

CHARITABLE LEAD TRUSTS:
THE UNDERUSED FAMILY WEALTH TRANSFER AND INCOME TAX
TECHNIQUE FOR THE CHARITABLY INCLINED

By: Donald O. Jansen, J.D., LL.M.
Senior Tax Attorney
Office of General Counsel
The University of Texas System
201 W. 7th Street
Austin, Texas 78701
(512) 499-4493
djansen@utsystem.edu
www.donaldjansen.com

BIOGRAPHY

Donald O. Jansen is Senior Tax Counsel, University of Texas System Office of General Counsel. He is a retired senior partner of Fulbright & Jaworski L.L.P. He is a Fellow of the American College of Trust and Estate Counsel and a Fellow of the American College of Tax Counsel. Mr. Jansen is a past Chairman of the Committee of Significant Current literature and Vice-Chair of the Insurance Committee, Probate and Trust Division, Real Property, Probate and Trust Law Section of the American Bar Association.

Mr. Jansen is a specialist in Estate Planning and Probate Law certified by the Texas Board of Legal Specialization and is the past Probate Editor of the Newsletter of the Real Estate, Probate and Trust Law Section of the State Bar of Texas. Mr. Jansen is a member of the Advisory Committee, Heckerling Institute on Estate Planning, University of Miami School of Law.

THIRTY-SEVENTH ANNUAL NOTRE DAME
TAX & ESTATE PLANNING INSTITUTE
September 15-16, 2011

CHARITABLE LEAD TRUSTS:
THE UNDERUSED FAMILY WEALTH TRANSFER AND INCOME TAX
TECHNIQUE FOR THE CHARITABLY INCLINED

TABLE OF CONTENTS

I.	SCOPE OF ARTICLE AND INTRODUCTION	1
II.	WHY IS CLT MOST ATTRACTIVE FOR INCOME AND GIFT TAXES TODAY?.....	1
	A. TODAY’S LOW SECTION 7520 RATE	1
	1. What is the Section 7520 Rate?.....	1
	2. Average Section 7520 rate from 1989-2011.....	1
	3. Today’s low Section 7520 Rate.....	1
	4. The Lower the Section 7520 Rate –	2
	5. Helpful for Minimizing Income and Gift Tax.....	2
	6. The 110 Year Exhaustion Test	2
	B. TWO YEAR \$5,000,000 BASIC EXCLUSION.....	2
	1. Zeroed Out Gift	2
	2. If Can’t Zero Out, Use the Increased Basic Exclusion.....	2
III.	USES OF CLT.....	3
	A. WEALTH TRANSFER TO FAMILY -- GIFT TAX FREEZE	3
	B. CHARITABLE INCOME TAX DEDUCTION.....	3
	1. Offset Income Spike	3
	2. Grantor Trust Needed	3
	3. Deduction Limited to 30% or 20% AGI.....	4
	4. Remainder Beneficiary	4
	C. REDUCE ESTATE TAXATION - TESTAMENTARY CLT.....	4
	1. Lowers Estate Taxes.....	4
	2. Differences From Inter Vivos CLT	4
	3. Zeroed Out Estate Tax for Testamentary CLAT	5
	D. UNLIMITED INCOME TAX CHARITABLE DEDUCTION FOR NON-GRANTOR CLT.....	5
	1. CLT Not Subject to Percentage Limitations.....	5
	2. Normal Set Up.....	5
IV.	IF CLT IS THE GREATEST THING SINCE SLICED BREAD, WHY ISN’T IT USED MORE?	5
	A. TO DATE CHARITABLE REMAINDER TRUSTS (CRT) ARE MORE POPULAR ...	5
	B. POSSIBLE REASONS FOR CRT STRENGTH.....	5
	1. The Economy and Estate Tax Uncertainty	5
	2. Gift of Income v. Gift of Remainder	6
	3. The Gift Tax Basic Exclusion Was Only \$1,000,000 Until 2011	6
	4. Low Section 7520 Rate Recent Phenomena.....	6
	5. Grantor Trust CLT Phantom Income After Inter Vivos Gift.....	6
	6. IRS Safe Harbor Trust Provisions	6
	C. BUT NOW MAY BE THE CLT MOMENT FOR YOUR CLIENT IF ONE OR MORE OF THE FOLLOWING IS PRESENT:.....	7
V.	THE CLT BASICS	7
	A. DEFINITIONS	7
	1. CLT Generally.....	7
	2. CLAT.....	7
	3. CLUT.....	7
	4. CRT Minimum and Maximum Rules Do Not Apply	7
	5. No Mixing of CLAT and CLUT.....	8

