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**Leverage Charitable Giving and Estate Planning  
with a CLAT**

**Houston Business and Estate Planning Council  
October 21, 2021**

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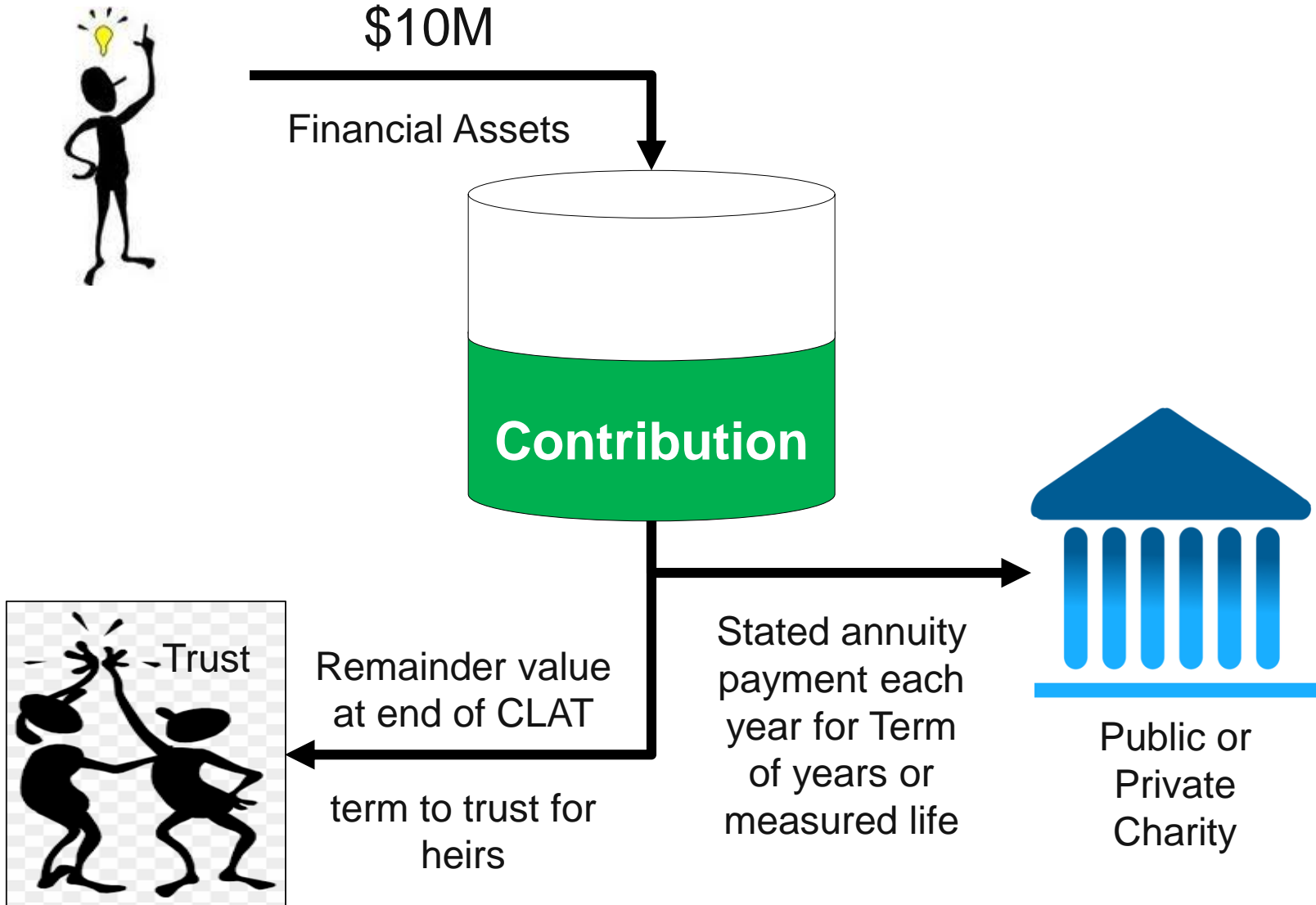
## Client Scenario

- Client desires to make a \$10M gift to charity(s)
- Portfolio is very income tax efficient causing a low AGI relative to the value of the assets
- Currently has significant carry over charitable deductions due to previous gifts
- Wants to make additional future gifts to heirs
- Has already utilized 100% of their available lifetime gift exemption for assets previously passed to heirs
- Has a diversified investment portfolio
  - Public companies
    - Individual holdings
    - Index funds
    - Hedge funds
  - Private equity funds that are in various stages of maturity

