Scholfield
Wealth Management, Inc.

A Twist on Charitable Giving:
Engaging a Charitable Lead Trust for Local Philanthropy

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Every once and a while, as a Financial Advisor, I'll see a client who experiences a large and unplanned infusion of cash that can cause an extremely high taxable event for that year. This could come from the sale of highly appreciated property or security, a large special one-time securities dividend, or perhaps a deferred compensation payout. Any of these scenarios require the additional cash to be treated as ordinary income for that year, which can in some cases add up to a tax bill of 50% when you consider federal, state and local taxes. It is in cases like these especially, that strategically engaging a Charitable Lead Trust (CLT) can provide a win-win for the family and the community.

How does a Charitable Lead Trust Work?

Most people know about Charitable Remainder Trusts, where a client gifts monies or securities to a trust and reserving an income right for themselves during their lifetime with the remainder of the trust assets passing to the selected charity at death. A Charitable Lead Trust is basically the opposite. For a family who is not looking for additional income, especially all in one year like that, gifting some portion to a Charitable Lead Trust provides an income either for a fixed period of years, or over one or more lifetimes or a combination of the two to a qualified charitable organization. Once the trust terms are fulfilled, the remainder principal is returned to the grantor and or beneficiaries named in the trust.

Grantor Charitable Lead Trusts

There are two basic foundational elements to a CLT: Whether it's a Grantor or Non-Grantor CLT. At its' basic level, a Grantor CLT creates a trust in which the initial amount funding the trust can be taken as a tax deduction up-front, while its' income flows to charity for a period of years defined by the trust. In this case, all the income generated by the trust is officially credited and taxable to the grantor each year. A Grantor CLT is often used to decrease the tax implications for an unusual and unexpected influx of income as earlier described.

Building on Potential Advantages of a Grantor Charitable Lead Trust: Leverage Annuities

As noted, all income generated from a Grantor CLT is taxable back to the client as ordinary income each year as if the client directly owned the securities or assets. Since all income earned within an annuity is tax deferred until taken as income, using an annuity within the framework of a Grantor CLT allows the grantor to limit the impact of the income each year to the amount agreed to be paid to a charitable organization with the remainder income left tax-deferred. So, for example, if a CLT is designated to provide $35,000/year to a charity, yet it earns $50,000 – without an annuity, the full $50,000 is taxable for that year, whether it is distributed or not. Within the annuity framework, only the $35,000 is taxable and any earnings above that is deferred from taxation for that year.

Additionally, within the framework of an annuity within the CLT, if a grantor survives the term of the trust, the annuity may pass out of the trust as an in-kind distribution back to himself continuing the tax deferral until he decides to take the income. Should the grantor pass within the CLT term, the trust would terminate and the estate would have a tax adjustment calculated by the amount of monies not received by the charities, and the annuity death benefit would return to the trust and pass to the family or beneficiaries.

What is a Non-Grantor CLT?

A Non-Grantor CLT doesn't provide the initial up-front tax deduction, and it provides the income to a charity for a specified term. None of the income is taxable to the grantor, and the amounts paid to charity qualifies for a gift tax charitable deduction each year, either to the grantor or their estate, until the term of the trust is fulfilled. Once the term is fulfilled, whatever principal remains is then transferred to one or more non-charitable beneficiaries, such as children. This variation may help place the assets outside the taxable estate of the donor.

A family's estate planning and philanthropic objectives help define which specific variation makes the most sense.

In Summary

Charitable Lead Trusts may not be suitable for all families with charitable inclinations. However, for those times when a family happens to come into a large one-time income bubble in a specific year especially, a CLT may be a great option to support gifting to local or national organizations while providing a tax shelter for the income.

As always, it is important to fully understand the full implications of these options. I strongly recommend working closely with your Attorney, CPA and Financial Advisor to best align tools like these with your family's goals, tax and estate planning, and overall investment objectives to ensure your family's best interests are maintained.

About Max Scholfield

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Licensed as a Financial Advisor in 1990, Max Scholfield is a retirement income strategist and provides wealth and investment management advisory services. Max is known for understanding his client's risk tolerance, their goals, and building investment strategies exclusively for them. He has seen several market cycles and how the various investments behave and has the experience to employ investment choices that are most likely to provide value for investors. Originally hired into the industry by Dean Witter, which later became Morgan Stanley, Max was an investment advisor and also served as the office manager for several years. He left to join UBS Financial Services and was with them over six years. He has now established his own practice within First Allied Securities, Inc. in November of 2011.

Playing an active role in the Durango community has always been important to Max. He has been a long-standing sponsor of the Big Brothers Big Sisters organization of Southwest Colorado, and key events like their annual Dos Mosca fly fishing fundraising tournament. He has also been a member of Kiwanis Club of Durango, BASS Masters of Southwest Colorado and qualified for the Colorado StateBASS fishing team in 2007.