B.	QUALIFIED CLT	8
1.	General Rule -- Partial Interest Gift Non-Deductibility	8
2.	Exception for Qualified CLT.....	8
C.	TERM OF TRUST	8
1.	Term of Years.....	8
2.	Live or Lives of Certain Individuals.....	8
3.	Term of Years and/or Measuring Lives.....	9
4.	The Term of the Trust May Not be Shortened	9
D.	DESIGNATION OF CHARITABLE BENEFICIARIES	9
1.	Any Qualified Charitable Organization.....	9
2.	Completed Gift.....	10
3.	Private Foundation May be Charitable Beneficiary	11
E.	CLT NOT TO MAKE PRIVATE PURPOSE PAYMENTS	11
1.	General Rule.....	11
2.	Exception.....	11
3.	Exception.....	11
4.	CLT Preceded by a Private Trust Should be Permissible.....	11
F.	ADDITIONAL CONTRIBUTIONS	12
1.	CLUT.....	12
2.	CLAT.....	12
G.	INCOME TAXATION OF NON-GRANTOR QUALIFIED CLT.....	12
1.	CLT Is Not Tax Exempt: Taxed as a Complex Trust.....	12
2.	CLT is Entitled to a Charitable Deduction	12
3.	Creating a Hierarchy of income Sources in Distributions to Maximize Charitable Deduction.....	13
4.	Payment in Kind of Guaranteed Annuity or Unitrust Interest.....	14
5.	Reporting Requirements.....	14
H.	INCOME TAXATION RULES FOR A QUALIFIED GRANTOR TRUST	14
1.	The Grantor Receives an Income Tax Deduction But He Is Taxed on the Trust Income.....	14
2.	Two Types of Grantor Trusts	15
3.	Grantor Trust Powers Which Work for Both a Typical Qualified Grantor Trust or a Super Grantor Trust	15
4.	Retained Excess of 5% Reversionary Interest Which Works Only for Typical Qualified Grantor Trust.....	17
5.	Most Other Grantor Trust Powers Risk Disqualifying the CLT or Running Afoul of the Private Foundation Rules	17
I.	PRIVATE FOUNDATION RULES	18
1.	Applicability	18
2.	Prohibition Against Self-Dealing - IRC Section 4941	19
3.	Excess Business Holdings - IRC Section 4943	20
4.	Jeopardy Investments - IRC Section 4944	21
5.	Taxable Expenditures - IRC Section 4945	21
J.	GENERATION SKIPPING TAX ISSUES	22
1.	GST Rules Apply to CLTs but With Some Peculiarities	22
2.	Allocation of GST Exemption to CLAT	22
VI.	VARIABLE ANNUITY CLAT	24
A.	CONCEPT, ADVANTAGES AND AUTHORITY	24
1.	Concept.....	24
2.	Advantages	24
3.	Supporting Authority.....	24
B.	SHARK FIN AND OTHER BACKEND LOADED CLATS	25

1.	Concept Without Regard to Life Insurance.....	25
2.	Are Shark Fin CLATs Qualified CLTs? - If Not, No Charitable Deduction.....	26
3.	Shark Fin CLATs With Life Insurance	27