RUSHFORTH FIRM LTD. NEVADA TRUST ADVICE	**CHARITABLE LEAD TRUST** *Should a CLT be a part of my estate plan?*

A. OVERVIEW

A.1 An Option to Transfer Taxes. In large estates, the estate tax[1] can result in the liquidation of hard-to-sell assets (such as family businesses), often resulting in "fire-sale" prices, which reduce even further the net distribution to the family or other beneficiaries. Estate liquidation can result in losses that make the estate tax seem higher than it really is. The charitable lead trust ("CLT") can be used to benefit charity while shifting benefits to other beneficiaries at a lower transfer-tax tax cost.

A.2 CLT, Generally. A CLT is usually designed as a trust for a term of years, and during the trust term a specified annual payment (based on a percentage of the value of trust assets) is paid to one or more designated charitable organizations. The settlor (creator of the trust) specifies the charitable organizations as the "lead" beneficiaries and children or other beneficiaries as the "remainder beneficiaries", who will receive the trust assets at the end of the trust's term.

A.3 Types. A CLT can be established during life or after death. A CLT can be a charitable lead unitrust (CLUT) or a charitable lead annuity trust (CLAT).

(a) A CLUT pays a specified percentage of the current trust value (as revalued each year) to one or more qualified charities. The amount must be paid annually, but it can be paid more frequently. For a number of reasons, CLUTs are rarely used.

(b) A CLAT pays the percentage as a guaranteed annuity based on the value of the assets at the time of the trust's creation.

A.4 Benefit to Residuary Beneficiaries. Although the specified payments are made to one or more charities during the trust's term, the asset itself is preserved for the residuary beneficiaries.[2] While the residuary beneficiaries may have to wait 5, 10, 15, or even 20 years in order to benefit from the trust's assets, it is often the best way to pass some assets to the residuary beneficiaries without the combined effects of estate taxes and asset liquidation costs. The longer they wait, the lower the taxable value of the remainder interest is for gift- or estate-tax purposes.[3]

B. LIFETIME CLT

B.1 Generally. During the term of the trust, the payment amounts (annuity or unitrust amount) are paid to one or more designated charities. When the term expires, the trust

1. In 2020, the maximum rate on gifts and trusts in excess of the applicable exclusion amount is 40%, and the applicable exclusion amount for the federal estate and gift taxes is $11,580,000. Of course, these numbers are subject to adjustment at any time by enactment of new federal legislation.

2 A "reversionary CLT" can provide for the trust to revert to the settlor, but this type of trust is rare. The reversionary CLT produces only the charitable gift, while the non-reversionary trust triggers a gift of the remainder interest to the non-charitable beneficiaries who receive the benefits of the trust assets after the charitable lead term.

3. Unfortunately, charitable lead trusts do not make good generation-skipping trusts because the GST exemption is applied when the charitable interest expires. For this reason, grandchildren may not be the ideal beneficiaries for charitable lead trusts.

benefits non-charitable beneficiaries (the "remainder beneficiaries"). The tax consequences depend on whether the trust is a grantor trust.

B.2 Grantor CLT. If the trust is designed as a grantor trust, the settlor is treated as the owner of the trust, and all income received is taxed to the grantor. When assets are contributed to the trust, the donor gets an immediate charitable deduction for the present value of the charitable term. That deduction is somewhat negated by the settlor's having to report trust income during the charitable term. This may be advisable to use in a year in which the settlor has significant income. It is sometimes used to accelerate the deduction for a multi-year charitable pledge into the first year. To reduce the impact of income taxation on trust income, some grantor CLTs hold tax-exempt investments.

B.3 Non-Grantor CLT. If the CLT is not a grantor trust, the settlor receives no charitable tax deduction, and the settlor is not taxed on trust income. There is no gift tax on the present value of the charitable interest, but the grantor must report the present value of the remainder interest as a taxable gift. It is possible to design a charitable lead trust so that the remainder has little or no value for gift-tax purpose. This is done when selecting the term of years and the amount that must be paid to charity each year. The non-grantor CLT is used unless the settlor is advised by his tax and legal advisors that the grantor CLT is better suited to the settlor's specific circumstances.

