Never respect men merely for their riches, but rather for their philanthropy; we do not value the sun for its height, but for its use.

—GAMALIEL BAILEY

Like most philanthropists, you would like to benefit from the tax savings that result from your generosity, yet you're not ready to give up entirely the investments or property available for our benefit.

You can have it both ways with an estate planning strategy called a *charitable lead trust*. This trust pays us an income for a number of years or for the life or lives of certain individuals; when the term is over, the principal goes to your chosen heirs, with estate or gift taxes reduced or even eliminated. The lead trust is an excellent way to transfer property to your children or other heirs at minimal tax cost. It's ideal if you're willing to forgo investment income on an asset for a time, but you don't want to deprive your heirs of the principal.

Some donors don't consider a charitable trust, because they assume the charity always ends up with the trust assets. With a charitable lead trust, that doesn't happen.

The trust gets its name because the chosen charitable beneficiary receives the income *before* the principal goes to your heirs. It's the opposite of the charitable remainder trust, which pays you an income for life and then gives the principal to the charitable beneficiary.

Comparing the Two Trusts

People are generally more familiar with charitable remainder trusts, so a comparison is helpful in understanding lead trusts. The two are the same in four ways.

1. Each must be irrevocable.

2. Each has two distinct and ascertainable financial interests: an initial income interest, and an eventual remainder interest in trust assets when the trust ends.

3. The income interest of both can be either a *fixed annuity* interest based on the initial funded value, or a *variable unitrust* interest, with payments a fixed percentage of the annually redetermined value of trust assets.

4. Both can reduce or eliminate federal transfer taxes, including the generation-skipping transfer penalty tax.

Choose Your Strategy

You can create a lead trust during your lifetime or in your will. Which option is right for you is a matter of personal preference, guided by your financial considerations.

Lifetime lead trust. If you set up a lead trust to benefit us now, you can realize these benefits:

- You ensure that the trust remainder ultimately passes to your family.
- You can fund the trust with growth assets, subject to the trustee's management, without later additional gift or estate tax on the future appreciation.
- You can observe how you have helped us reach our goals with monies that might otherwise have been sharply cut by income taxes.

Lead trust in your will. A testamentary lead trust provides us with income for a period of time, after which the principal will be paid to your heirs. Your children and, with careful planning, grandchildren or great-grandchildren can receive the remainder with reduced or eliminated estate and generation-skipping transfer taxes.

Establishing the Terms

You decide the type of payment we will receive—an *annuity* interest or a *unitrust* interest.

With an annuity interest, the trust pays us a fixed dollar amount each year during the trust term. You determine the dollar amount when you create the trust.

With a unitrust interest, we receive an amount, at least annually, determined by multiplying the fair market value of the trust assets as revalued each year by a fixed percentage rate. You set the percentage at the start.

With either arrangement, you specify the number of years the trust will continue, or base its term on the life or lives of individuals living at the time of the transfer.

Which is better, a guaranteed annuity interest or a unitrust interest? That depends on your situation. Consider the charitable deduction, the estimated amounts that ultimately will go to your family, the kinds of assets you want to use to fund the trust, and the anticipated trust income and appreciation.

One advantage of the annuity payout is that we are guaranteed a fixed amount annually, unaffected by market value fluctuations of the trust assets. From our standpoint, fixed annuity payments may be less desirable. Over many years, we likely would be better off with a unitrust payout, geared to the annual valuations of the trust assets, assuming they grow in value. Should the trust assets decline in value, the eventual beneficiaries of the trust assets might regard annuity payouts as a disadvantage, because the trust might have to consume some of the principal to make the fixed annual payments.

A further advantage of the unitrust is that it permits you to make additional deductible contributions to the trust, which you can't do with an annuity trust. This allows for more planning flexibility. With either form of trust, no matter how much the trust assets increase in value, there will never be any additional gift or estate taxes when assets are distributed to the eventual beneficiaries.

The Tax Savings

The lead trust can enable people subject to federal gift and estate tax rates—which can rise above 55%—to avoid these taxes on most, and possibly all, of the trust assets.

The gift or estate tax savings are based on the current value of the aggregate amount of income paid to us over the trust term. The greater the payment or the longer the term—or both—the greater the value of the gift to us.

