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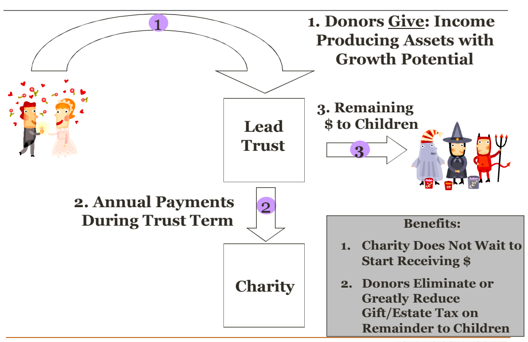
"Somewhere Over the Rainbow, Lead Trusts Can Come Trust"

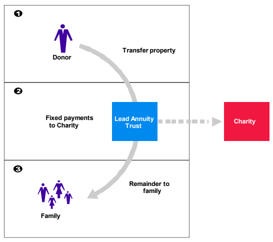
What We Will Learn Today

- How standard non-grantor lead trusts ("CLT") work
- The world of grantor lead trusts
- Example 1: Defective grantor lead trusts
- Example 2: Reversionary grantor lead trusts or enhanced pledges
- Example 3: Shark fin/balloon payment funded with life insurance and annuity
- Why CLTs don't happen often?
- What can we do to make these happen?

How Lead Trusts Work



How Lead Trusts Work



How it Works

1. You transfer cash, securities, or other property to a trust. You receive a gift tax deduction.
2. During its term, the trust pays a fixed amount each year to Charity.
3. When the trust ends, its remaining principal passes to your family or other heirs you name. Trust growth passes to them tax-free.

Lead Trusts – Typical Features

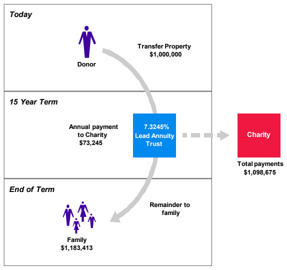
- Irrevocable
- Fixed income stream to charity
- Remainder in trust to family
- Typically for a term up to 20 years but can be for much longer!
- Only for prospects facing estate tax

Lead Trusts – Tax Benefits

- Charitable income tax deduction
  - Lead trusts are generally NOT done for charitable income tax deduction purposes
  - New ideas WILL garner donors an income tax deduction but with a major caveat
- Capital gains
  - Lead trusts are NEVER done for capital gains avoidance
  - But, maybe delay of gains or letting parent gen pay cap gains tax from own pocket…
- Estate tax avoidance
  - Was thought to be the ONLY real tax benefit
  - But, as we will see the other tax benefits are very powerful

How Lead Trusts Work

15-Year, 7.3245% Charitable Lead Annuity Trust
8% Internal Trust Return – 1.2% AFR



Benefits

Immediate
Gift tax deduction of $1,000,000.
Remove trust principal from your estate.

Annual
Annual payments to Charity of $74,376 for 15 years.

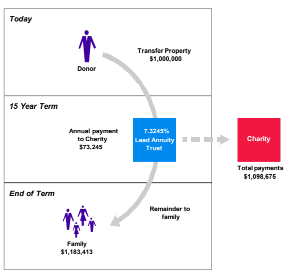
Projected total payments to Charity of $1,098,675.

Future
Projected net to family of $1,183,413 from trust based on **8% investment return**.

Reduced estate taxes and costs. Trust growth transferred to family tax-free.

How Lead Trusts Work

15-Year, 7.3245% Charitable Lead Annuity Trust
8% Internal Trust Return – 1.2% AFR



How and Why it Works

To produce $1,098,675 in payments to charity over 15 year term, you need $1,000,000 earning 1.2% (AFR/IRS Discount Rate for 7/12) per year.

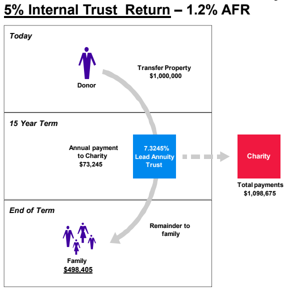
Therefore, the "present value" of the promised income stream to charity equals the value put into the trust.

In other words, the entire "gift" to family of the $1 million put into the trust is offset by the "present value" of the income stream ($1 million) going to charity.

The gamble is whether the lead trust investment can earn much more than the AFR to produce a significant "estate tax free" transfer to children.

How Lead Trusts Work

15-Year, 7.3245% Charitable Lead Annuity Trust
5% Internal Trust Return – 1.2% AFR



Benefits

Immediate
Gift tax deduction of $1,000,000.
Remove trust principal from your estate.

