



DO THE ASSETS USED FOR FUNDING AFFECT THE INCOME TAX CONSEQUENCES TO YOU AND THE ADMINISTRATION OF THE CLAT?

If a donor wishes to transfer assets other than cash, cash equivalents and unrestricted publicly traded securities to a CLAT, the donor should review the funding plan with his or her accountant and legal counsel to confirm the income tax consequences of the proposed gift to the donor, as well as the tax and administration consequences to the trust and the trustees of accepting and holding the proposed gift.

Funding the CLAT with appreciated assets will not cause the donor to recognize capital gain, and the unrealized appreciation will not be a preference item for AMT purposes on the donor's income tax return. However, if the CLAT must pay a large capital gains tax in order to reinvest low basis assets contributed to the trust, it will be harder for the CLAT to make all the required annuity payments and build up property to be distributed to the remainder beneficiaries when the charitable term ends.

Care should be taken to ensure that the funding of the CLAT is not deemed to be an "assignment of income" by the donor. If a CLAT is funded with appreciated property that is subject to a binding sales contract or any agreement or understanding under which the trustees are obligated to sell the property to a third party, the donor will recognize gain on his or her personal income tax return when the trust sells the property. Caution should also be exercised if the donor transfers stock in a closely held corporation during an ongoing tender offer and pending merger that the donor has participated in negotiating and planning. In such a case, the donor could be deemed to have already converted the stock into a fixed right to receive cash at the time the stock is contributed to the CLAT.

The CLAT does not qualify as a shareholder of S corporation stock.

If the CLAT will hold more than 2% of the ownership interests in any business enterprise (corporation, partnership, other entity), the trustees should consult legal counsel with respect to the application of the excess business holdings rules.

Holding or making investments in entities that are disqualified persons, as well as co-investing with or holding investments in common with disqualified persons, can create a variety of self-dealing problems. The trustees should review the private foundation self-dealing rules to confirm that the CLAT's investment plan will not give rise to any potential self-dealing issues.

Care should be taken before funding a CLAT with or investing CLAT assets in stock of a donor-controlled corporation, stock subject to a voting trust, or insurance policies on the life of the donor and/or the donor's spouse, and before funding a CLAT with property encumbered by a mortgage or other similar lien. While there are certain exceptions that may be applicable in a given situation, generally a donor risks that a gift of mortgaged property to a CLAT will generate relief of indebtedness income and be taxed as a bargain sale, be a prohibited act of self-dealing at the time the gift is made and when the CLAT makes payments on the debt, and give rise to debt-financed income as to which only a portion (not more than 50%) can be sheltered from income tax by the annuity amounts paid to charity.