


**manatt**

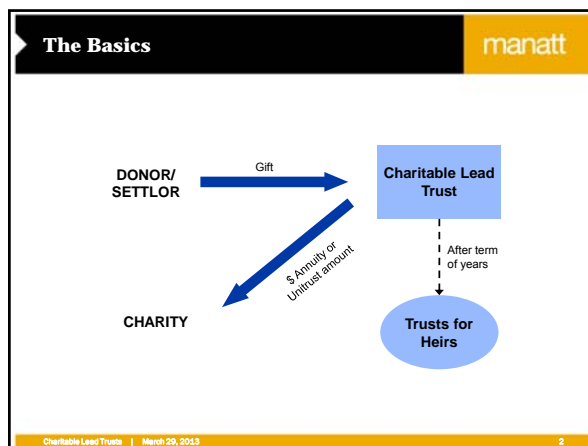


## Charitable Lead Trusts: The Basics, Tips, & Traps for the Unwary

Northwest Planned Giving Roundtable

March 29, 2013

Jill S. Dodd, Esq.  
Manatt, Phelps & Phillips, LLP  
San Francisco, CA



**Why Establish a Charitable Lead Trust?** **manatt**

- ◆ Assets to heirs at discounted rates
- ◆ "Endow" your gift to charity for a term of years
- ◆ Deplete your taxable estate at low or no gift or estate tax cost

Charitable Lead Trusts | March 29, 2013 3

**Who Should Establish a Charitable Lead Trust?** **manatt**

- ◆ Philanthropic intent
- ◆ Do not need all your assets to live on
- ◆ Heirs can wait a period of time before receiving assets from Trust

Charitable Lead Trusts | March 29, 2013 4

**Basic Types** **manatt**

Three Basic Design Decisions:

- ◆ Annuity Trust v. Unitrust
- ◆ Testamentary v. Intervivos
- ◆ Grantor v. Non-grantor

Charitable Lead Trusts | March 29, 2013 5

**Annuity v. Unitrust** **manatt**

- ◆ Unitrust: fixed percentage
  - GST planning possible
- ◆ Annuity: fixed payments
  - Generally more for heirs
  - GST planning difficult

Charitable Lead Trusts | March 29, 2013 6

## Testamentary v. Intervivos

manatt

- ◆ Testamentary
  - Estate tax charitable deduction for present value of annuity stream
  - Can allocate GST but same issue of CLAT v. CLUT

Charitable Lead Trusts | March 29, 2013 7

## Testamentary v. Intervivos

manatt

- ◆ Intervivos
  - Gift tax: completed present gift to heirs of a future interest  
completed present gift to charity
  - Estate tax: out of estate so long as settlor does not retain control of beneficial enjoyment
    - Who can be the charitable annuitant?
    - Who can be the trustee?
  - Income tax: grantor v. non-grantor

Charitable Lead Trusts | March 29, 2013 8

## Grantor v. Non-Grantor CLT

manatt

- ◆ Non-Grantor CLT
  - Donor does not get income tax deduction upon contribution
  - CLT is separate taxpayer
    - Compressed rate table
    - Higher marginal rates for ordinary and passive income
  - CLT has unlimited deduction from income tax for payments to charity
    - Gifts to foreign charities qualify
    - No carryforward
    - Watch unrelated business income trap
  - All testamentary CLTs

Charitable Lead Trusts | March 29, 2013 9

## Grantor v. Non-Grantor CLT

manatt

- ◆ Grantor CLT
  - Grantor gets charitable income tax deduction for present value of annuity payments
    - Gift “for use of” charity
    - Recapture
  - Grantor pays income tax as additional tax-free gift to heirs
  - Caution: Capital gains to donor on distribution of appreciated assets in payment of annuity
  - Grantor retains certain powers
    - Toggle powers off

Charitable Lead Trusts | March 29, 2013 10

## Gift Tax - How Does It Work?

manatt

- ◆ Completed present gift to heirs of a future interest
- ◆ Three factors determine size of gift
  - Length of term
  - Annuity or unitrust percentage
  - 7520 rate
- ◆ What is a successful CLT?

Charitable Lead Trusts | March 29, 2013 11

## 3 Ways to “Supercharge” the Gift

manatt

- ◆ Fund with discountable asset
- ◆ Increasing annuity payments
- ◆ Grantor trust

Charitable Lead Trusts | March 29, 2013 12

## Discountable Assets manatt

- ◆ Example: gift of limited partnership interest holding passive investment assets
  - Assume: 7520 rate = 1.4%  
\$1 million NAV  
discount off NAV = 25%
  - Without discount: hurdle rate = 1.4%
  - With discount: Gift valued at \$750,000  
Hurdle amount =  $(\$750,000)(0.014) = \$10,500$   
Hurdle rate =  $\$10,500/1\text{mm} = 1.05\%$

Charitable Lead Trusts | March 29, 2013 13

## Increase Annuity Payments manatt

- ◆ Like GRAT: increase by 20% each year
- ◆ Shark Fin CLAT
- ◆ Issue: what is charitable intent of donor?

Charitable Lead Trusts | March 29, 2013 14

## Grantor Trust manatt

- ◆ CLT is not depleted by having to pay income taxes
- ◆ Grantor's taxable estate likewise depleted without paying gift tax
- ◆ Toggle off grantor trust status

Charitable Lead Trusts | March 29, 2013 15

## Traps for the Unwary manatt

- ◆ Private foundation rules apply
  - Self-dealing
  - Excess business holdings
  - Jeopardizing investments
  - Taxable expenditures
- ◆ Unrelated business income reduces charitable deduction in non-grantor trust
- ◆ Asset must generate cash flow required to pay annuity
  - Unwanted discount if interests in closely held business used to pay annuity
    - Could be deemed self-dealing if appraised value per unit is too high
  - Deemed sale of appreciated assets distributed from grantor trust

Charitable Lead Trusts | March 29, 2013 16

## Traps for the Unwary (Cont'd) manatt

Best assets to use

- Discountable
- Reliable cash flow
- Pop in value a plus
- Avoid risks of self-dealing
- Avoid unrelated business income tax

- ◆ Application to closely held family business

Charitable Lead Trusts | March 29, 2013 17

## manatt

Jill S. Dodd, Esq.  
Manatt, Phelps & Phillips, LLP  
One Embarcadero Center, 30<sup>th</sup> Floor  
San Francisco, CA 94111  
(415) 291-7421  
jdodd@manatt.com

307824238  
Charitable Lead Trusts | March 29, 2013 18