## TOPIC: Charitable Lead Trusts

A charitable lead trust (CLT) is a mechanism by which a donor can gift periodic payments from investment assets to a charity for a period of years (or over the donor's lifetime) and at the end of the time period have any remaining trust assets revert back to the donor or the donor's heirs.

Charitable lead trusts can be of two types. If the annual payments going to the charity are a fixed amount, the trust is a charitable lead annuity trust (CLAT). If the payments going to the charity are a fixed percentage of the trust assets each year, the trust is a charitable lead unitrust (CLUT).

The donor can receive an immediate income tax deduction for the value of the periodic payments to the charity, but only if the trust is structured so that income from the trust is taxable to the donor each year. If it is not, then there is no immediate deduction for the value of the periodic payments.

For example, assume the donor places $1,000,000 in a charitable lead trust that is structured such that the income from the trust is taxable to the donor. The trust is to make monthly payments of $2,500 ($30,000 annually) for fifteen years to a local education foundation. At the end of the fifteen years, the trust assets revert back to the donor.

Because the income from the trust is taxable to the donor, the establishment of the trust will result in an immediate tax deduction, The amount of the deduction is calculated using the Section 7520 interest rate; the lower the interest rate, the greater the current deduction. The donor can choose the lowest rate from the current month's rate or the rates for the prior two months.

Assume the applicable 7520 rate is 1.6%. You next look up the single life annuity factor for a fifteen year term annuity at 1.6% on the applicable IRS table. The factor is 13.2423.

However, this factor is for annual payments, and must be adjusted because payments to the charity are being made monthly. To adjust for monthly payments, you must look up the adjustment factor for monthly payments at 1.6% on the applicable IRS table. The adjustment factor is 1.0073.

The amount of annual payments ($30,000) is then multiplied by the annuity factor (13.2423) and the adjustment factor (1.0073), which results in a current tax deduction of $400,169. In other words, the amount of the charitable deduction is simply the present value (calculated at the applicable interest rate) of the monthly payments for fifteen years to be made to the education foundation.

Ideal candidates to benefit from use of a CLT include those who:

- Want to make current annual gifts to charity
- Do not need current income
- Can afford to set aside a portion of assets for a period of years
- Want to ensure that heirs receive an inheritance – eventually
- Want to reduce their estate – and potential estate taxes
- Own securities or other assets expected to increase in value over the term of the CLT – especially at a rate faster than the 7520 rate

## CONTRAST WITH THE CHARITABLE REMAINDER TRUST (CRT)

The charitable lead trust is the opposite of a charitable remainder trust. In a charitable remainder trust the annuity payment goes to the donor, but the remainder interest goes to the charity. In a charitable lead trust this allocation is reversed: the annuity payment goes to the charity and the remainder interest goes back to the donor or heirs.

Whether or not to use a charitable lead trust or a charitable remainder trust depends upon the particular goals the donor is trying to accomplish. However, if all other things are equal, charitable lead trusts will be more favorable during periods of low interest rates, while charitable remainder trusts will be more advantageous during periods of high interest rates. This is because with a charitable lead trust, the current tax deduction is greater the lower the interest rate, while with a charitable remainder trust, the current tax deduction is greater the higher the interest rate.

Also, because with a charitable lead trust the income of the trust is taxable to the donor, the trust may generate an annual tax-liability to the donor even though the donor is not currently receiving any cash. With a charitable remainder trust, the donor is only taxed on amounts actually received from the charitable remainder trust.

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