Prepared for the Benefit of
Friends of Bluefield College

As those who care deeply about Bluefield College work on financial planning, it is not uncommon to wrestle with how to best maximize an inheritance to children or grandchildren while also continuing to make significant charitable gifts to Bluefield College. Do you want to benefit from the tax savings that result from supporting Bluefield College, yet not give up any assets that you'd like your family to receive someday? You can have it both ways with a charitable lead trust.

A charitable lead trust is a trust that you establish either during life (an *inter vivos* trust) or at death (a testamentary trust). The asset within the trust distributes income from the trust to a charitable institution, like Bluefield College, typically for a stated number of years. After that period, the assets inside the trust are then distributed to your family or other named beneficiaries.

This edition of the Estate Planning Newsletter (or what your institution calls your newsletter) highlights an estate planning/giving instrument called the charitable lead trust. The charitable lead trust is available to people who want to provide immediate financial support to help Bluefield College and, at the same time, protect their estates from substantial erosion due to taxes.

What is a Charitable Lead Trust?

Individuals who wish to make substantial current contributions to support Bluefield College while controlling the eventual distribution of their assets may want to consider the charitable lead trust. A lead trust can be appropriate when you and your family have little need for the current income an asset is generating and wish to transfer the asset to a charity of choice for a period of time. There are no minimum payout requirements with a lead trust and no specific limitations on the trust's term.

At its most basic level, a charitable lead trust works in the following way: The grantor, or person establishing the charitable lead trust, makes a contribution to fund the trust which is set up to operate for a fixed term such as a set number of years or the life of one or more people. Payments from the trust are disbursed to the selected charity or charities as either a fixed annuity payment or a percentage of the trust, depending on how the trust has been structured. Finally, at the end of the term, the remaining assets are distributed to non-charitable beneficiaries, often family members. Following is a summary of the process.

1. **Make a contribution to fund the trust.** Depending on the type of charitable lead trust you select, you may be eligible to take an immediate partial tax deduction with cash contributions. The calculation of the income tax deduction takes into consideration the term of the trust, the projected lead payments, and IRS interest rate that is used to assume a certain rate of growth of trust assets. Certain assets such as publicly traded stock, real estate, private business interests and private company stock could also be contributed but come with added considerations about tax treatment and may need to be sold to ensure enough revenue to fund the trust payments.

2. **Payments are sent to the charity.** The charitable lead trust provides payments on at least an annual basis to at least one qualified charitable organization for a fixed number of years, the lifespan of one or more individuals, or a combination of the two. Unlike charitable remainder trusts, charitable lead trusts are not held to the same mandatory time limit of 20 years if you select the fixed term option. Also, there is no required minimum or maximum payment to charitable beneficiaries, as long as payments are made at least annually.

3. **After the specified trust term, the remaining charitable lead trust assets are distributed to the designated non-charitable beneficiaries.** Once the term of the charitable lead trust ends, the principal is distributed to you or the other designated beneficiaries in a manner that can minimize or even eliminate transfer taxes.

The word “lead” in charitable lead trust refers to a “lead interest” in the trust, which is the charity’s right to receive payments for the trust for the specified term. The charitable lead trust comes in two versions: 1) annuity trust and 2) unitrust. If established as an annuity trust, the charity will receive a specified amount from the trust each year that typically remains the same from year to year. If established as a charitable lead unitrust, the charity will receive a specified percentage of the trust assets each year and the precise amount of the payment to the charity can vary from year to year accordingly. The choice of annuity vs. unitrust payments may have implications for the value of the assets at the end of the trust term.

Simply put, a charitable lead trust is akin to lending income-producing assets of cash to Bluefield College for a predetermined period of time. Bluefield College would receive annual income from your trust assets over a specific number of years as determined by you and your advisers. At the end of a term of years, the income-producing trust asset(s) returns to you or, more commonly, to your children, grandchildren or other family members. The advantages are significant savings in gift tax or estate tax that otherwise may come due whenever you try to give substantial amounts of property to your heirs. Here are the basic considerations in arranging a lead trust:

Type of Lead Trust	**Income Tax Advantages**	**Gift/Estate Tax Advantages**
1) Lifetime trust - assets pass to heirs when trust ends	The trust, rather than donor, pays taxes on trust income reduced by a charitable deduction for its payments to charity	Substantial potential savings in gift tax
2) Trust in will - assets pass to heirs when trust ends	Heirs are not taxed on trust income	Substantial potential savings in estate tax
3) Lifetime trust - assets return to donor	Upfront tax deduction - but donor taxed on trust income*	Income paid out to charity avoids gift and estate taxes

*Adverse federal income tax results can be reduced if the trust is funded with growth stocks and tax-free bonds.