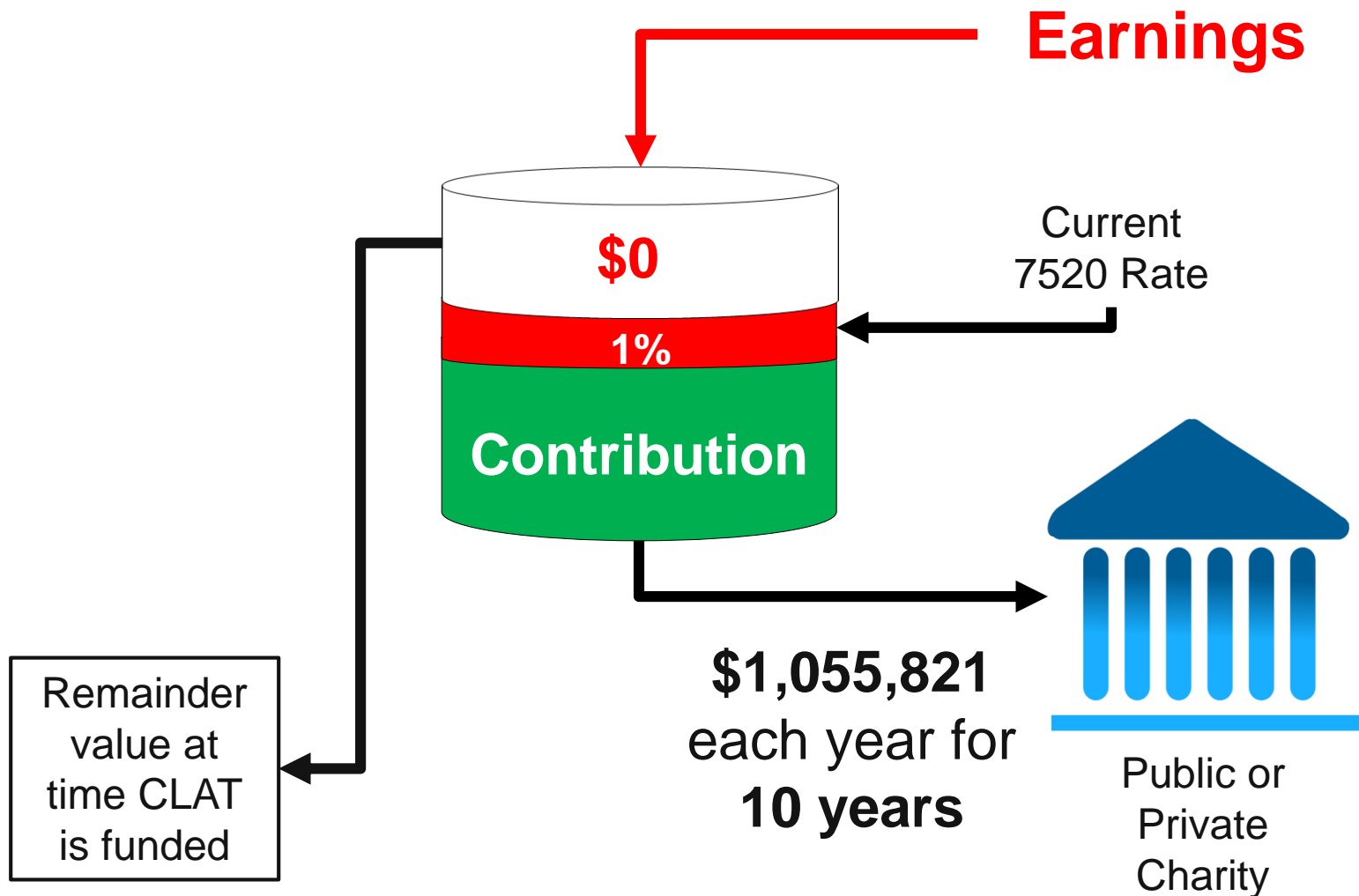


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# Utilize a Charitable Lead Annuity Trust



