CLTs
A Charitable Trust That Takes The Lead

Are you inclined to help a charity for a period of time without ultimately giving up the property? Consider the benefits of a charitable lead trust (CLT). This type of trust is essentially the opposite of the charitable remainder trust (CRT), a better-known alternative (see “Is a CRT A Better Option?” below). With a CLT, the property reverts to family members — not the charity.

At the same time, the CLT provides a stream of annual income to the charity for a term of years. So everyone wins.

How It Works

A CLT may be funded during your lifetime or a testamentary trust can be created through your will or other estate planning documents. In either case, the trust is irrevocable. You can incorporate this technique into your estate plan to accommodate charitable intentions.

The basic premise is relatively simple although the mechanics can be complicated. Generally, you contribute property to the trust set up to last for a specific number of years. The charity (or group of charities) designated as the income beneficiary receives payouts during the trust term. Depending on the CLT’s structure, payments are made as fixed annuity payments or a percentage of the trust. When the trust term expires, the remaining assets are distributed to the designated beneficiaries — typically your children or grandchildren.

Traditionally, the property transferred may include assets like publicly traded securities, real estate, business interests and even private company stock. In some cases, property may be sold to produce the desired revenue. Caveat: Depending on the way that the CLT is structured, a sale may result in a capital gain that’s immediately taxable.

Charitable Deduction Implications

One of the main attractions of a CRT is that you can claim a current tax deduction for the value of the remainder interest. However, if you use a CLT, your deduction may be limited or nonexistent, depending on whether it’s a grantor or nongrantor trust.

With a grantor CLT, you can claim a current deduction for the present value of the future payments to the charitable beneficiary, subject to other applicable deduction limits. However, there's a downside to this arrangement: The investment income generated by the trust is taxable to the grantor during the term.

Conversely, if the CLT is set up as a nongrantor trust, the trust itself — not the grantor — is treated as the owner of the assets, As a result, the trust is liable for the tax due on the undistributed income. Thus, the trust, but not the grantor, can claim the charitable deduction for distributions to the organization.

Each situation is different, but the resulting income tax liability for a grantor trust often outweighs the benefit of the current tax deduction. Furthermore, any charitable deduction for contributions of property is limited to 30% of adjusted gross income. For these reasons, you may prefer the nongrantor trust setup.

Note that a properly structured CLT will produce a gift or estate tax deduction for the value of that portion of the trust designated for charity. This makes it possible to transfer a remainder interest to family members at a relatively low tax cost.

Ins And Outs

The CLT must provide annual payments to at least one designated charity for a specific number of years, the life of one or more individuals, or a combination of the two. Unlike CRTs, there's no mandatory timeframe of 20 years, nor does the trust have to impose maximum or minimum requirements each year.

When the trust term finally expires, the remainder passes to the designated beneficiaries named at the outset. Accordingly, the assets eventually wind up in the hands of those whom you most want to have them.

Is a CLT right for you? It depends on your circumstances. Discuss this option with your estate planning advisor.

SIDEBAR: Is A CRT A Better Option?

Consider whether a charitable remainder trust (CRT), a close cousin to the charitable lead trust (CLT), is a preferable option for your situation.

With a CRT, the trust typically pays out income to the designated beneficiary or beneficiaries — for example, the trust creator or spouse — for life or a term of 20 years or less. If it suits your needs, you may postpone taking income distributions until a subsequent date. In the meantime, the assets in the CRT continue to appreciate.

When you transfer assets to the CRT, you qualify for a current tax deduction based on several factors, including the value of the assets at the time of the transfer, the ages of the income beneficiaries and the federal Section 7520 rate. When structuring a CRT, keep in mind that the greater the payout, the lower the deduction.

There are two types of CRTs: The charitable remainder annuity trust and the charitable remainder unitrust. With either version, the income beneficiary must be entitled to annual payments for his or her lifetime or a period of no more than 20 years. In addition, other tax law requirements apply.

Finally, like a CLT, a CRT is irrevocable. In other words, once it's executed, there's no going back and you can't make other changes. So, you must be fully committed to this approach.

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