

Charitable Lead Unitrust

CLUT

In General

A donor may transfer assets to an irrevocable Charitable Lead Unitrust (CLUT) – sometimes referred to as a charitable income unitrust. The trust then pays a fixed percentage of its assets to a qualified charity for either a set number of years or the lifetimes of individuals. When the term of the trust has ended, the remaining assets are distributed to the donor, his or her spouse, heirs or other individuals.



Valuation of assets is required every year to determine the amount of the payment for the year. Payments to charity will vary from year to year, depending upon the investment performance and expenses of the trust.

After the lead (or income) period has expired, if the beneficiary of the trust is other than the donor or his or her spouse, there may be a taxable gift. The gift tax would be based on the present value of the beneficiaries' right to receive the trust remainder at some future time. This calculation is dependent upon the term of the trust, the amount payable each year to the charity and the applicable federal rate (AFR) at the time of the transfer.

Planning Considerations

A donor establishing a CLUT needs to consider several key issues:

- **Income tax deduction:** If certain requirements are met, an income tax deduction is allowed for the value of the income passing to charity. With a grantor trust the donor is considered the owner of the trust (taxable on the income under the grantor trust rules) and is allowed the tax deduction, subject to certain percentage of AGI limitations. If the trust is a non-grantor trust, the trust itself is permitted an unlimited tax deduction for distributions to qualified charities. If these requirements are not met, no charitable income tax deduction is allowed to either the donor or the trust.
- **Remainder interest:** At the end of the trust term, should the assets remaining in the trust revert to the donor or pass to other individuals such as the donor's heirs?
- **Generation-Skipping Transfer Tax (GSTT):** A taxable event for GSTT purposes will occur if the individuals who ultimately receive the assets when the trust terminates are considered to be "skip" persons, such as the donor's grandchildren or a later generation.

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Estate Tax Reduction

Frequently, CLUTs are set up as non-grantor trusts, with the ultimate beneficiary of the trust assets being someone other than the donor or his or her spouse. Such CLUTs typically provide no income deduction to the donor, but do provide a means of transferring assets to children or grandchildren, with substantial valuation discounts. For example, at a 4.2% AFR, a 10-year CLUT, paying 5% annually¹ to a charity, offers a 39.3% discount from market value. The same trust, over a 15-year term, offers a 52.7% discount from market value; over 20 years a 63.2% discount from market value is achieved.

The CLUT is an excellent way for affluent individuals to meet charitable obligations, as well as make discounted, deferred transfers to heirs.

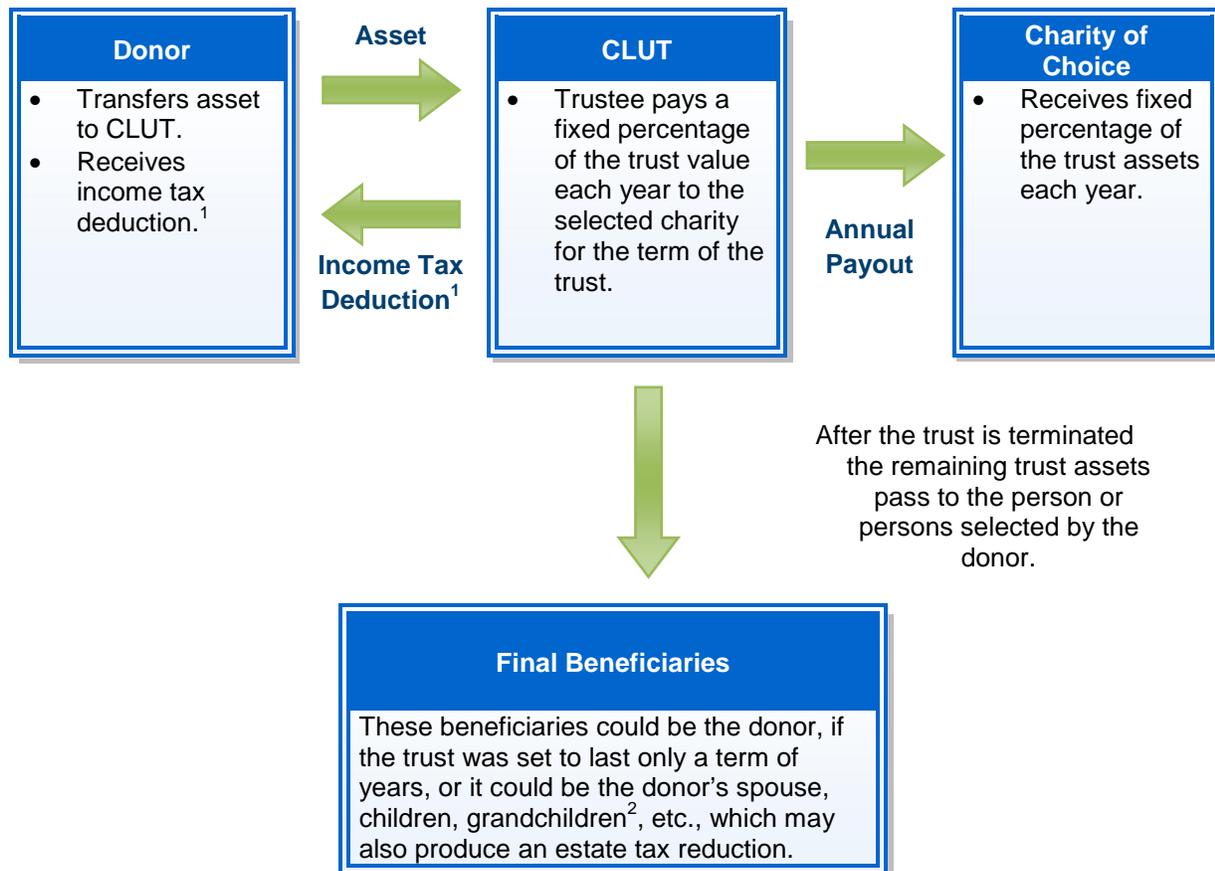
¹ This amount is 5% of the value of the assets, as revalued each year.

How a Charitable Lead Unitrust Works

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The donor transfers an asset to the trustee of the Charitable Lead Unitrust (CLUT), which pays a fixed percentage of the trust assets as valued each year thereafter to a selected charity. A current income tax deduction is generally allowed for the present value of the income interest paid to the charity.

At the end of the term of the trust, the remaining assets pass to the donor's heirs, spouse or sometimes back to the donor, if living.



¹ The income tax deduction, allowable only to grantor trusts, may have to be spread over more than one year if it exceeds certain percentage of income limitations.

² Choosing grandchildren (or later descendants) to receive the assets when the trust terminates may trigger the Generation-Skipping Transfer Tax (GSTT).