



VIDEO TRANSCRIPT: Charitable Lead and Reminder Trusts

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Bruce Van Vreede:

All right good morning everybody. Welcome back to our Estate, Trust, and Gifts series, a video not quite as highly anticipated as Yellowstone or The Sopranos or a new season of Breaking Bad coming out but here we are. Mark, good to see you again. I'm with Mark Kassens, he heads up that side of our practice, and today we are talking about charitable trusts. Mark why don't you get us going with that, and I think the first one there's two charitable remainder trust and charitable lead trust. So why don't you start us off with the charitable remainder.

Mark Kassens:

Okay, great. Good to see you again Bruce. All right, first of all the thing that these two vehicles have in common is 1) they're both charitable, and 2) the charities get an interest in each one of these trusts. Now whether it's a lead part of it, you know, during the trust, or whether it's the remainder of what's left after the trust is over depends on the trust document and the plan that we've put together before that so let's start with the charitable remainder trust.

One, it's irrevocable; the donor sets it up for either a term--let's say 10 20 years--or a lifetime or dual lifetimes. Let's say until my spouse or myself are both deceased then you know the payments come to us. So these are normally funded with highly appreciated assets that the donor who is charitably minded doesn't want to pay the tax on all in one year but they want to get rid of the assets for whatever reason or can get rid of the assets and to also fund a charitable purpose. The charitable deduction is priced out at the remainder portion of the trust.

And how do we calculate that? Well, the IRS has mortality tables for Lifetime Trusts, and it's based on the growth rate the present value of the growth rate that we assume or that the IRS assumes dependent on the 7520 rates. So that's Internal Revenue Section 7520 is how they calculate that, and they release those rates every month. You're able to go back two months before you fund the trust and use any of those rates that are available to you either the current month rate or the prior two to get the optimal charitable deduction out of this. So payments come out to the donor based on what's in the trust.

Normally it's you know 5% sometimes a little bit higher than that--5% annuity let's say--you can have an annuity or you can have a unitrust, so a unitrust the payments change every year and the unitrust amount is based on the fair value at the beginning of the year. So let's say that you put a million dollars in you get a \$600,000 charitable deduction based on the 7520 rate, and you take that \$600,000 deduction--you know--right on that first year when that when that trust is funded. And that's a great benefit for most people.

So then the payments come out to the donor--let's say quarterly--and it's an annuity, so it's set every year the unitrust is redefined every year or revalued every year, and let's say you get 5% of whatever the



unitrust amount is and the payments change and the taxability changes as well. So this is all reported on a 5227 it's a split interest income tax return filed with the IRS uh and the trust issues k1s to the donor or k1s to the donors. And this these are kind of complicated because let's say the trust earns this set amount of money and pays this annuity out the character of that income can change every year depending on what is going on in the underlying trust so we have to go through pools as we distribute income.

The first pool that gets depleted is the ordinary income pool so the highest tax rate pool. Next is capital gains, which are normally lower than your ordinary rate, and then you go to Corpus or I'm sorry to non-taxable income so tax-free municipals and things like that, and then you go to Corpus so you know what you put in the property that you put in. So if that first ordinary income pool is depleted, then we're distributing capital gains income that's recognized on the 1040. And like I said, that changes every year. It's a little bit complicated, but once you put it in the trust return, it's fairly easy to follow from year to year. You can follow the pools. Let's see what else can we talk about.

We talked about the annuity whether it's an annuity or a unitrust, and then the big thing about this is that because you're setting these things up with highly appreciated assets, what you're doing is deferring that capital gain over a number of years instead of paying it all in one year. And you're doing that through the pooling, and you're controlling the pools through what investments you invest in. So the great benefit of that is you have income throughout the term or for the rest of your life from this annuity or unitrust. You have a really good charitable deduction when you're setting it up, and then the big thing is that you're deferring those capital gains on the highly appreciated assets. Thank you for that.

Bruce Van Vreede:

Not to put you on the spot, but is there like a number one question you get as people try to set up charitable remainder trusts? Is there one particular area where they sort of get hung up on?

Mark Kassens:

Normally, the one is how much charitable deduction can I get for this, or you know how much income can I or how much payments do I get off of this investment? It's really almost like setting up your own private annuity with a charitable bent to it. So really it's those. What we do is we have--now--we have software to provide us with the optimal amounts of payouts or charitable deductions. We can peg how much we need to put in to a trust to allow for such and such and such payments over the over the term, or if somebody wants a set amount or kind of an area of a charitable deduction we can figure out how much they're going to have to put into the charitable trust or limit the payments in any which way to get that charitable deduction that they're really looking for but again that's really all done with the help of software.

