Achieving your giving goals with charitable lead trusts

Recent tragic events have resulted in an unprecedented outpouring of charitable giving, as Americans look for ways to fulfill their desire to help those less fortunate than themselves. In addition to direct giving during their lifetimes, many people are looking at how they can incorporate charitable giving in their estate plans. While many options are available, one plan that allows you help charities and preserve and grow assets for your beneficiaries at the same time is a charitable lead annuity trust.

Fixed payments to charity

When you set up a charitable lead annuity trust (or CLAT, for short), the intention is for the assets of the trust, and the income they generate, to ultimately one day pass to one or more non-charitable beneficiaries, for example, your children. Before then, however, you may want one or more charities to receive some of the funds. Under a typical CLAT, the charity receives a fixed payout for a pre-determined number of years or, in some cases, for the lives of specified persons. The payments to the charity remain the same regardless of how the trust performs and no minimum payment is required. In most cases, the rules do not allow your beneficiaries to receive anything from the trust until the trust ends.

Last year, the IRS imposed some new rules on CLATs. Individuals who can be used as the measuring lives would be restricted to the donor's life, the life of the donor's spouse, or a lineal ancestor of the beneficiaries. The IRS did this to prevent abuse of CLATs. Some people had tried to artificially inflate the tax benefits of CLATs by using unrelated individuals, who were seriously ill and were expected to die prematurely, as the measuring lives. As a result, the charity received much less than it would have had the person survived. The new rules have some complicated exceptions depending on the precise drafting of the trust.

Tax benefits

When the trust ends, the assets of the trust and the income earned by the trust pass to your beneficiaries tax-free. That is a potentially huge savings of federal estate and gift taxes. The top federal estate and gift tax rate in 2002 is 50 percent. If the original trust assets were passed directly to your heirs, taxes could reduce significantly your bequest. Placing the assets in a CLAT helps to preserve – and more importantly – grow them. The estate tax is fixed when the CLAT is created and not when the assets pass to your beneficiaries.

Generally, income paid to the charity is subject to tax by the owner of the trust. However, careful planning, such as funding the trust with tax-exempt bonds, can reduce or eliminate any tax liability on the part of the owner.

Timing the creation of a CLAT

CLATS need not be set-up after you die. You can fund a CLAT today and see the benefit of your gift as a charity makes good use of it. However, if you want to create a CLAT during your life, keep in mind that you will not be able to use assets in the trust.

A CLAT -- created either before or after your death -- can continue your legacy of giving to your favorite charities, while yielding overall tax savings for you and your family. Please contact the office if you have any questions on how a CLAT, or another variety of charitable trust, might work for you.