

Charitable lead trusts offer philanthropic and family benefits

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Affluent families who wish to give to charity while minimizing gift and estate taxes should consider a charitable lead trust ("CLT"). These trusts are most effective in a low-interest-rate environment, so conditions for taking advantage of a CLT currently are favorable. Although interest rates have crept up a bit in recent years, they remain quite low.

CLTs come in two flavors

A CLT provides a regular income stream to one or more charities during the trust term, after which the remaining assets pass to your children or other noncharitable beneficiaries.

There are two types of CLTs: (1) a charitable lead *annuity* trust ("CLAT"), which makes annual payments to charity equal to a fixed dollar amount or a fixed percentage of the trust assets' initial value; and (2) a charitable lead *unitrust* ("CLUT"), which pays out a set percentage of the trust assets' value, recalculated annually. Most people prefer CLATs because they provide a better opportunity to maximize the amount received by the noncharitable beneficiaries.

Typically, people establish CLATs during their lives because it allows them to lock in a favorable interest rate. Another option is a testamentary CLAT that is established at death by your will or living trust.

Interest matters

Why are CLATs so effective when interest rates are low? When you fund a CLAT, you make a taxable gift equal to the initial value of the assets you contribute to the trust, less the value of all charitable interests. A charity's interest is equal to the total payments it will receive over the trust term, discounted to present value using the Section 7520 rate, a conservative interest rate set monthly by the IRS. As of this writing, the Section 7520 rate has fluctuated between 2.8% and 3.4% this year.

If trust assets outperform the applicable Section 7520 rate, the trust will produce wealth transfer benefits. For example, if the applicable Section 7520 rate is 2.5% and the trust assets actually grow at a 7% rate, your noncharitable beneficiaries will receive assets well in excess of the taxable gift you report when the trust is established.

Act now

If a CLAT appeals to you, the sooner you act, the better. In a low-interest-rate environment, outperforming the Section 7520 rate is relatively easy, so the prospects of transferring a significant amount of wealth tax-free are good. Please contact us with questions.

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