TCLAT vs. PAY ESTATE TAX

PREPARED FOR:

SAMPLE CLIENT

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PRESENTED BY

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DISCLAIMER

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The effectiveness of any of the strategies described will depend on your individual situation and on a number of complex factors. You should consult with your other advisors on the tax, accounting, and legal implications of these proposed strategies before any strategy is implemented. After reviewing your personal situation, we may recommend that you not use any strategy in this plan but instead consider various other planning instruments available through our practice.

This document has been prepared as a sample case to illustrate the possible benefits of using the TCLAT strategy.

All numbers and projections in this correspondence are based on hypothetical data. Any discussion in this presentation relating to tax, accounting, regulatory, or legal matters is based on our understanding as of the date of this presentation. Rules in these areas are constantly changing and are open to varying interpretations.

TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

PROJECTED VALUES IF DEATH OCCURS THIS YEAR

ASSUMPTIONS			
CONTRIBUTION	$ 1,000,000	**DEDUCTION FACTOR**	100.0%
DISCOUNT ON FLP	30%	**PAYOUT RATE**	9.59%
TOTAL RETURN	8.0%	**TERM**	14
CURRENT 7520 RATE	4.2%	**ESTATE TAX RATE**	50%

	TCLAT Benefits			Alternative: Pay Tax & Invest	
				Investment Account Balance	
Year	Gross Value of FLP Assets In TCLAT	TCLAT Distribution to Charity	TCLAT Gross Value Benefits to Heirs	Amount Lost to Estate Taxes	Amount leftover For Heirs ($0 to charity)
1	1,446,934	95,923	-	723,467	723,467
2	1,465,296	95,923	-	761,087	761,087
3	1,485,128	95,923	-	800,664	800,664
4	1,506,428	95,923	-	842,298	842,298
5	1,529,315	95,923	-	886,098	886,098
6	1,553,906	95,923	-	932,175	932,175
7	1,580,328	95,923	-	980,648	980,648
8	1,608,717	95,923	-	1,031,642	1,031,642
9	1,639,220	95,923	-	1,085,287	1,085,287
10	1,671,994	95,923	-	1,141,722	1,141,722
11	1,707,209	95,923	-	1,201,091	1,201,091
12	1,745,045	95,923	-	1,263,548	1,263,548
13	1,785,699	95,923	-	1,329,253	1,329,253
14	1,829,379	95,923	1,829,379	1,398,374	1,398,374
Totals (2017)		$ 1,342,926	$ 1,829,379	$ 1,398,374	$ 1,398,374
NPV (2004)		891,605	809,136	723,467	723,467

TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

General Overview

A Testamentary Charitable Lead Annuity Trust (TCLAT) is an irrevocable trust funded with assets from the estate of the donor. It is designed to make periodic distributions to charity for a period of years. At the end of the term, the assets in the trust (the remainder interest) are distributed to beneficiaries selected by the donor, usually the donor's children. The donor establishes the amount of income and the term that charity will receive distributions from the trust. This amount distributed to charity annually is fixed and will not change regardless of the investment performance of the assets in the trust. The donor's estate receives a charitable estate tax deduction equal to the present value of the charitable distributions. Depending on the size of the charitable distributions and the length of the term of the trust, the contribution to the trust may be fully deductible from the estate, eliminating any estate tax that might otherwise have been levied upon the assets contributed to the TCLAT. Because the amount of the charitable deduction cannot be set without knowing certain factors at the time of the donor's death, a TCLAT can be structured to allow the donor's personal representative to adjust the term and payout rate to maximize the estate tax savings.

Benefits

· Pass significant assets to the family.
· Reduce or eliminate estate tax attributable to assets contributed to the trust.
· Make generous distributions to charity.

Qualified Prospect

Generally, qualified prospects include those who:
· Want to defer a portion of the inheritance they leave their family, or has left sufficient other assets to the family such that the amount allocated to the TCLAT is not material to the immediate inheritance.
· Want to reduce or eliminate the estate tax costs attributable to the deferred portion of their inheritance.
· Want to make significant charitable gifts from their estate.

Example of How the Strategy Works

Jack and Francis, age 50, have a net worth of $8 million. They have two children in their twenties. Jack and Francis like the estate planning philosophy of leaving a portion of their inheritance to their children directly from the estate of the survivor and deferring a portion of the estate until 15 years later. They also want to make significant charitable contributions during their lives and from their estates. They establish a master plan in which their children will receive a total of $2 million directly from their estates. This is the amount that will pass estate tax free in 2003. They have also established a life insurance trust to provide another $2 million estate tax free bringing their children's immediate inheritance total to $4 million. By revising their Wills and Revocable Trusts, they establish and fund a TCLAT upon the death of the survivor. Their estate planning documents direct their trustee to create a TCLAT with terms so that the contribution to the trust will be fully deductible from their estate.

