



IS THERE AN INCOME TAX BENEFIT TO CREATING A CLAT?

Generally, when a charitable lead trust is created for gift or estate tax planning purposes, it is not structured to qualify for a federal income tax charitable deduction.

A lead trust gift that does not qualify for an income tax charitable deduction can still be useful to the donor for income tax purposes. Although the donor receives no income tax charitable deduction for funding the trust, the trust's income will not be includible on the donor's tax return. For a donor whose charitable deductions already exceed the amount he or she can use to offset taxable income, this type of lead trust can generate an indirect tax deduction for the donor because the trust's income will be taxed to the trust, instead of the donor. Although the lead trust will report and pay tax on its own income, it is allowed an unlimited deduction for income it distributes to charity. Generally, if the lead trust's taxable income each year does not exceed the amount it pays to charity for the year, the trust will not pay any income tax.

If the donor wishes to receive an income tax deduction for funding a charitable lead trust, the donor must create a special kind of trust that is treated as if it were owned by the donor for income tax purposes. This means that in order to claim an income tax deduction for funding a lead trust, the donor must be willing to report all of the trust's annual income and gains on his or her individual tax return. The donor's only income tax deduction will be for funding the trust. The donor will not be able to claim any additional deductions when the trust makes its payments to charity each year. If the donor dies during the charitable term, a portion of the tax deduction benefit the donor received from funding the lead trust will be included as income on the donor's final income tax return.

This type of lead trust can be useful when the donor is in an exceptionally high income tax bracket in the year the donor funds the trust and expects to be in a lower income tax bracket in subsequent years when the trust's income will be taxed to the donor. The donor's deduction for funding the trust is equal to the value of the charitable gift, subject to certain limitations that are based on the type of property used to fund the trust, the status of the charity as a public charity or a private foundation, and the rules limiting how much income the donor can offset with a charitable deduction in any year (the maximum amount is 30% of adjusted gross income).

In appropriate planning situations, a "super charitable lead trust" can be created to combine the income, gift and estate tax advantages of the two types of charitable lead trusts. The structure of a super lead trust is more complicated because the donor must create a trust that will be treated as if it were owned by the donor for income tax purposes, but do so in a manner that does not cause the trust to fail to achieve its intended gift and estate-tax advantages. The donor must also be in such a financial position that the donor's obligation to pay tax on the lead trust's income and gains for a number of years (e.g., 10 to 25 years) would be viewed as a tax-planning opportunity rather than a burden.

Please note that the federal discount rate is recalculated each month. The lower the rate, the easier it is to structure a charitable lead annuity trust that will "zero out" the taxable gift. Donors have some planning flexibility because they can use the discount rate in effect in the month they fund a lead trust or the rate that was in effect in either of the two preceding months.