

Charitable Lead Trusts

A Smarter Way to Give

AZZAD ASSET MANAGEMENT WHITE PAPER SERIES

SUMMARY

A charitable lead trust is a way for taxpayers to leverage their generosity, producing tax savings that can be used to provide greater benefit to themselves, spouses, charities, and others. It can allow the grantor to support a charitable cause for a certain time period while leaving the remainder to an individual beneficiary, helping to provide an income stream to a favorite charity and ensure a gift to specified individuals.

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WHAT IS A CHARITABLE LEAD TRUST?

A charitable lead trust is a trust with both charitable and non-charitable beneficiaries. It is called a lead trust because the charity is entitled to the lead (or first) interest in the trust property, and the non-charitable beneficiary receives the remainder (or second-in-line) interest. Every year for the trust term, the charity receives a payment from the trust property. At the end of the trust term, the remaining assets pass to the non-charitable beneficiary.

To start a charitable lead trust, the first step is to transfer property to a trust. The property can be almost anything: cash, securities, real estate, a rare collectible item (though this would need to be sold to produce income). After the property has been transferred, the owner chooses a non-charitable beneficiary: for example, him/herself, a spouse, or a friend.

Also important is determining how much money a chosen charity will be paid each year from the trust assets. This payment can be a specified percentage of the value of the trust assets based on an annual revaluation of the assets. The charity can be a recipient of assets for a set term of years or for the life of an individual who is then living.

At the end of the stated period of time, all the remaining trust assets pass to the non-charitable beneficiary.



Invest with faith

Example: Musa decides to donate some money to his favorite charity. He transfers \$200,000 to a 10-year charitable lead trust and names his wife, Kulsum, as the non-charitable beneficiary. Musa specifies that the payout rate to the charity will be a fixed 7 percent amount. The result is that, every year for 10 years, the charity will receive a payment of 7 percent of the trust's market value. After 10 years, all the remaining property in the trust will pass to Kulsum.

Charity paid from the CLT can be counted towards Zakah due when it is distributed to Zakah eligible recipients.

HOW DOES IT WORK?

With a charitable lead trust, you can provide an income stream to your favorite charity for a period of years, potentially receive an income tax deduction, and, at the same time, provide for the eventual return of the trust property to a non-charitable beneficiary. The income stream to charity is in the form of a unitrust payment and is paid to the charity at least once per year. When the trust term ends, the remaining trust assets pass to the non-charitable beneficiary.

WHAT ARE THE BENEFITS?

Charitable Planning. A charitable lead trust is an orderly way to donate to charity on an annual basis for a predetermined period of time. The money used to fund the trust is money that might otherwise go largely for taxes.

Income Tax. If you are both the donor and the owner of the trust (as defined by the IRS), you are entitled to a one-time income tax deduction in the year of the trust's creation for the present value of the interest to charity. If you qualify for a deduction, your deduction is limited to either 30 percent or 50 percent of your adjusted gross income, depending on the type of property donated to charity (via the trust) and the classification of the charity as a public charity or a private foundation. If you cannot take the full deduction in a given year, you can carry over and deduct the remaining amount the following year, for up to five years (assuming you still itemize deductions).

Caution: The tradeoff off is that if you are the owner of the trust, the IRS taxes you on the income earned by the trust each year.

Gift and Estate Tax Haven. When you establish a charitable lead trust, the IRS assigns an immediate value to the interest of the non-charitable beneficiary, even though this person will not receive the trust assets until the trust term is over. Yet, during these years, the trust assets might appreciate substantially in value. When the assets eventually pass to the non-charitable beneficiary, any appreciation in the property's value is not included in your gross estate for purposes of determining estate tax liability, nor is the appreciation considered in determining the value of your gift to the non-charitable beneficiary.

Caution: If you have any doubts about donating to charity, you should think twice before establishing a charitable lead trust. Once you transfer property to the trust, it is the charity's to keep for the duration of the trust.

Example(s): Samir transfers \$500,000 worth of Acme stock to a 15-year charitable lead trust and names his son, Yahya, as the non-charitable beneficiary. The trust is to pay the charity an amount of 8 percent. Using special IRS tax tables and an interest rate of 3 percent, the charity's interest is determined to be \$477,516. Thus, Yahya's interest is \$22,484. The result is that Samir has made a taxable gift and may owe federal gift tax. However, any gift tax due may be offset by Samir's applicable exclusion amount (\$5,340,000 in 2014), if it is available. Yet, the value of the gift to Yahya has been reduced substantially by the value of the charity's interest. The advantage is that if the stock appreciates significantly in Samir's lifetime, Samir will not owe any federal gift tax on the appreciation amount. Similarly, the value included in determining Samir's gross estate is fixed at \$22,484. In addition, the gift tax Samir paid can be credited against any estate tax that may be owed. (Note: State gift tax may also be imposed.)

PRACTICAL STEPS

To begin the process of setting up your own charitable lead trust, it is important to follow these steps:

- Consult a competent legal advisor to draft the trust document
- Pick a non-charitable beneficiary
- Pick a charity you wish to donate to, and verify that it is a qualified charity
- Identify the asset(s) you want to use to fund the trust
- Determine the duration of the trust
- Select a trustee
- File Form 5227 - Split Interest Trust Information Return annually

WHEN TO USE A CHARITABLE LEAD TRUST

The primary purpose of a charitable lead trust is to support a charitable cause for a specified time period. However, using a charitable lead trust can also help accomplish other financial goals to help you make better use of your wealth:



- **Retirement savings.** Non-qualified assets you do not need until retirement can be placed into a charitable lead trust. By naming yourself as the non-charitable beneficiary, you may qualify for an upfront income tax deduction which can be useful while you are still in your high income earning years. The trust can be set up to terminate near your planned retirement date. (Be careful with this strategy, however. Income generated in the trust will be taxable annually.)
- **Future Milestones.** Just like you plan for retirement, other future events may require you to retain financial benefit of your assets. A charitable lead trust can be used to benefit a charity but terminate at a time in the future when a child might be starting college or an aging parent may need more help.
- **Transferring wealth.** You may want to leave wealth to children or grandchildren. Giving them large amounts of money now may not be desirable if they are young or immature. However, holding on to those assets may mean that future appreciation will create a gift or estate tax liability. By using a charitable lead trust, you can ensure that your assets transfer to non-charitable individuals, like children and grandchildren. If the assets appreciate significantly in your lifetime, you will not owe any federal gift tax on the appreciation amount.

You have several tax-smart options when donating to your favorite charity, including the charitable lead trust. To find out if it might be right for you, call your Azzad advisor today.



ABOUT AZZAD ASSET MANAGEMENT

Since 1997, the mission of Azzad Asset Management, advisor to the Azzad Mutual Funds and sponsor of the Ethical Wrap Program, has been to provide investment performance without compromising their values.

Azzad is proud to serve as investment advisor to the Azzad Wise Capital Fund, the first Halal, socially responsible fixed-income fund investing in:

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