THE PRIVATE TRUST COMPANY

Using Charitable Lead Trusts and Charitable Remainder Trusts

There are many options for those seeking to incorporate charitable giving into their estate plan. Two of the most popular—Charitable Lead Trusts (CLTs) and Charitable Remainder Trusts (CRTs)—can offer estate tax benefits and an opportunity for donors to give to the charity of their choice.

Yet the two trusts are fundamentally different. They essentially work in opposite fashions. A CLT pays income to a charitable beneficiary for a certain period of time, after which the remaining assets in the trust (the "remainder interest") pass to a non-charitable beneficiary or beneficiaries, such as children or grandchildren, or even the donor. With a CRT, the assets placed in the trust provide a stream of income to non-charitable beneficiaries for a period of time, after which the assets become the property of a charity. Income tax, capital gains tax, and estate and gift tax differ significantly between CLTs and CRTs.

Charitable Lead Trusts

A CLT can be set up to pay either a fixed annuity or a unitrust amount to a charitable organization. This means that it can pay either a fixed dollar amount each year or a fixed percentage of the fair market value of the trust's assets. While there is no limit on the amount of time a CLT can remain in effect, it must be for either a predetermined number of years or until the death of the donor.

CLTs are often the tool of choice for individuals with assets that have a high potential for future appreciation as the beneficiaries will reap the benefit upon receipt. They may also be well suited for those with heirs who are minors or otherwise not ready to assume full control of significant assets. By creating and funding a CLT, a grantor can make final arrangement for the disposition of an estate, but defer the date at which beneficiaries actually receive and control the property. In the meantime, the charity of choice receives immediate and ongoing benefits. When the assets do eventually pass to the non-charitable beneficiaries, they are not subject to the federal estate tax.

Keep in mind, however, that the grantor is not able to claim an income tax deduction for making contributions to a CLT. In addition, the grantor may have to pay a federal gift tax on a portion of each contribution, albeit only on the value of the remainder interest earmarked for non-charitable LPL Financial beneficiaries.

Also remember that while a CLT allows assets to pass to heirs with no federal estate taxes, a CLT is not a tax-free entity. Any income the trust generates in excess of the amount paid to charity is still taxable. And the sale of appreciated assets held within the trust may trigger capital gains taxes.

Charitable Remainder Trusts

In the eyes of a charity, a CRT is the mirror image of a CLT. A CRT first pays income to noncharitable beneficiaries before permanently awarding ownership of its assets to the charity. But in the eyes of Uncle Sam and taxpayers, the most significant differences lie elsewhere.

First and foremost, a CRT is a tax-exempt entity. For this reason, CRTs can be extremely useful for individuals who want to sell appreciated assets, such as clients eager to liquidate highly appreciated, concentrated stock portfolios in order to reallocate the money within more diversified portfolios or to create income streams for themselves or beneficiaries.

In addition, a grantor can claim a tax deduction for his or her donation to a CRT equal to the present value of the charitable remainder interest. And although a CRT's assets are ultimately distributed to the charity free of estate and gift taxes, the non-charitable beneficiaries of a CRT must pay income taxes on the income received from the trust.

As with CLTs, CRTs are classified according to their payment methods. A charitable remainder annuity trust pays a fixed dollar amount at least annually, whereas a charitable remainder unitrust pays a fixed percentage of the fair market value of the trust's assets. Each type of CRT must pay no less than 5% of its fair market value annually and not more than 50%, according to IRS guidelines. A CRT may remain in effect for life or for a predetermined period of time, not to exceed 20 years.

CLTs vs. CRTs at a Glance

	CLT	CRT
Taxes on contributions	No deductions to current income; gift taxes may apply	Partial deductions on contributions
Beneficiary during life of trust	Charity receives current income	Specified beneficiary receives current income, but must pay taxes on it
Beneficiary at trust termination or death of donor	Specified beneficiary	Charity
Federal estate taxes	None	None

*Tax rules governing trusts are complex. You should seek the advice of a qualified tax and trust professional before determining which strategy is best for your situation.

Points to Remember

1. CLTs and CRTs have the potential to help families and individuals simultaneously address two important aspects of a wealth transfer strategy: charitable giving and tax-efficient estate planning.
2. A CLT pays income to a charitable beneficiary for a period of time, after which the assets in the trust become the property of non-charitable beneficiaries. A CRT is just the opposite; it pays income to non-charitable beneficiaries before ultimately handing over its assets to a charity.
3. With a CLT, the grantor cannot claim an income tax deduction and must pay a federal gift tax on the value of the contribution earmarked for non-charitable beneficiaries. However, assets pass to heirs without being subject to estate taxes.
4. With a CRT, the grantor can claim a tax deduction for a portion of each contribution, and assets pass to heirs without gift or estate taxes.
5. A CLT may be appropriate for donors with heirs who are minors or heirs not yet ready to assume control of assets. A CRT, which is tax exempt, may be appropriate for people who want to sell highly appreciated assets without triggering capital gains taxes.
6. When contributing an asset, which is expected to appreciate greatly, you may want to consider a CLT so the beneficiaries will ultimately benefit from the increased value.

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