Furthermore, they direct their trustee to fund the trust with an amount of assets that will bring their taxable estate to zero. If they both died today, the TCLAT would be funded with $6 million. The exact terms of the trust will not be established until the estate of the survivor is being settled. However, for discussion purposes we may assume that a payout rate of 10% and a term of 15 years will permit the assets contributed to the TCLAT to be fully deducted from the estate.

Thus, charity would receive $600,000 annually for 15 years for a total of $9 million in distributions. Jack and Francis will establish a family foundation to be the beneficiary of these charitable distributions. Their children will run the foundation in the future. At the end of 15 years, the assets remaining in the trust will pass to their children, who will be in their late thirties at that time. If the assets earn a total return of 10% annually during the term of the trust the principal should maintain its original value and their children should receive about $6 million at the end of the term.

Alternatively, Jack and Francis could have simply left the $6 million directly to their children instead of contributing it to the TCLAT. If they did this, their estate would owe about $2 million in tax and their children would receive an extra $4 million. If the children invested these funds wisely, their principal would probably have grown to be worth considerably more than the $6 million they might receive from the TCLAT.

But, in that scenario, charity would receive nothing. Furthermore, Jack and Francis do not feel they should leave the maximum possible inheritance to their children. Instead they want to leave the right inheritance. Finally, Jack and Francis realize that this arrangement will probably not be suitable once they reach their seventies. In that case their children would have to wait too long for their second inheritance. They plan to review their estate plan periodically and revise it as needed to accommodate their changing needs and circumstances.

Income Tax Implications

The CLAT is a separate legal entity but unlike its cousin, the charitable remainder trust, it is not a tax exempt trust and may, depending on the circumstances, pay its own income tax. Like a person, the CLAT has income and deductions. All interest, dividends, rents and capital gains are reported as gross income. All distributions to charity are deductible against the earnings of the trust assets. If the annual charitable distribution is equal to or greater than the earnings, no income tax is owned by the trust. If the earnings exceed the charitable distribution deduction, the excess is taxable income and subject to income tax at the trust rates.

Estate and Gift Tax Implications

When a decedent makes the contribution to the trust he or she is deemed to make a gift to the charitable income beneficiaries equal to the present value of the distributions to charity.

TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

The estate receives an estate tax charitable deduction for this contribution. The value of this deduction is determined by reference to Treasury Regulation tables and is affected by the payout rate to charity, the term of the trust, current interest rates and other factors. It is possible to design the trust so that the estate tax charitable deduction equals the initial contribution. The difference between the amount of the contribution and the deduction, if any, is included in the estate.

If remainder beneficiaries include grandchildren, a generation skipping transfer tax test must be applied at the termination of the CLAT. If the investment performance of the assets in the trust has exceeded the growth rate assumed in the original tax calculations, a generation skipping tax may be due when the trust terminates.

Design Ideas and Strategies

This deduction is determined by reference to Treasury Regulation tables. Donors that elect to make higher trust distributions to charity and choose longer trust terms receive higher estate tax deductions.

Individuals desiring to favor grandchildren with an arrangement of this nature should also consider a Charitable Lead Unitrust. This variation is not subject to the revaluation requirement for GST purposes, however, it is not mathematically possible to reduce the taxable value of the Charitable Lead Unitrust low enough to eliminate all estate taxes on the assets contributed to the trust.

Risks

If the payout to charity is too high and/or if investment performance is too low, the assets of the trust could decline in value leaving less to the heirs than what was anticipated.

Suitable Assets

Suitable assets include cash and investment type property. Assets should generate income or be salable or be suitable collateral for loans so that the requisite amount of cash can be generated each year to make the charitable distributions.

Family limited partnership interests may make ideal contribution assets if the assets owned by the partnership can be managed to generate enough cash and if the general partner will make cash distributions as needed by the trust for charitable distributions.

Qualified retirement plans, deferred compensation plans, annuities, and any personal or real property that a client wants to leave directly to heirs for sentimental reasons are not appropriate for a TCLAT.

Trustee, Management and Administrative Issues

A trustee is appointed to oversee the asset management, administrative and tax reporting responsibilities of the trust. An individual, a bank, or a charitable organization can serve as trustee.