

Charitable Lead Trust

A charitable lead trust is a trust that the estate owner establishes either during life (an inter vivos trust) or at death (a testamentary trust). The income from the trust flows to a charitable organization, like Community SeniorServ, typically for a stated number of years. After that period, the assets inside the trust are then distributed. The fact that the assets will one day be transferred to another person means that this trust has one further distinction: it is a "nongrantor" trust, as opposed to a grantor trust. "Nongrantor" means the trust assets are not owned by the person who established the trust, and the assets are not going to be returned to him or her someday. (A "grantor" trust is one in which the assets will eventually be distributed back to the donor. As a result, the donor is subject to tax on the assets.)

The Tax Benefits

Of all the charitable vehicles available to donors, the charitable lead trust is among the most complex. However, a nongrantor lead trust does offer the advantage of providing excellent tax benefits to the estate owner.

Let's take a look at an example of how the trust works: A person transfers \$1 million to the trust. The donor does *not* receive an income tax deduction. And, Community SeniorServ receives an income for 20 years. That income is either a fixed dollar amount or a percentage of the trust value as it is determined each year. For our purposes, let's assume that the Community SeniorServ is to receive \$50,000 each year. This means that we will receive \$1 million over a 20-year period, a wonderful gift for Community SeniorServ. At the end of that time, the assets in the trust, which may or may not have grown in value, are then distributed (in our example) to a child or even a grandchild with extra planning.

How does this gift impact the donor? As mentioned earlier, the donor receives no income tax deduction. This fact makes it difficult for many people, including attorneys, to understand the benefit to the donor. In fact, the donor may have to pay a gift tax for the privilege of establishing a charitable lead trust.

A Look at the Issues

When the gift is established, the IRS requires a calculation to be made to determine the present value of the amount going to the child or grandchild someday; in our case, in 20 years. Let's say that value, based on the data we have assumed, is \$400,000. This means that the value to Community SeniorServ over the years, as calculated by the IRS, is \$600,000. If the donor is subject to tax and he or she is at the 35 percent marginal level, the gift tax due on establishing the gift could be nearly \$140,000. Not a good deal. Or is it?

When the gift is established, the tax paid is the only tax that will ever be due on that transfer. As far as the IRS is concerned, the transfer is being made on the day of the gift, not in 20 years. Now, consider the possibility that the trust has grown over the years, which is highly likely. And, let's say the value is ultimately \$3 million. This means that the child will receive \$3 million and no tax is due. If that asset were transferred outright at that time, the estate tax at the 35 percent rate assigned to that asset would be \$1.05 million, far more than the \$140,000 (even in inflation-adjusted terms) paid 20 years earlier. Further, during that time, the Community SeniorServ has an annual income from the trust of \$50,000.

Clearly, there are many issues to consider, both legal and personal, when considering the establishment of a charitable lead trust. In the end, you may find that such a trust represents one of the best ways to help the Community SeniorServ while planning a deferred transfer of assets to children or grandchildren. For more information about how a charitable lead trust may look for you call Phil Beukema at (714) 229-3362.