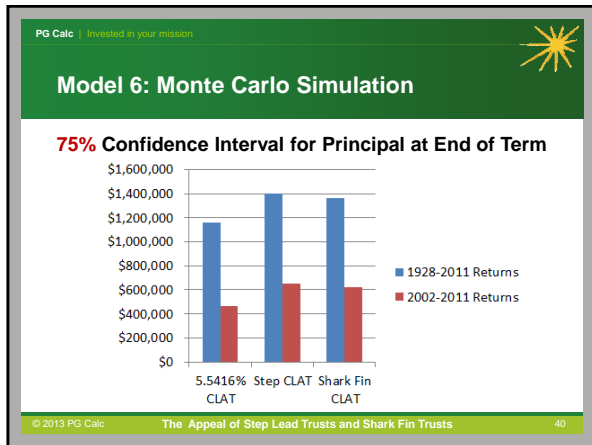
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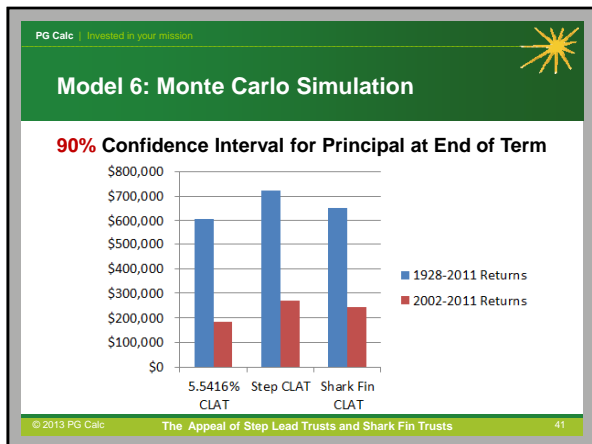
Model 6: Monte Carlo Simulation

25% Confidence Interval for Principal at End of Term

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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

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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

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

Scenario	Benefit to Family (\$)	Charity (\$)	Total Taxes (\$)
5.5416% CLAT	~\$2,000,000	~\$1,000,000	~\$1,500,000
Step Lead Trust	~\$2,500,000	~\$500,000	~\$1,000,000
Shark Fin Trust	~\$2,500,000	~\$500,000	~\$1,500,000
No Trust	~\$3,500,000	~\$0	~\$1,000,000
RIT	~\$3,500,000	~\$0	~\$1,000,000

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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



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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


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Questions and Answers



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Still Have a Question?

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