Annual
Annual payments to Charity of $74,376 for 15 years.

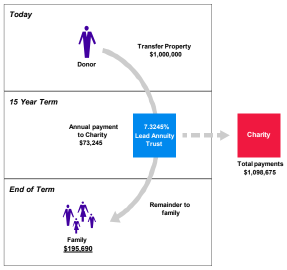
Projected total payments to Charity of $1,098,675.

Future
Projected net to family of **$498,405** from trust based on **5% investment return**.

Reduced estate taxes and costs. Trust growth transferred to family tax-free.

How Lead Trusts Work

15-Year, 7.3245% Charitable Lead Annuity Trust
3% Internal Trust Return – 1.2% AFR



Benefits

Immediate
Gift tax deduction of $1,000,000. Remove trust principal from your estate.

Annual
Annual payments to Charity of $74,376 for 15 years.

Projected total payments to Charity of $1,098,675.

Future
Projected net to family of **$195,690** from trust based on **3% investment return**.

Reduced estate taxes and costs. Trust growth transferred to family tax-free.

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Federal Estate/Gift Taxes

Avoiding Federal Gift and Estate Taxes WAS the ONLY real reason to do one of these

- Each person will have a $5.49 million (2017) Federal Gift and Estate tax exemption
- Total for married couples: a whopping $10.98 million exemption!
- Low AFR (currently 2.2%) still makes these attractive for planning purposes
- Annual gift tax exclusion is $14,000 (2017)

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Lead Trusts – What Are They?

- A way to pass assets to children or grandchildren at greatly reduced or no gift/estate tax
- The trust is a contract between the trustee and the donor
- Charity should NEVER serve as trustee; donor cannot either (unless…)
- Rate/term chosen by donor based on various factors to produce desired gift tax reduction and potential remainder to children
- Lead trusts typically designed to produce a $0 or very small reportable gift to children
    - **NOTE: high life-time gift/estate tax exemption offers individuals room to report some gift**

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Lead Trusts – What Are They?

- Lead trusts are NOT tax-exempt charitable trusts
- For standard versions (called a non-grantor lead trust):
  - The lead trust itself pays taxes on all income (all types including capital gains) in excess of the charitable payments
  - If a lead trust is funded with appreciated property that is sold by the trust, there could be a very significant loss to taxes
- For non-standard versions (called a grantor lead trust):
  - Donor can take upfront income tax deduction for present value of income to charity
  - But, donor has to pay taxes on all income/gain of trust, regardless of charitable payments (a good thing, if you really think about it)
  - Reversionary grantor lead trusts would allow donor to trustee!

Unique Characteristics

- Minimum trust sizes start at $1 million
- Trust must be drafted and implemented by donor's attorney
- Funded with assets that can (with relative assurance) produce a return that out paces the payments to charity
- Preferred assets to be held in a structure (like LLC or LLP) which offers a "discount" that enhances the payment rate by reducing the "value" of the remainder interest to children (for lack of control/marketability)
- Trustee files trust tax return which could OWE tax (CLTs are not tax exempt entities)
- Trustee can not be the donor or a charity - trust companies or professional trustees administer

My reasons why very few CLTs happen

- Avoiding estate tax isn't as immediate and pressing as avoiding income and capital gains taxes which are due NOW
- CLTs are not flexible in general, clients/donors can use much more flexible options (i.e. GRATs, dynasty trusts, etc…)
- Usually the family part is not guaranteed and often risky
- Take too long – any term longer than 10 years seems too far fetched (and most standard CLTs require 20 or more year terms to work smoothly)
- Donors just can't get their arms around it – what's the hook?

Types of Lead Trusts

- Non-Grantor Lead Trusts – No upfront charitable income tax deduction
  - Lead Annuity Trust – Pays fixed annual amount for term to charity
  - Lead Unitrust – Pays fixed annual percentage of annual value (as of Jan. 1 each year) to charity
- Grantor Lead Trusts – Upfront charitable income tax deduction
  - Reversionary Grantor Lead Trust – Pays amounts (Annuity or Unitrust) to charity for term and principal returns to donor (grantor) at end of term
  - Defective Grantor Lead Trust – Pays amounts (Annuity or Unitrust) to charity for term and principal donor's heirs at end of term
  - Both Grantor versions require donor (grantor) to **pay income tax on all income/gain during trust term realized by the trust**

Advanced Lead Trust Options

- Shark-Fin Lead Trusts
  - Laddered payments to charity
  - Balloon payment to charity
- Term options
  - Term of years or death of donor – which ever happens first
  - Term of years or death of another person (must be in good health)
- Commuted/Prepayment options
  - Must be drafted into trust
  - No discounting of payments to charity