B.4 Present Value Calculations. The present value of the charitable lead interest and of the remainder interest are determined from the IRS-published interest rates and tables. Tax professionals use software to make these calculations, and different scenarios using different terms and rates can be illustrated.

C. TESTAMENTARY CLT

C.1 Post-Mortem CLT. For a CLT established upon the settlor's death, which is referred to as a "testamentary charitable lead trust", there is a charitable deduction for estate-tax purposes triggered by the contribution of assets to the CLT. The present value of the remainder interest is subject to the estate tax, and the value of the "lead" interest generates a charitable deduction.

C.2 Documentation. The terms of the CLT can be incorporated into a revocable trust or into a Will if the CLT is not going to exist until after death. Because the CLT is not legally formed until after death, it can be modified or eliminated at any time prior to the settlor's death.

D. ILLUSTRATIONS

D.1 Lifetime CLT . X has an apartment complex that generates net income equal to 6% of the value of the property. It is presently valued at $1 million.

(a) If X donates this apartment complex into a CLUT that pays out 5% of value of the property to charity for 20 years, the charity will receive $50,000 the first year. If the property appreciates or depreciates during the term of the trust, the annual amount payable to charity will go up or down accordingly because the property must be re-appraised each year, and the 5% will be applied to the new appraised value.

(b) If the 7520 rate is 0.4%, the "lead" interest is worth $955,200, and the "remainder" interest is worth $40,800.

(i) If it is a non-reversionary grantor trust, the lead interest generates an income tax deduction, and the remainder interest is a taxable gift. The grantor will pay income tax on all trust income during the charitable term.

(ii) If it is a reversionary trust, there is no taxable gift.

(iii) If it is a non-grantor trust, there is no charitable deduction, and no income tax to pay on trust income.

(c) As long as the income is sufficient to cover the required annual payments, the underlying asset will remain intact (although the trustee could sell and re-invest the assets during that period), and the assets will pass to the designated beneficiaries free of any additional transfer taxes.[4] By using $40,800 of one's applicable exclusion amount, an asset worth $1 million (plus an appreciation) has been moved to the next generation, after a 20-year wait, of course.

(d) For non-reversionary CLTs, increasing the payout rate will reduce the value of remainder interest; however, to avoid paying out trust principal, the income from the CLT's investment must equal the payout amount plus administrative expenses.

(e) Another way to reduce the remainder interest of a CLAT is to provide for a limited payout for all years except the last one, in which a balloon payment is made. The balloon payment is determined by a formula. If trust assets appreciate over the charitable term, the remainder beneficiaries will get a sizeable payout even after the balloon payment is made. This is sometimes referred to as a "shark-fin CLAT".

D.2 Testamentary CLT. Assume that W dies owning investments valued at $2.5 million and assuming that the applicable exclusion has been completely used up with lifetime gifts. Under current tax law, those assets will be subject to a tax of 40% or $1 million.

(a) In contrast, if W's living trust provides for those investments to go into a 20-year charitable lead trust with a 5% annuity and the 7520 rate is 0.4%, the remainder interest is valued at $102,000, and the tax would be $40,800. If that tax is paid from non-CLT assets and if the income is more than sufficient to pay the annuity and administrative expenses, the remainder beneficiaries end up with $2.5 million of assets plus appreciation.

(b) Assuming the same facts except that the income from the investments only permits a 3.5% payout, the remainder interest would be valued at $821,400.00, generating a tax of $328,560, which is still better than $1 million. With a shark-fin CLAT, there would be no estate tax at death, but the $2,500,000 trust would be reduced by a balloon payment of $977,170. That is better than $1 million in tax because the payment is paid 20 years later and it goes to charity and not the IRS. If the trust property has appreciated, the remainder beneficiaries get the appreciation free of estate tax.

4. There could be a generation-skipping transfer tax if a distribution is made to a "skip person", which is a grandchild or someone in that or a lower generation.

E. CONCLUSION

The charitable lead trust is a useful tool for those who are charitably inclined and who are want to provide for a deferral of benefits for the beneficiaries in order to reduce the overall federal estate tax that is imposed on their taxable estates.

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