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Summary of Advantages of a
Charitable Remainder Lead Trust (CLAT)

A Charitable Lead Trust is an estate planning technique that involves creating a trust that makes payments to one or more charities for a term of years. Although the term during which the payments are made to charities can be measured by one or more lives, most often the term is measured by a specific number of years. At the end of the trust term, the remaining trust property can be returned to the person who creates the trust (the “Grantor”) or to family members or other non-charitable persons. A CLAT is the opposite of a Charitable Remainder Trust (“CRAT”), in which the payments for a term of years or a lifetime are made to non-charitable recipients, and at the end of the trust term payments are made to one or more charities.

The charitable payments during the trust term can be either as an annuity, a unitrust payment by which a specified percentage of trust assets is paid annually to the charity, or as a hybrid in which all of the trust income is annually paid to the charity.

Depending on how the CLAT is structured, the Grantor may receive a gift or an estate tax deduction for the present value of the payments that are made to charity during the trust term. If the trust is considered a “grantor” trust, the Grantor receives an income tax charitable deduction for the present value of the interest passing to charity, but if the trust is not a grantor trust, the income tax charitable deduction is not available. If the trust is a so-called Grantor Charitable Lead Trust, the Grantor pays income tax on income produced by the trust and will not receive an income tax charitable deduction when payments are made to the charity. The reason that the Grantor does not receive an annual income tax charitable deduction when payments are made to a charity is because the Grantor received an initial income tax deduction for the present value of the payments made to charity during the trust term. If, however, the trust is a non-grantor trust that has not received an immediate income tax deduction for the present value of the payments to be made to charity, an annual income tax charitable deduction will be available for payments made by the trust.

In a low interest rate environment, a CLAT can be an ideal estate planning tool for charitable-minded persons. This is because the lower the interest rate under IRC Section 7520, the more assets that will ultimately remain in a CLAT at the end of the trust term (after all annuity payments have been made to charity) to be transferred tax free to the trust beneficiaries, as demonstrated by the example located on page 3 of this memorandum. The low interest environment is, however, favorable only for CLATS that are structured as annuity trusts. Low interest rates usually do not affect, one way or the other, the benefits of a CLAT structure as a unitrust.

If the CLAT is structured as a unitrust, the trust will annually pay a fixed percentage of the annual fair market value of trust assets to the charities. This payment is call the “Unitrust Amount.” Contrary to an annuity amount, the Unitrust Amount can increase or decrease annually as the value of the trust assets increases or decreases. As with an annuity trust, at the end of the trust term the remaining trust assets usually pass to family members or other family or other non-charitable beneficiaries.

The following example illustrates how a CLAT can be effectively used in the current low interest rate environment:

At an 8% 7520 rate (in the past the 7520 rate has been as high as 11.6%) the amount needed to zero out a ten-year one million dollar CLAT that produces no gift is $149,029.00. In other words, $149,029.00 is the annuity that would have to be paid annually to charity for there to be no gift component. If the 7520 rate is, however, 1.4% (the rate as of January 2012), the annual annuity amount needed to zero out the same CLAT is $107,861.00, an annual difference of $41,168.00.

Therefore, assuming the 7520 rate is 1.4% and the assets in the CLAT produce a return of 4%, at the end of the ten-year term the CLAT will have $185,254.00 remaining in the CLAT (after the annuity payments to charity) to pass on to the trust beneficiaries, usually the Grantor's children. If the assets produce a return of 8% the CLAT will have $596,390.00 to pass on to the trust beneficiaries. If the assets produce a return of 12% the CLAT will have $1,213,024.00 to pass on to the trust beneficiaries! The designated charity or charities will receive ten annual annuity payments of $107,861.00, totaling $1,078,610.00.

We have found that CLATs can be used not only for effective tax planning purposes, but also to engage family members, particularly children, in perpetuating their parents' charitable gifting patterns. The children therefore derive a sense of giving continuity if they are involved in making annual decisions as to which charities are to receive the CLAT payments. The CLAT also provides an opportunity for the children to work together in continuing the charitable generosity their parents exhibited during the parents' lifetime. At the end of the CLAT term, if the trusts assets have been prudently invested and have grown in excess of the 7520 rate (currently 1.4%), substantial assets will remain to be distributed tax free to the children. Consequently, if the trust term is structured to end at the time the children reach retirement age and are less productive, the distribution of assets at that time may be more helpful to the children than if the distribution were made at the time of the parents' deaths.

RLZ: 01-03-11

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