# Charitable Lead Trust

Thank you for your inquiry regarding charitable lead trusts.

A Family Charitable Lead Trust is a charitable device to which a donor irrevocably transfers assets during life. The trust then makes agreed upon payments for a specific period of time to charity. After the payment period, what remains in the trust passes to the donor's family. The charitable lead trust is often described as a charitable remainder trust in reverse: the charity gets income and the family gets trust corpus, instead of the other way around. The charity's interests "lead" the family's.

Charitable lead trusts are not used nearly as often as charitable remainder trusts in part because of the lead trust's somewhat speculative nature. The donor deliberately triggers a gift tax by funding the trust, betting that dealing with a gift tax now will be far less expensive than paying a much larger estate tax years later. If the trust assets grow in value, the lead trust could save heirs thousands of dollars in estate taxes while allowing the donor to make lifetime contributions to a favorite charity.

Many find charitable lead trusts confusing at first, especially after getting comfortably acquainted with charitable remainder trusts. Remembering that the term "lead trust" means that charity's interests come before or "lead" the family's interest helps dissipate the fog. The family charitable lead trust provides gift and estate tax benefits rather than income tax benefits. The donor, by transferring an asset to the trust, is making an irrevocable future gift to heirs. The transfer triggers a gift tax. But the commitment by the trust to make annual payments to charity before the heirs receive anything from the trust triggers a simultaneous gift tax deduction which in some cases completely offsets the gift tax. The size of a lead trust's gift tax deduction is affected by the Applicable Federal Rate, a measure of what you can earn from long-term bonds. The lower the Applicable Federal Rate when a charitable lead trust is funded, the higher the charitable gift tax deduction the trust will produce for the donor. In simple terms, the lower interest rates are, the more attractive lead trusts are.

After the trust terminates, assets remaining in the trust pass to the heirs without any additional estate or gift tax. Families wishing to reduce estate tax and to benefit charity typically fund the trust with assets that are likely to appreciate in value. These assets are held in the trust and not sold. (Unlike a charitable remainder trust, charitable lead trusts do not bypass capital gains tax on the sale of appreciated assets.) The gift tax is triggered when the transfer is made to the trust. Years later, the trust assets pass to heirs with no further tax due, even if the assets in the trust have grown greatly in value.

The description above touches on a few lead trust fundamentals, but is by no means complete. Lead trusts are complicated philanthropic and estate planning tools. They are usually used by wealthy individuals relying on their estate planning advisers rather than on information provided by charities. Here is a simple (for a lead trust) example that may help:

> **A grandmother is cautioned by her attorney that heavy estate tax awaits her if she doesn't plan now. He suggests she consider a charitable lead trust. She decides to start out small and places $200,000 of stock in a 15-year charitable**

**lead annuity trust. She names her grandson, age 20, as the remainderman of the trust and allows him to name the charity that will receive $10,000 a year for fifteen years from the trust. If she had simply given the $200,000 to him, she would have to report about an $189,000 gift. Also, she doesn't feel completely at ease providing him with $200,000 at age 20. Because the trust must pay charity $10,000 a year for fifteen years, the taxable gift to her grandson is reduced to $99,728. She estimates the stock will have a total return of 9% a year, 2% of which will be income and 7% will be growth. If her estimate is correct, her grandson, when he is a mature thirty-five-year-old, will receive $434,887 in stock without any further tax. He will also have had the satisfaction of seeing a charity of his choice receive a total of $150,000 over fifteen years in his name. Of course, the grandmother could have named the charity herself, but she wanted her grandson to learn the family tradition of philanthropy.**