Example: Julie has an estate in the 50% federal tax bracket. Her son will be in that bracket, too. For each $100,000 she leaves to her son off the top of her estate, the government will get $50,000 and her son will get $50,000.

To minimize the tax bite and to help us, Julie creates a $400,000 lead trust that will pay us an annuity of $28,000 a year for 20 years.[1] When the trust ends, the principal will go to Julie's son. Based upon U.S. Treasury valuation tables, this plan will result in a $301,300 gift tax deduction. In other words, Julie's lead trust will reduce the estate tax burden on the $400,000 by 75%.

This is just one example. The size of the trust, its term and type and the annual payout are up to you.

Payout Affects Charitable Deduction

In addition to making a charitable gift, an important goal of a person who creates a lead trust is to reduce or avoid gift and estate transfer taxes on assets that eventually pass to family members. This saving is determined by the size of the charitable deduction, which in turn is based on the aggregate amount of income paid to the charitable institution over the trust term.

U.S. Treasury tables are used to compute this. The resulting deduction is based on a formula that combines the yearly payment and the trust term. The greater the payment and the longer the term, the greater the deduction.

Example: A married couple, John and Laura, have decided to create a lead trust that will pay yearly a guaranteed annuity interest to their chosen charity. They are now deciding how long the trust should last before the remainder is paid to their children. They want the deduction to be as high as possible so the gift tax due will be greatly reduced. They consider the following range of terms and payout percentages (the percentage of initial trust principal to be paid annually):

[1] This and the following examples are based on annual payments and a 6.8% charitable midterm federal rate; this rate changes monthly.

ANNUAL PAYOUT PERCENTAGE				
Number of Years	100% Deduction	90% Deduction	80% Deduction	60% Deduction
10	14.11%	12.70%	11.29%	8.47%
15	10.85%	9.76%	8.68%	6.51%
20	9.30%	8.37%	7.44%	5.58%
25	8.43%	7.59%	6.75%	5.06%

Laura and John agree to an 8.37% annual payout over 20 years, which will result in a 90% deduction.

If your objective is a 100% deduction, you make the payout higher or the term longer. If you are satisfied with a smaller deduction, you reduce either the payout or the trust term. In any event, the tax will be much lower because of the charitable lead interest.

Generation-Skipping Transfer Tax

The *generation-skipping transfer tax* was established to make sure the government does not lose revenue when assets skip a generation. For example, if a grandfather makes a large gift of assets to a grandchild, the government does not receive the gift or estate taxes that would have been imposed on the estate of the grandchild's parent, had the parent been given those assets instead.

The generation-skipping tax is levied at a flat rate of 55% in such a case. However, a $1 million-per-transferor exemption is allowed, so unless an individual transfers more than $1 million down more than one generation, this tax is of no consequence.

If you are contemplating a larger transfer, the computation of the tax for a charitable lead *unitrust* may allow you to leverage your exemption. By allocating a relatively small amount of the exemption, a much larger amount of principal will pass to your beneficiaries.

A Generation-Skipping Situation

A widow who has an estate worth $3,700,000 wants to assure that her numerous grandchildren will be financially secure. Here are the results of a plan leaving her entire estate to the children (assuming death in 1999):

Adjusted gross estate	$3,700,000	100%
Tax after use of estate tax credit	(1,464,500)	40%
To children, subject to tax again when passed to grandchildren	$2,235,500	60%

On learning how she could (1) reduce federal transfer taxes on amounts passed to her family, (2) assure the financial security of the grandchildren, and (3) contribute substantially to her philanthropic interests, the widow funds a $1,700,000 charitable lead unitrust, with her grandchildren as the remaindermen. The most favorable applicable federal midterm rate at the time is 6.8%.

An appropriate payout rate and a trust term are selected to eliminate the generation-skipping penalty tax on transfers in excess of the $1 million exemption. The result is a 4% annual payout to charities and a term of 14 years, which produces a charitable deduction of $703,783 and a taxable transfer of $996,217.

The projected results of the plan (excluding the likely growth in lead trust assets eventually received by the grandchildren) are:

Of $2 million remaining assets, children to receive (after estate and gift taxes)	$ 922,505	
Grandchildren to receive	$1,700,000	
Total distribution to family (up 17%)	$2,622,505	71%
Charities to receive $68,000 annually, for 14 years	$952,000	
Total desired distributions (increase of $1,339,005 over prior plan)	$3,574,505	97%

If You Want the Trust Assets Back

You can also achieve this with a grantor lead trust. The tax results are also different, however. Because the principal will revert to you, the value of the trust assets will be included in your estate. However, the value of any payments still due us, the lead interest, will qualify for the federal estate tax charitable deduction.