Advanced Lead Trust Options

Funding with discountable assets – LLC or partnership interests

- IRS allows for 20%-30% reduction in the "value" of asset for lack of control or marketability
- $1 million dollar asset paying 7% or $70,000
  - 16-year trust to create zero gift tax
- If same property in LLC or LLP, on paper is only worth $700,000 and payment of $70,000 is now looks like a 10%
  - 11-year trust to create zero gift tax

Real Case Study #1

- December 2014 request for 4 CLT illustrations from client
- $250,000/$500,000 for 10 and 20 years – for both total amounts going to client
- Forgot about it
- Client emails me more than a year later that they are ready to sign the CLT
- Really?

First Try with Attorney – Defective Grantor CLT

ASSUMPTIONS:
Projection begins in 2015 and runs for 5 years.
Lead trusts make annual, end of period payments to charity.
Original principal of $1,000,000 has a cost basis of $1,000,000.

	10% Super Grantor Lead Annuity Trust (8% Return)	10% Super Grantor Lead Annuity Trust (5% Return)	10% Super Grantor Lead Annuity Trust (3% Return)	11.7647% Super Grantor Lead Annuity Trust (8% Return)	11.7647% Super Grantor Lead Annuity Trust (5% Return)	11.7647% Super Grantor Lead Annuity Trust (3% Return)
Principal Placed in Plan	$1,000,000	$1,000,000	$1,000,000	$850,000*	$850,000*	$850,000*
5 Year Annuity to charity	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
Gift Tax and Income Tax Deduction	$471,346	$471,346	$471,346	$471,346	$471,346	$471,346
Reportable Gift	$528,654	$528,654	$528,654	$378,654	$378,654	$378,654
Principal after 5 Years to children	**$882,668**	**$723,718**	**$628,360**	**$882,668**	**$723,718**	**$628,360**
Total Distributed to charity	$500,000	$500,000	$500,000	$500,000	$500,000	$500,000

*Assumes assets contributed to the trust are worth $1,000,000 in face value but are in the form of limited partnership shares or other discountable interests using a 15% discount.

Second Try with Attorney is a Winner!

ASSUMPTIONS:
Projection begins in 2015 and runs for 10 years.
Lead trusts make annual, end of period payments to charity.
Original principal of $1,000,000 has a cost basis of $1,000,000.
2.2% AFR (September 2015)

	5% Super Grantor Lead Annuity Trust (8% Return)	5% Super Grantor Lead Annuity Trust (5% Return)	5% Super Grantor Lead Annuity Trust (3% Return)	5.8824% Super Grantor Lead Annuity Trust (8% Return)	5.8824% Super Grantor Lead Annuity Trust (5% Return)	5.8824% Super Grantor Lead Annuity Trust (3% Return)
Principal Placed in Plan	$1,000,000	$1,000,000	$1,000,000	$850,000*	$850,000*	$850,000*
10 Year Annuity to charity	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000
Gift Tax and Income Tax Deduction	$444,466	$444,466	$444,466	$444,466	$444,466	$444,466
Reportable Gift	$555,534	$555,534	$555,534	$405,534	$405,534	$405,534
Principal after 10 Years to children	**$1,434,597**	**$1,000,000**	**$770,722**	**$1,434,597**	**$1,000,000**	**$770,722**
Total Distributed to charity	$500,000	$500,000	$500,000	$500,000	$500,000	$500,000

*Assumes assets contributed to the trust are worth $1,000,000 in face value but are in the form of limited partnership shares or other discountable interests using a 15% discount.

Keys to This Gift

- Donor had been an accountant and understood that his paying the taxes on a Grantor Lead trust was a good thing!
- Willingness to use part of lifetime exemption gave us tremendous flexibility to create a conservative CLT
- Even with so-so returns, there is still something left for family
- Donor did not opt for more complex/aggressive LLC or LLP discounting – made it much easier to close
- Relatively small trust yet nice starting point with the donor for potentially greater gifts down the road

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Real Case #2 – Reversionary Grantor CLT

- Brad Gortno's "iCLAT" concept – focuses on donors' immediate tax needs
- Donors receives an upfront income tax deduction for the "present value of the income stream" going to charity
- Remaining principal goes back to the donor at end of term
- Donor CAN be trustee of this one because it's not going to family but back to himself
- Can be structured to return most or all of principal (like a loan) at end of term or some of principal or none of principal

