

# THE CHARITABLE LEAD TRUST IN TODAY'S LOW-INTEREST ENVIRONMENT

Recent interest rates are the lowest they have been in decades. This can be advantageous if you are buying a home or a car, but very disadvantageous if you are dependent on interest income. If you are charitably inclined, you can take advantage of low interest rates by using a **charitable lead trust** to make a gift to charity and a highly leveraged gift to family members at substantially reduced or no gift tax cost.

## What is a Charitable Lead Trust?

A charitable lead trust is a trust that makes annual payments to a charity for a certain number of years, after which the trust assets will pass to non-charitable beneficiaries designated by the donor (typically children or grandchildren).



The annual payments to charity can be either a fixed annuity amount or a fixed percentage of the fair market value of the trust each year. A charitable trust that pays a fixed annuity amount is called a charitable lead annuity trust; a charitable trust that pays a percentage each year is called a charitable lead unitrust.

## Why is a Charitable Lead Trust so Attractive in a Low-Interest Environment?

The reason why it is such an opportune time to establish a charitable lead trust is that the rate used to calculate the present value of charitable payments, called the Section 7520 rate, is based on federal interest rates and changes each month. As the federal interest rates decrease, so does the Section 7520 rate, which in turn allows for a greater charitable deduction and lower taxable gift.

Consider the following example:

Donor contributes \$1 million to a charitable lead annuity trust that will make annuity payments to the University of Chicago for a term of years, after which the trust will be

distributed in equal shares to Donor's three children.

If the charitable term is 20 years and the annuity payment to the University is \$70,000/year, the charitable gift tax deduction will be equal to \$1,000,000, meaning there will be zero taxable gift and no gift tax owed. Compare this to the amount of taxable gift that results when the section 7520 rate is higher:

<b>Section 7520 Rate</b>	<b>Taxable Gift</b>
2.0% (February 2009)	\$0
7.2% (historic average of all rates to date)	\$269,810

Under this scenario, the University will receive an aggregate gift of \$1,400,000 over 20 years. In addition, assuming a 7.9% rate of return, the donor's three children will receive an aggregate sum of \$1,100,000, gift tax-free, at the end of 20 years.

### **How is a Charitable Lead Trust Taxed for Income Tax Purposes?**

A charitable lead trust is typically structured so that although the donor *will not* receive an income tax deduction for the gift, the trust will be entitled to a 100% income tax deduction each year for the value of the payment to charity. To the extent that the trust income exceeds the payment to charity in a given year, the trust will pay income tax. All after-tax accumulated income and appreciation will then pass to the non-charitable beneficiaries tax-free at the end of the charitable term.

### **How is a Charitable Lead Trust Administered?**

If the University serves as the trustee of your charitable lead trust, the University, with the expertise of its investment advisers, will manage the trust assets. The University will provide you with all necessary tax documentation and financial statements to show how the trust assets are performing. The University will charge a management fee, but one which will likely be less than the fee charged by a corporate fiduciary. Of course, you are free to choose anyone other than the University to serve as trustee, provided that to achieve the leveraging power of a charitable lead trust, it is generally not advisable for you (the donor) to act as Trustee.

### **If I am Interested in a Charitable Lead Trust, What Should I Do Next?**

If you are interested in discussing how current low interest rates and a charitable lead trust can be used to meet your estate planning and charitable goals, please call the University's Office of Gift Planning at (866) 241-9802. We will be happy to work with you and your tax advisers to determine how this gift vehicle can be used to meet your specific needs.