Charitable Lead Trust: Frequently Asked Questions

How does this plan that gives money to charity also function as vehicle to transfer wealth to children or grandchildren, free of gift and estate taxes?

The principal of the lead trust is a gift from the grantor to his or her beneficiaries. However, transfer taxes (gift and estate taxes) are avoided because the lead trust offers charitable deductions to offset those taxes.

What is it about present economic conditions (2014) that makes charitable lead trusts work so efficiently at this time, compared to other periods in history?

This is a period of historically low interest rates. When valuing the grantor’s deferred gift to his/her beneficiaries, the IRS uses a factor that is reflective of the overall low rate environment (the IRS discount rate). When this discount rate is low, as now, the deemed present value of the gift to the beneficiaries is smaller. The discount rate is released each month. For example, the discount rate for September 2014 is 2.2 percent. Thus, the IRS deems the trust principal to be growing at 2.2 percent per year although the actual return on the invested assets may be greater.

What has the IRS done to make setting up a charitable lead trust easier than ever before?

In 2007 and 2008, the IRS released a series of revenue procedures containing sample lead trust forms that meet all the relevant requirements. The sample forms are accompanied by annotations and alternate provisions for further guidance.

Which assets make the best candidates for transfer into a charitable lead trust?

Assets place in the lead trust grow outside the grantor’s estate. Generally, the ideal asset for a lead trust is one with high growth potential. Transferring low cost basis assets is not necessarily an advantage. The trust receives the grantor’s basis in the transferred property and the remainder beneficiaries receive the trust’s basis.

Will the generation skipping transfer (“GST”) tax be an obstacle if grandchildren are beneficiaries of a lead trust?

Many lead trusts are designed to benefit grandchildren. By using a unitrust rather than annuity trust format and by allocating his or her GST exemption to the trust at the time it is created, a grantor can reduce or avoid the GST tax. Upon distribution of principal to the grandchildren from the charitable lead unitrust, no GST tax is due.
Must the lead trust pay the same amount to the charity each year of the trust’s term?

No. Payments can step up from year to year. A “step” payment trust features payments that increase by a certain percentage each year. Depending on market conditions, this type of plan can increase the value of the principal that the grantor’s family will eventually receive.

How does the charitable lead trust compare to the charitable remainder trust?

These two trusts are the reverse of each other – the lead trust pays annual income to charity and gives its remainder to individuals; the remainder trust pays annual income to individuals and distributes the remainder to charity.