FROM THE PROFESSIONALS

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Get the Reward You Deserve! A Look at Charitable Lead Trusts

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Many of you, the supporters of Pinchot Institute, are generous people. Every year you know that a certain amount of your resources will be donated to charitable causes and used to benefit society and the causes you love. While being a person who has a habit of generosity has its own psychic, spiritual and life rewards, it is advantageous that it also often has rewards in the form of charitable tax deductions. This article will help you discover a strategy for maximizing this well deserved reward for your habit of generosity.

Everyone, including Mr. Miser who would never give a dime to a charitable cause, is entitled to take a standard deduction on their individual income tax return. In order for you, our habitually generous friend, to get a larger tax advantage than Mr. Miser you must give more than the standard deduction.[1] Your deduction is only larger than Mr. Miser's to the extent your giving exceeds the standard deduction. That does not seem reasonable and we agree.

TO ILLUSTRATE THIS POINT:

Each year you give $10,000. You itemize your deductions because it is more than the standard deduction. But your tax advantage is only $300 more than if you had not given a red cent. You do not get the standard deduction at all if you itemize.

However, there is a way to even the field with Mr. Miser and fully maximize your tax deductions. This strategy will leverage your charitable deductions by allowing you to take advantage of the standard deduction.

THE STRATEGY IS SIMPLE

Get the deduction for all your charitable giving for five or more years in the year the trust is funded through the use of a Charitable Lead Trust. This will take full advantage of the charitable deduction in the year the trust is funded and use the standard deduction in the other years. The good news is you get to use the standard deduction in the four years you would otherwise lose. Even better news is that you can do it without permanently giving up control of your money.

Charitable Lead Trusts have long been a tool used by estate planners to avoid estate taxes on large estates. However, a less known and utilized purpose of these trusts is to use them as a device for income tax planning.

Another way of looking at this strategy is by looking at the source of the money used for charitable giving. If you are earning an average of 5% on your investments, it takes $200,000 of those investments to fund your $10,000 per year charitable giving habit. This strategy in essence takes that $200,000 and sets it aside for your charitable giving purposes. At the end of the term of the trust, the principal returns to you.

To explain further, a Charitable Lead Trust is a trust created for a term of years. It provides a payment to charity during the trust term. The tax deduction is given in the year of funding of the trust. A specified charity is the recipient of the payments. Use of a qualified donor advised fund as the beneficiary of a trust will give flexibility in which charity receives the payment.

LET'S LOOK AT AN EXAMPLE OF HOW POWERFUL THIS TOOL CAN BE.

Phil Anthropist gives $10,000 a year to his favorite charities. He is in the 33% tax bracket earning $250,000 a year and generally itemizes his deductions.

Because he is itemizing, he has never been able to use the standard deduction. Phil decides with his tax planner that a Charitable Lead Trust with a five year term would be a good vehicle to help him continue his charitable giving while maximizing his income tax benefits. They decide to use $200,000 to fund the charitable lead trust. They design the trust to last for five years, at which time the

principal on the trust will revert to Phil. Phil has the $10,000 annual payment go to a donor-advised fund at a local community foundation from which he will direct the ultimate charities to receive his gift.

The creation of the trust generates a $44,526 charitable deduction.[2] This saves Phil $14,693.58 in taxes in the year of the funding of his trust.

In the five years of the trust, Phil's charitable giving is done through the amounts deposited in his donor-advised fund. His tax deductions look like this for the 5 years of the trust with and without the creation of a charitable lead trust.

Year 1	$44,526	$10,000
Year 2	$ 9,700	$10,000
Year 3	$ 9,700	$10,000
Year 4	$ 9,700	$10,000
Year 5	$ 9,700	$10,000
Total	$83,326	$50,000

Through this technique, Phil has generated an additional $33,326 in income tax deductions and saved almost $11,000 in taxes most of which is saved in the first year of the plan. His charitable giving will be adequately funded and Phil has the security knowing that the principal will be returned to him at the end of five years. This is important to Phil who does not need the funds now, but worries that he might if his or his wife's medical situation changes dramatically in the next few years.

For purposes of clarity, we have used a very simple example. Each individual's situation will be slightly different and this technique will not be beneficial in every person's situation. However, for many of you who are already generously sharing their resources and generating charitable deductions, this can be a fantastic way of maximizing the rewards you are entitled to for your generosity.

Lead Trusts are not difficult instruments to create, but it is very important that they are structured correctly in order to achieve the tax goals you desire. It is therefore important that you use professionals familiar with their formation and requirements so that instruments are created that meet your goals and will pass the scrutiny of the IRS.

Contact the author at glenngre@yahoo.com or Liz Siddle (lsiddle@pinchot.org) at (202) 797-6582 at Pinchot Institute for information on professionals in your area who will be able to help you decide if this instrument is right for you.

1. The standard deduction for the 2004 tax year is $9,700 for a married couple under age 65 filing jointly.

2. Deduction based on 4.6% CFR rate applicable in September, 2004.

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