



***ABA RPTE/TAX SECTIONS
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**CHARITABLE LEAD TRUSTS IN
BUSINESS PLANNING**

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BUSINESS AND ESTATE PLANNING FACTS & CLIENT GOALS

- Client has the following facts and estate planning goals:
 - Client owns a closely held business interest worth \$50 million that he controls
 - Client's estate is otherwise illiquid
 - Client is not insurable, or insurance is too expensive
 - Client is single/widowed
 - Client has a large estate tax exposure--\$25 million
 - Client is "somewhat" charitably inclined
 - Client's primarily goal is to:
 1. Maintain control of business during his lifetime
 2. Pass the business to his children at death
 3. Minimize estate taxes





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

- Overview of the Charitable Lead Trust
 - A charitable lead trust (CLT) provides for a series of periodic payments from the trust, at least annually, to one or more qualifying charities until the end of a pre-determined period of time, which can be measured by a term of years or the life of one or more qualifying individuals (or some combination of the foregoing).





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

- Overview of the Charitable Lead Trust (Cont.)
 - At the end of the term, the remaining assets of the CLT pass to pre-designated beneficiaries (usually the client's descendants) without the imposition of gift or estate taxes.





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

- Overview of the Charitable Lead Trust (Cont.)
- A qualifying CLT can be either a charitable lead annuity trust (CLAT) or a charitable lead unitrust (CLUT).





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- **Overview of the Charitable Lead Trust (Cont.)**
 - In a CLAT, the periodic payments to qualifying charities take the form of a guaranteed **annuity**, which the trust instrument can describe as either a **fixed amount, a fixed percentage, or by formula** of the initial fair market value (FMV) of the assets transferred to the CLAT.





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

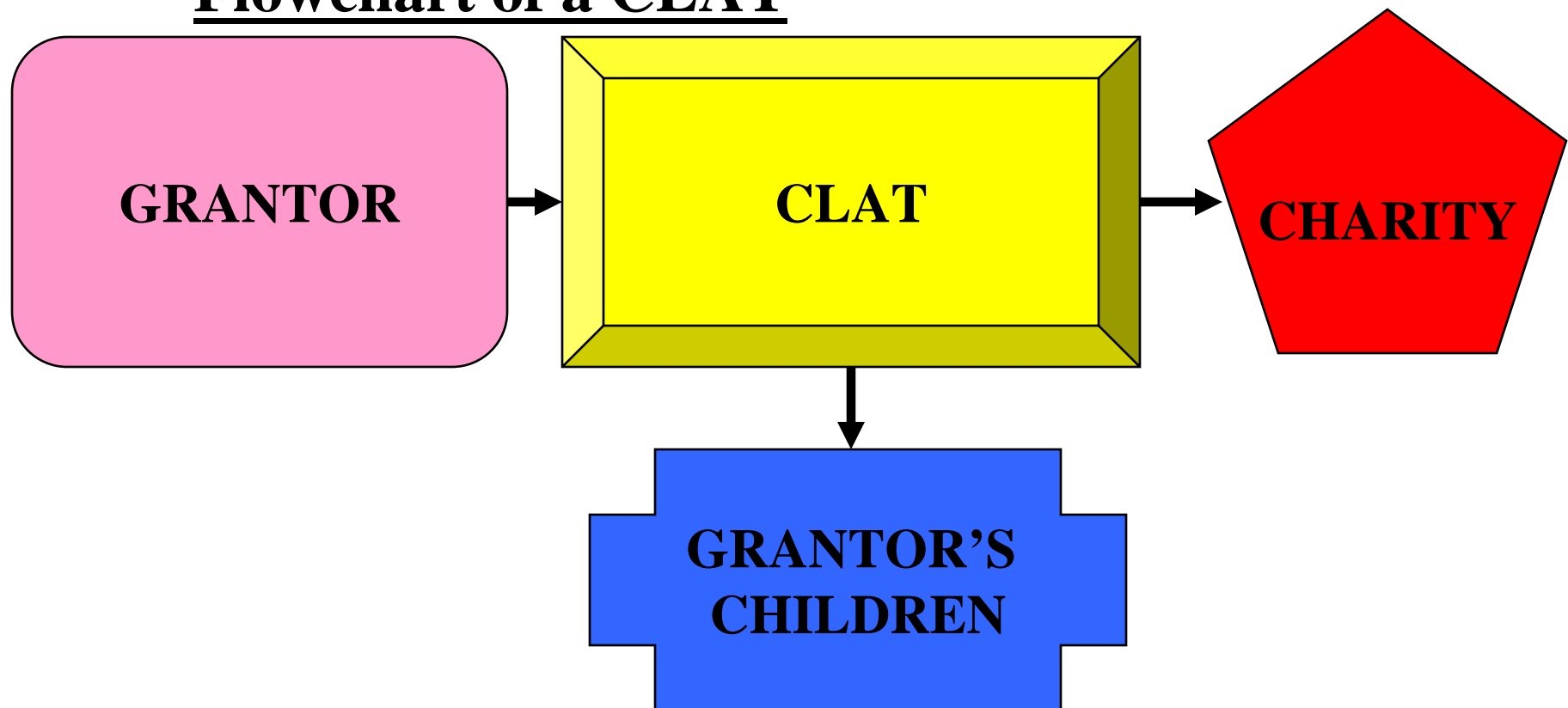
- **Overview of the Charitable Lead Trust (Cont.)**
 - *Example-If a CLAT held assets worth \$10 million and provided for a guaranteed annuity of 8% paid annually, qualifying charities would receive \$800,000 from the CLAT each year. The guaranteed annuity would remain unchanged whether the value of the assets of the CLAT decreased to \$9 million or increased to \$11 million.*