Lead trusts pay annually to charity and your gift or estate tax deduction depends on the trust's payout percentage and how many years the trust lasts (the higher the payout and the longer payments are made to [name of institution] the higher your income tax deduction). For a lead annuity trust, a further critical factor in determining the amount of the charitable deduction is the federal interest rate that is applicable at the time the trust is created. For a lead annuity trust, it is possible for your family to "beat the tables" -- any actual investment return earned by the lead annuity trust over and above the applicable federal interest rate factor that was in effect on the date the trust was created will benefit only your family. (By the same token, the family alone would suffer the detriment of a poor investment performance in a lead annuity trust.) By contrast, the benefit (or detriment) of the actual investment performance of a lead unitrust is split on a pro rata basis between the charitable lead trust and the family.

Case Study: Lifetime Lead Trust to Benefit Heirs

Theresa is the owner of a privately-held company, who, like other professionals, knows she faces future transfer tax burdens -- namely, federal gift or estate taxes. She owns stock worth $1,000,000 that she plans eventually to transfer to her children. She also wants to provide an important gift to Bluefield College. What can we suggest to Theresa that would satisfy most, if not all, of these aims? A charitable lead annuity trust that pays income for a period of years to Bluefield College might be one solution.

Theresa could decide to establish a lead trust that pays a 6% annuity to Bluefield College for 20 years. At the end of 20 years the stock will transfer to the children. Theresa is considered to have made a taxable gift to her children on the day she creates the trust . . . but not of $1,000,000. The gift is reduced by the value of Bluefield College's right to receive $60,000 a year for 20 years. The charitable gift to the trust as computed under the IRS tables is $926,574, so Theresa will have made a taxable gift of only $73,426 ($1,000,000 – $926,574). (Note: Deductions vary each month according to the IRS Discount Rate; the rate for this illustration is 2.6%.) It should be noted that Theresa can use a small portion of her lifetime gift tax credit (the credit shelters up to $11.18 million in taxable gifts under current law) to avoid paying any gift tax on the $73,426 gift.

Case Study: Lead Trust in Will for Eventual Benefit of Children

Ted is a wealthy 74-year-old widower who supports Bluefield College enthusiastically. He has two grown children and is concerned about federal estate taxes. Ted is also concerned whether his son and daughter may be able to handle their inheritance responsibly. He wants to do something truly significant for Bluefield College through his estate plan, but he wants the bulk of his estate eventually to pass to his children.

We suggest that Ted establish a charitable lead trust which will save taxes and provide generously for (name of institution.) A charitable lead trust, contained in his will, can pay income to Bluefield College while ultimately passing all of the trust principal to family beneficiaries, with significant estate tax savings. Lead trusts are sometimes called "wait awhile" trusts. The message to family members is: "You're going to get everything from my estate, with one caveat; you will merely have to wait awhile!" This form of charitable giving can be more attractive to surviving family members than outright bequests to charity.

Suppose that, without regard to any lead trust, Ted's taxable estate totals $15 million. The federal estate tax on this amount in 2018 (assuming that Ted has made no significant lifetime gifts) would be $1,580,000*. Now suppose that Ted's will creates a lead trust funded with $5,000,000, which is to make a payout to charity of $400,000 (8.0%) a year for 15 years. At the end of the trust term all principal is to be distributed outright to Ted's children. Assuming a 2.6% federal interest rate, the charitable deduction allowed to Ted's estate will be approximately $4,916,320. This deduction would save $1,966,528 in federal estate taxes, because the $4,916,320 charitable deduction substantially reduces Ted's federal taxable estate.*

Furthermore, assuming the value of the trust assets neither increases nor declines during the trust term, and assuming the trust assets generate a return equal to the payout, the children will receive the $5 million at the end of the trust term. What they lose is the use of $3.48 million during the trust term. However, if they do not need the use of that amount during the trust term, the loss may not be critical to the children. What is gained is (a) a substantial benefit to charity and (b) an estate tax deduction that helps to reduce taxes and eases the need for estate liquidity.

Summing up, who receives what from this arrangement?

Without lead trust:

1)	Heirs receive	$13,720,000
2)	U.S. Treasury gets	$1,580,000

With lead trust:

1)	Heirs receive	$15,000,000 -- $5,000,000 each when Ted dies; $5,000,000 15 years later
2)	Charity gets	$6,000,000 over 15 years
3)	U.S. Treasury gets	$83,680 (vs. $1,580,000 without trust)

In Conclusion

The charitable lead trust is one of several income tax and estate tax planning tools to consider in financial planning. Not only does it provide a substantial wealth preservation role for families, it is also very beneficial for furthering the mission of Bluefield College. The "nuts and bolts" to remember about lead trusts are simple:

1) A lead trust provides vital gift income annually for our institution for a period of years;
2) Particularly for persons with larger estates, a lead trust can create significant tax benefits for you and your heirs;
3) Family members (or perhaps you, the donor) eventually recover property placed in trust, often at an increased value.

As always, please seek the counsel of your professional financial and legal advisers regarding all aspects of estate and gift planning. If you would like to discuss any aspect of planned giving with someone from our development office, please contact Hal Keene (276.326.4209, vkeene@bluefield.edu, 3000 College Ave, Bluefield VA, 24605) and we will be happy to speak with you in person or by phone.

* Ted's estate may also be subject to state estate tax, depending on the state(s) in which Ted lived and held property at his death.