You will receive an income tax charitable deduction for the lead interest in a grantor lead trust. This is subject to a ceiling of 30% of your adjusted gross income, with a five-year carryover for any excess. If you die before the trust terminates, a portion of the tax savings generated by this deduction may be paid to the IRS.

Generally, you are taxed on the income earned by a grantor lead trust. However, the benefit of your charitable deduction may outweigh the potential tax if your tax bracket for the year you create the trust is higher than your bracket for the balance of the trust term. If you fund the trust with tax-exempt bonds, you receive a charitable deduction without paying any tax on the trust income.

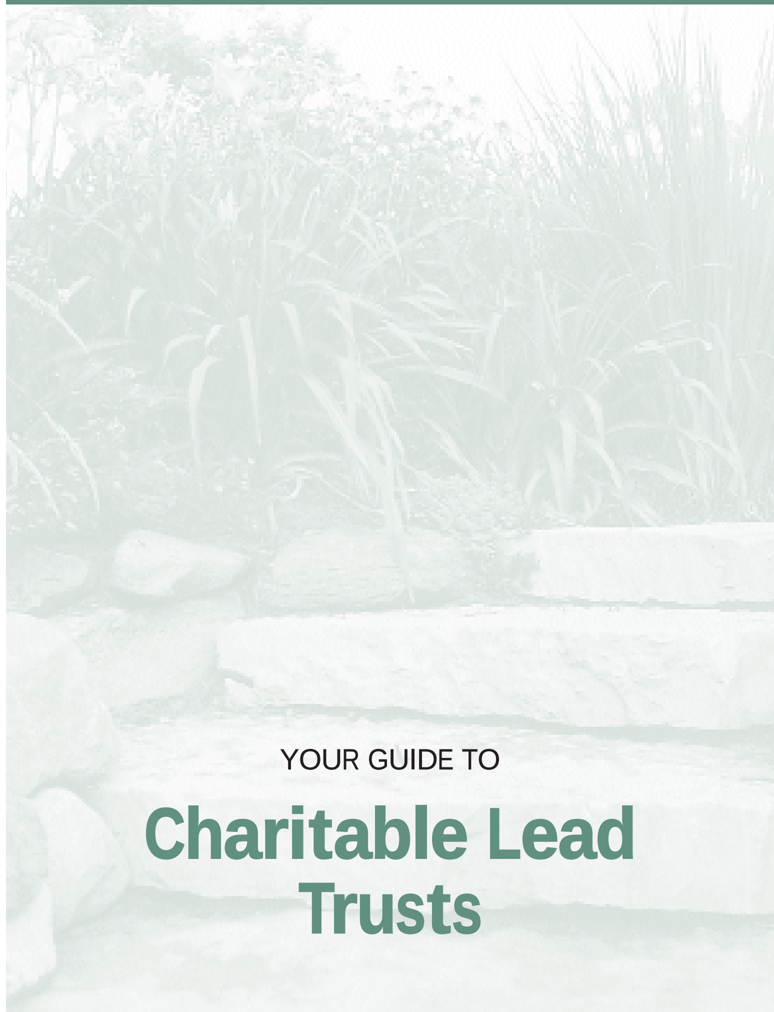
The grantor lead trust *does* offer valuable tax breaks. This is especially true if you make regular gifts to us and want to accelerate future deductions into the current year.

To Summarize

A lead trust that benefits us at the start and your chosen heirs later is created to save gift and estate taxes; it doesn't produce an income tax charitable deduction. By the same token, you are not taxed on the trust's income.

By funding a charitable lead trust now, you will obtain a gift tax deduction for the present value of the income interest given to us. If you create a lead trust by will, an estate tax charitable deduction will be allowed for the present value of the income interest bequeathed to us.

A lead trust is particularly gratifying, because your gift makes it possible for us to fulfill our pressing needs much sooner than with a charitable remainder trust. To find out if a lead trust is right for you, please contact us to learn more.



YOUR GUIDE TO

Charitable Lead Trusts