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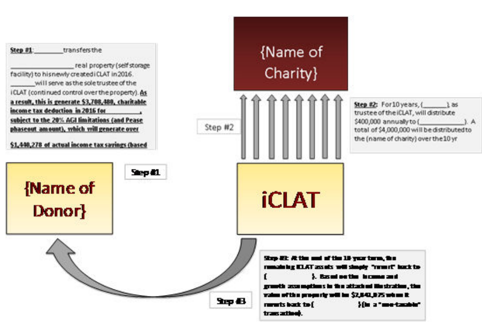
Gornto Reversionary iCLAT Illustration



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Gornto Reversionary ICLAT Illustration

Donor Name		
Beginning Value		**$ 4,000,000**
Annual Charitable Payments	**10%**	**$400,000**
Assumed Annual Income /Growth Rate		**7%**

Year	Beginning Principal	Assumed Net Income Rate	Assumed Net Income Amount	**Charitable Payments to {Name of Charity}**	**Assumed Capital Appreciation Rate**	**Assumed Capital Appreciation Amount**	**Year-End Principal**	**Net Growth Amount**
1	$ 4,000,000	7.0%	$ 280,000	**$ 400,000**	1%	$40,000	$3,920,000	$(80,000)
2	$ 3,920,000	7.0%	$ 274,400	**$ 400,000**	1%	$39,200	$3,833,600	$(86,400)
3	$ 3,833,600	7.0%	$ 268,352	**$ 400,000**	1%	$38,336	$3,740,288	$(93,312)
4	$ 3,740,288	7.0%	$ 261,820	**$ 400,000**	1%	$37,403	$3,639,511	$(100,777)
5	$ 3,639,511	7.0%	$ 254,766	**$ 400,000**	1%	$36,395	$3,530,672	$(108,839)
6	$ 3,530,672	7.0%	$ 247,147	**$ 400,000**	1%	$35,307	$3,413,126	$(117,546)
7	$ 3,413,126	7.0%	$ 238,919	**$ 400,000**	1%	$34,131	$3,286,176	$(126,950)
8	$ 3,286,176	7.0%	$ 230,032	**$ 400,000**	1%	$32,862	$3,149,070	$(137,106)
9	$ 3,149,070	7.0%	$ 220,435	**$ 400,000**	1%	$31,491	$3,000,995	$(148,074)
10	$ 3,000,995	7.0%	$ 210,070	**$ 400,000**	1%	$30,010	$2,841,075	$(159,920)
TOTALS			$ 2,485,941	**$ 4,000,000**		$355,134	**$2,841,075**	$(1,158,925)

Year 1 Charitable Income Tax Deduction	**$ 3,708,480**	**% of Total Payments to {____________}**	**92.71%**
Actual Income Tax Savings*	**$ 1,483,392**	**Assumed Income Tax Rate**	**40.0%**

**subject to AGI limit & Pease reduction on itemized deductions*

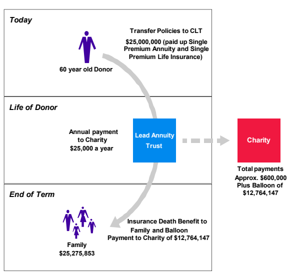
AGI Necessary for Full Yr 1 Charitable Deduction	20% Limit (funded w/real estate)	$ 18,542,400
**with 5 year carry forward*	30% Limit (funded with cash)	$ 12,361,600

Reversionary Grantor CLTs – The possibilities!

- Enhanced Pledge
- Short Term Loan
- If donors puts enough assets in, all of principal can be returned!
- Diminishing principal
- Some return of principal – all depends on donors other goals
- DONOR CONTROL!!!! – ONLY CLT THAT GIVES DONOR FULL CONTROL
- FLEXIBILITY

Example #3: Shark Fin Balloon Funded with Insurance

Charitable Lead Annuity Trust on Life of Donor



Benefits

Immediate
Income and Gift tax deduction of $25,000,000 worth $5 million in immediate tax savings.
Remove trust principal from your estate.

Annual
Annual payments to Charity of $25,000 for approx. 24 years.

Projected total payments to Charity of $600,000 plus $12,764,147 upon passing of Grantor.

Future
Net to family of $25,275,853.