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

- Flowchart of a CLAT





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING

- **The Leveraged Family Business CLAT- Overview of the Technique**
 - **Client's revocable trust/will incorporates a testamentary zeroed out CLAT.**
 - **An inter-vivos option agreement with decedent's children/trust to purchase the family business is executed. It includes the following basic terms:**
 - ✓ Fair market value, appraisal of stock
 - ✓ Promissory note, commercially reasonable terms, interest rate (AFR)
 - ✓ Down payment
 - ✓ Probate court approval
 - ✓ Security/pledge
 - ✓ Consideration paid for option





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING



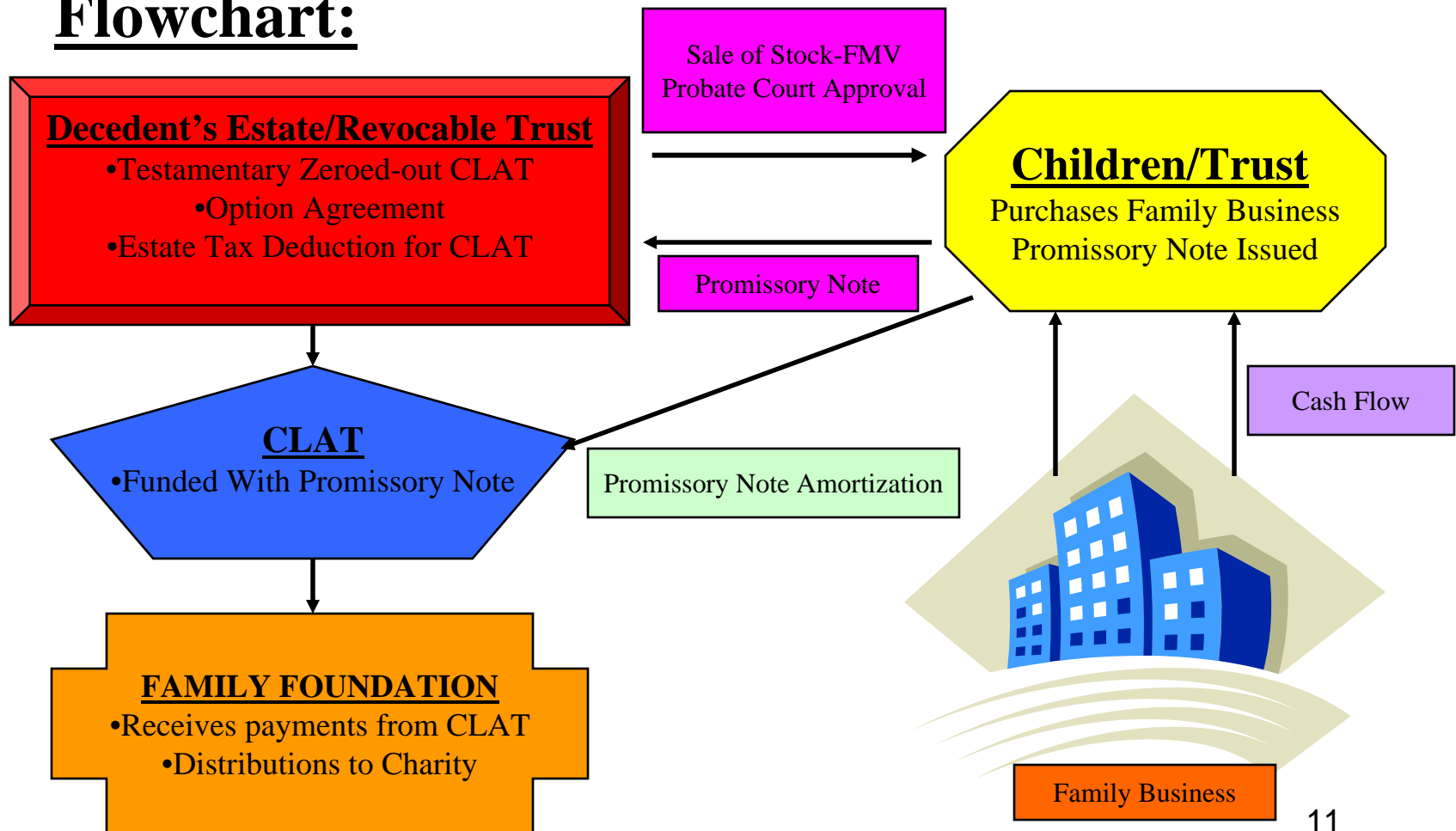
- **Key Tax Issues**

- **Private foundation rules, disqualified person**
- **Self-dealing rules-IRC Section 4941**
- **Exceptions to self-dealing rules-Reg. 53.4941(d)-1(b)(3)**
 - ✓ **The fiduciary has the power to sell the stock pursuant to an option**
 - ✓ **The stock sale is approved by the probate court**
 - ✓ **The stock sale occurs during the estate administration period**
 - ✓ **The estate receives fair market value for the stock**
 - ✓ **The CLAT is funded with a promissory note which must be “as liquid” as the stock sold.**



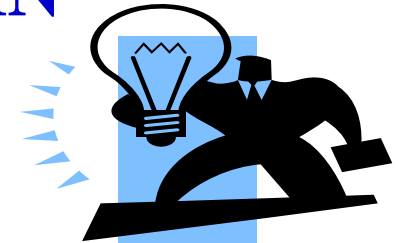
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• **Flowchart:**





CHARITABLE LEAD TRUSTS IN BUSINESS PLANNING



- **Estate Planning Benefits**

Client/Decedent:

1. **Control.** The client retains control of the company stock (“Stock”) during his or her lifetime.
2. **Step-Up in Basis.** The client’s estate receives a full step-up in income tax basis to fair market value of Stock at death.
3. **Avoids Estate Tax.** The client’s estate receives a 100% estate tax charitable deduction for the face amount of the promissory note (“Note”) contributed to CLAT which avoids all estate taxes on the value of the Stock
4. **Provide for Charity.** The client provides a legacy to charity (or his or her private foundation).
5. **Revocable Planning.** Since all of these transactions take place at death, the client can change his estate plan at any time before death.

Children:

1. **Asset Protection.** The Stock is sold/owned by an irrevocable trust for children (“Trust”) free from private foundation rules/penalties and restrictions, and free from children’s creditors.
