

A Charitable Lead Trust– How to Give and Pass Wealth to Heirs

Where Local Good Grows

Hendricks County Community Foundation

Why Now?

Individuals looking for a tax-efficient way to pass wealth to family members and make a generous gift to charity look to charitable lead trusts, especially in a low-interest-rate environment. Why? Because low interest rates mean greater savings in transfer taxes (both gift and estate taxes).

How Does a Lead Trust Work?

With careful planning, you can use a charitable lead trust (CLT) to substantially reduce or even eliminate the taxes customarily due on the transfer of wealth to loved ones. It works like this:

- You transfer assets to an irrevocable trust.
- The trust exists for a set number of years or for your lifetime (or the life of another individual).
- The trust makes annual payments to the charity.
- At the end of the trust term, the assets remaining in the trust either pass back to you (grantor lead trust) or to someone else (non-grantor lead trust or family lead trust).

In the following question and answer section, we will focus on the most popular form—the non-grantor lead trust.

How Does the Lead Trust Reduce Taxes?

When you establish the trust, IRS rates are used to calculate the value of the remainder interest that is expected to go to family members. When the charitable payments end and the trust distributes the assets, the assets may have increased in value—possibly by a significant amount. If so, no tax is due on this appreciation. This means that when the charitable interest expires, you can pass more wealth to loved ones.

How Much Is the Charitable Deduction?

The size of the deduction for *gift and estate tax* purposes is based on three factors:

- The amount paid to charity,
- The length of the trust term, and
- The applicable federal rate (AFR) when the trust is established.

A family lead trust does not provide you with a charitable *income tax* deduction—its primary purpose is to minimize or eliminate estate and gift transfer taxes that can be a serious drain on resources.

How Do Interest Rates Affect Lead Trusts?

When the applicable federal rate (AFR) is low, the calculated value of the charity's income interest is greater, which in turn generates a higher charitable deduction. Moreover, the value of the remainder going to heirs is lower, and this is the amount on which the transfer tax is based. The lower expected remainder results in a lower estate tax.

Thus, there is a double tax benefit—you can maximize charitable deductions and reduce transfer tax liability. This means you can pass more wealth to loved ones while providing immediate support for our mission.

What Is the Best Way to Fund a Lead Trust?

The best choice is to select marketable securities with strong growth potential for the benefit of the remainder beneficiaries, but there are other considerations. The lead trust is not tax-exempt—it must pay taxes on its income and realized gains. Even though the trust can claim tax deductions annually for the amounts paid to charity, it requires careful management to offset tax liabilities and ensure sufficient income and liquidity to make the annual charitable payments.

How Do the Income Payments to Charity Work?

To qualify for a charitable deduction, the lead trust must make income payments to charity. You can set the payments as a fixed dollar amount (a lead annuity trust) or a fixed percentage of the trusts assets as revalued annually (a lead unitrust). Whichever method you select, there are no minimum or maximum payout requirements. Still, the payout should be commensurate with the trust's ability to generate the required income payments to charity.

What Is the Best Time to Establish a Lead Trust?

You can establish a lead trust during life or create one by will. However, while the AFR is low, there is an added incentive to create and fund a lead trust in the near term rather than risk higher rates and a lower charitable deduction in the future.

Creating a lead trust during life also reduces the size of your taxable estate. And remember, all appreciation in the value of the trust properties that occurs after the trust is funded is completely free of gift and estate taxes.



Can Donors Designate Gifts?

Yes. We welcome gifts designated for a specific purpose, as they provide you with the opportunity to influence and shape our future. But we also are grateful for unrestricted gifts that allow us to direct support to the areas of greatest need. Whether restricted or unrestricted, we can use the income from a lead trust gift immediately to support our mission.

Is a Lead Trust the Right Choice?

There are many factors to consider in determining if a lead trust makes sense for you. Certainly, the charitable lead trust is not for everyone—it requires a substantial financial commitment over a long period of time. But for affluent individuals who want to pass more wealth to heirs and make an immediate impact with their giving, the charitable lead trust is worth exploring.

OUR MISSION:

The Hendricks County Community Foundation partners with generous people to realize their charitable goals while addressing community needs in meaningful and lasting ways.

OUR VISION:

Hendricks County is a vibrant, giving community.

Where Local Good Grows

Hendricks County Community Foundation

William A. Rhodehamel
President & CEO

Hendricks County Community Foundation
6319 East U.S. Highway 36, Suite 211
Avon, IN 46123

317.268.6240
www.hendrickscountycf.org

Tax information provided herein is not intended as tax or legal advice and cannot be relied on to avoid statutory penalties. Always check with your tax and financial advisors before implementing any gift. CLT0119