All right, then I think the second one to cover is the charitable lead trust. Walk us through that please. Okay--and again--this is this is an irrevocable trust, and this one, the charitable leads the way. So the



lead part of the income from year to year goes to the charity or the charities that are outlined in the trust from the donor. The donor is kind of cut out at that point, as far as the income goes, he doesn't get income like the remainder trust. He gets to pay the income tax for what the charity--really the income that charity is getting. So all right. So how this works is you have an extraordinary event in one year, so your income is going to spike up, and part of that is your taxes are going to spike as well.

So these charitable lead trusts--are again--to help mitigate that kind of spike to take out that extraordinary event or to help mitigate that extraordinary event. And again, this has to be these are for charitably minded people for the most part, and the great thing about these two is that they're an estate planning vehicle as well. So how we do this is we can set up a grantor lead trust. The grantor gets the tax deduction based on the fair market value of the income interest that's going to go to the trust.

And again these are based on the 7520 rates that the IRS produces and also the annuity payment the unitrust payments that will go out to the to the charitable the charitable lead. Everything else--and the great thing about these--we can do a zeroed out lead trust. A zeroed out lead trust means that you're basically pricing it out or paying an annuity out to the charity that zeros out that remainder interest. So you assume, just based on the tables you assume that nothing's going to be left after the charity is paid for the term, nothing is going to be left to the remainders. It's fairly easy to beat those.

So we do those by investment strategies to make sure that you're over you're over performing the 7520 rate or the payout to the charity. So let's say we put in a million dollars to this lead trust, we have a zeroed out trust, so you're getting a million dollar deduction--okay--in this in this one year. And then every year after that, as that in earns income your paying the tax on that income. You're not receiving the income, but you're paying the tax on the income. The charity is getting their annuity amount. So let's say this only earns \$10,000 worth of dividend income, but you have to pay this charity \$50,000.

The charity is getting \$50,000, and you're paying the tax on the \$10,000. We can also set up the zeroed out things where we have--normally those are scaled payments, so an increasing annuity--a 20% increase every year. So as long as it's set it's still considered annuity the payment's going to change, and be kind of back weighted. That allows more appreciation to be within the trust--held within the trust--and not paid out to the charity.

And then after the term, and the charity has received all the annuity payments that they're going to get, it goes to the beneficiaries. And these are normally the children of the donor or the grantor. And we've made a shift, really a state tax neutral, because it it was zeroed out. Basically, we priced it out so the charity got everything, and then what was left goes to the heirs. You also don't want to have these skip people, or try to avoid it as best you can.

And the reason we do that is because that inclusion ratio for generation skipping tax can't be established until that trust has run its course. That's really too much more than what I wanted to get into but just be aware that you don't want to have grandchildren for the most part be part of these lead trusts. It can



cause problems. The other side of these lead trust can be a non-grantor lead trust. So that's where the trust gets the income tax deduction every year for the amounts that are paid to charity.

There's no charitable deduction to begin with when you fund these things. And again this is mainly due to estate planning considerations, not individual charitable, it's not individually driven by the charity. So it's more of an estate plan play when you use a non-grantor. Again these can be a unitrust amount, changes every year, or an annuity amount, or the increasing annuity payment, which helps to zero out those amounts and I think that's pretty much that's pretty much it for the lead trust. I've kind of jumped around a lot and babbled a lot.

But I think that pretty much gets some important points across. And both of these vehicles: the remainder trust and the lead trust, are very good tools for 1) estate planning considerations, and 2) also for income tax considerations. And they can really be beneficial in different ways to different people, but again, planning is key. And as long as we have a plan, we can we can use these to kind of hit our objectives.

Bruce Van Vreede:

Okay. Well thank you Mark, and just like some of our favorite episodes, the plot does jump around a little bit, so no problem there. All right, well again thank you Mark Kassens, lead of our estate trust and gifts here at Brady Ware. I'm Bruce Van Vreede, director of marketing, so I appreciate it Mark. And if you have interest in knowing more, a couple of ways to do that is through the Contact Us on our website at the upper right corner of our website. And you can find Mark Kassens on our website and email him directly. But just in case, mkassens@bradyware.com. Mark all right thanks again; we'll be back with three or four more as we cover through the all of these. So again thank you for watching.