2. **Minimize Income Tax-Trust.** The Trust receives an income tax deduction for interest payments on the Note to minimize income tax on Trust earnings.
3. **Minimize Income Tax-CLAT.** The interest payments on the Note approximate the CLAT annuity payment, thus sheltering the CLAT from current income taxes.
4. **Appreciation to Children.** All appreciation of the Stock in excess of the Note payments passes tax free to children.
5. **Current Trust Distributions.** The children as Trust beneficiaries can receive current distributions from the Trust—they do not have to wait until the CLAT term ends.
6. **S Corporation Rules Not Violated.** A CLAT cannot qualify as QSST S Corporation shareholder, but the Trust can.



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• Authority

1. Estate administrative exception to the private foundation self-dealing rules. *Treas. Reg. § 53.4941(d)-1(b)(3):*
 - *PR or trustee has power to sell property or is required to do so pursuant to an option;*
 - *The sale is approved by the probate court;*
 - *The sale occurs during the estate administration period;*
 - *Trust trust or estate receives fair market value for the property sold.*
2. Deduction of contribution of promissory note. Generally, one does not get a charitable deduction if you contribute ***your*** note (client's "promise to pay") to charity. However, a third party, secured note works. *Rev. Ruls. 68-174, 1968 CB 81; MacKay, 34 AFTR 2d 74-5899*
3. Self-dealing issue. The private foundation self-dealing rules under IRC § 4941 are inapplicable because of the estate administrative exception. *Ltr. Ruls. 200124029; 200024052; 818063; 9724018; 9501038; 9434043; 8611056; 8006029*
4. Promissory note is "as liquid as" stock. In order to qualify, the promissory note must be "as liquid as" the property sold--a number of ruling have held that a "note for stock" transaction qualifies. *Ltr. Ruls. 200232033; 200207029; 200124029; 9501038; 8611056.*
5. Jeopardy investment rules of IRC § 4944 do not apply to CLAT. The jeopardy investment rules do not apply where a third party promissory note is gratuitously contributed to a private foundation. *Ltr. Ruls. 20024052; 8335114.*



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QUESTIONS?