Shark Fin Balloon Funded with Insurance

Program Parameters

Lifetime Grantor CLAT
1.4% 7520 Rate
Charitable Income tax deduction up to 30% of AGI with any balance carried forward for 5 years based on intial contribution
Chartiable Lead Annuity satisfied with a single premium immediate annuity
Final payment to charity and to remainder beneficiaries satisfied by 1 pay No Lapse Universal Life Policy
Remainder to family income and estate tax free

Male 60 Preferred

CLAT Contribution			**10,000,000**
Lead Annuity	**25,000 /year**	Allocation:	(490,000)
Lifetime Remainder Payment to Charity	**12,764,147**	Allocation:	(3,191,036)
1 Pay No Lapse Life Policy Portfolio			
Balance			6,318,964
Remainder to Family Income & Estate Tax Free 1 Pay No Lapse Life Policy Portfolio	**25,275,853**	Allocation:	(6,318,964)

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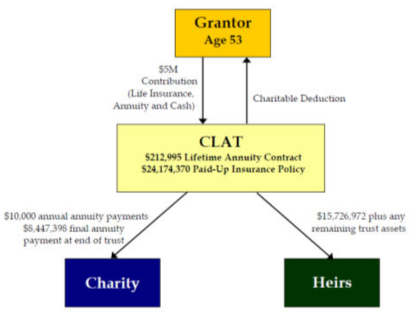
Shark Fin Balloon Funded with Insurance



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Shark Fin Balloon Funded with Insurance

Lifetime Grantor CLAT
2.2% 7520 Rate
Charitable Income tax deduction up to 30% of AGI with any balance carried forward for 5 years based on initial contribution
Charitable Lead Annuity satisfied with a single premium immediate annuity
Final payment to charity satisfied by 1 pay No Lapse Universal Life Policy
Remainder to family income and estate tax free

Male 53 Preferred

CLAT Contribution			5,000,000
Lead Annuity	10,000 /year	Allocation:	(212,996)
Lifetime Remainder Payment to Charity	8,447,398	Allocation:	(1,672,752)
1 Pay No Lapse Life Policy Portfolio			
Balance			3,114,252
Remainder to Family Income & Estate Tax Free 1 Pay No Lapse Life Policy Portfolio	15,726,972	Allocation:	(3,114,252)

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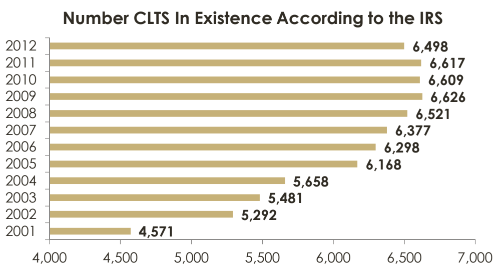
Shark Fin Balloon Funded with Insurance

- Life insurance and single premium annuity both must be paid up in full and contributed to create the CLT
- CLT must be on the life of the insured – when that person passes away, trust ends and parties paid from death benefit
- Annual tax consequences?
- Is this for real?
- Yes – the biggest attorneys have confirmed!
- Biggest obstacle?
- Upfront cash payments to purchase policies

How Popular Are CLTs?



Top 10 Reasons CLTs are Rare!

1. The required payout rates to avoid all or most gift/estate tax are too high!
2. The required terms to avoid all or most gift/estate tax are too long!
3. The investment returns to make lead trusts work are not realistic in most cases!
4. Finding the right funding asset/investment is close to impossible!
5. Professional advisors are not knowledgeable about them.
6. Charity advisors aren't knowledgeable about them.
7. It may not even be the best planning option for ultra-wealthy philanthropists with heirs.
8. Complex, complex, complex!
9. Did I mention finding the right donors is also like finding a needle in a haystack?
10. Too many easier giving/planning options that make more sense to your donors.

Organizational Benefits

- Largest gifts
- Opportunity for major campaign naming commitments
- Great for organizational planning purposes
- Discussions with prospects for lead trusts may lead to more simple, immediate gifts

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Organizational Challenges

- Foolish charity being trustee puts organization at significant legal risk
- Over involvement, even not as trustee, can lead to legal liability
- Staff lack of education/experience could lead to unproductive conversations
- How are we going to sell these really cool but overly complex plans?

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What can we do to make these happen?

- Seminars for professionals and donors
- Creative marketing
- Focus on the best hook – save taxes immediately
- Get educated and comfortable
- Have people to turn to (Brad Gornto, for example)
- Target well – know what your donor can handle, what moves him or her, etc.. Don't inundate!

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Takeaways

- CLTs are…
  - NOT a great option for start-up planned giving programs
  - A great option when a donor's estate planner is leading the gift
  - NOT a great option for dealing with income or capital gains taxes UNLESS you are going with one of the Grantor versions and your donor gets it!
  - A great option for avoiding estate tax
- CLTs are only for your wealthiest donors
- CLTs may be great for discussions with prospects which may lead to less complex gifts

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For more information or to receive a copy of this presentation, contact:

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