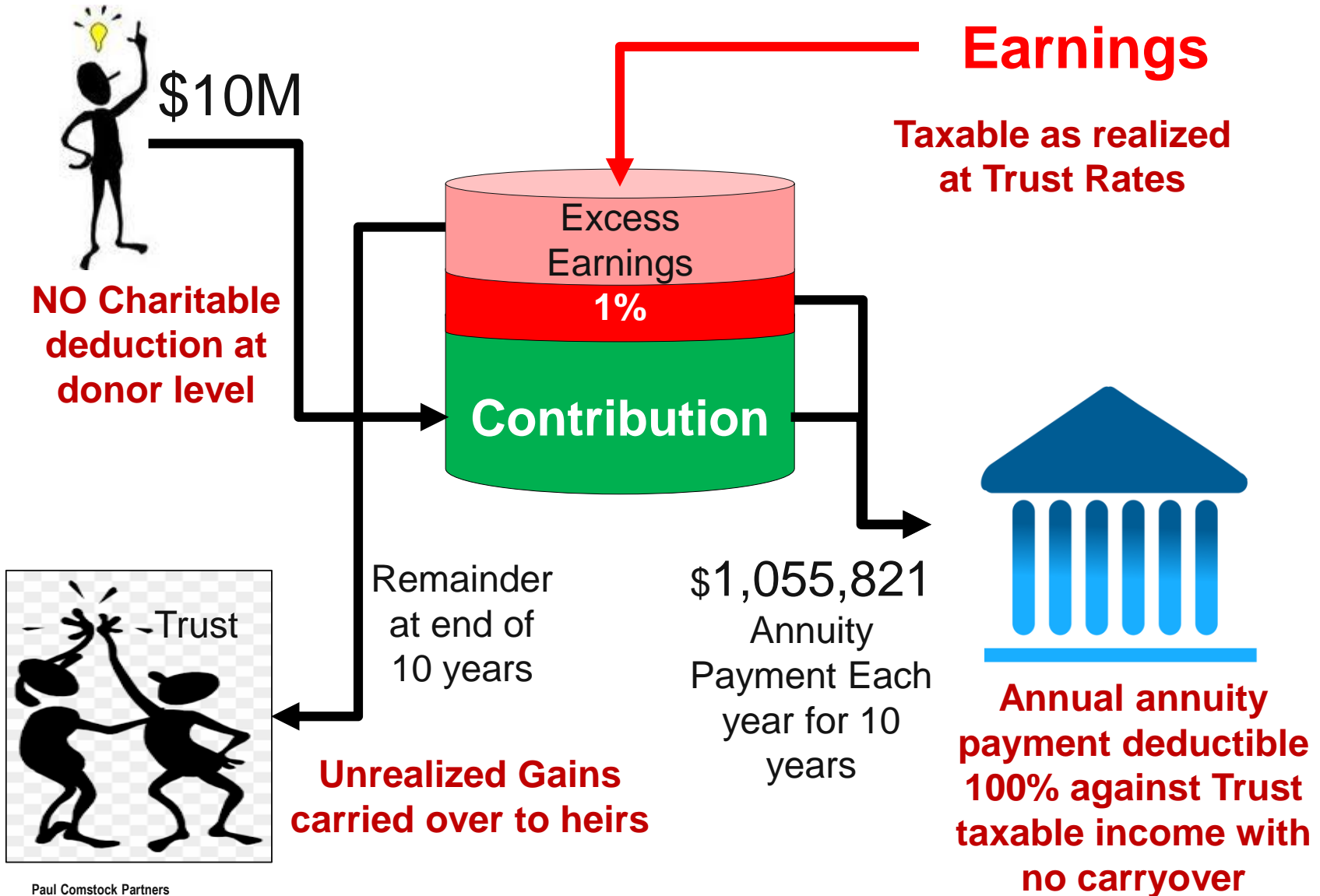
# Avoiding Gift Tax on Benefit to Heirs when trust is established





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# NON GRANTOR Charitable Lead Annuity Trust Income Taxation





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## Illustrating a CLAT to your client is easy or is it?

### Inputs

Transfer Date:	9/2021
§7520 Rate (for 9/2021):	1.00%
Calculation Type:	Term
FMV of Trust:	\$10,000,000.00
Annual Payout:	\$1,055,821.27
Payment Period:	Annual
Payment Timing:	End
Exhaustion Method:	IRS
Term:	10
Number of Payments:	10
Growth of Trust:	?

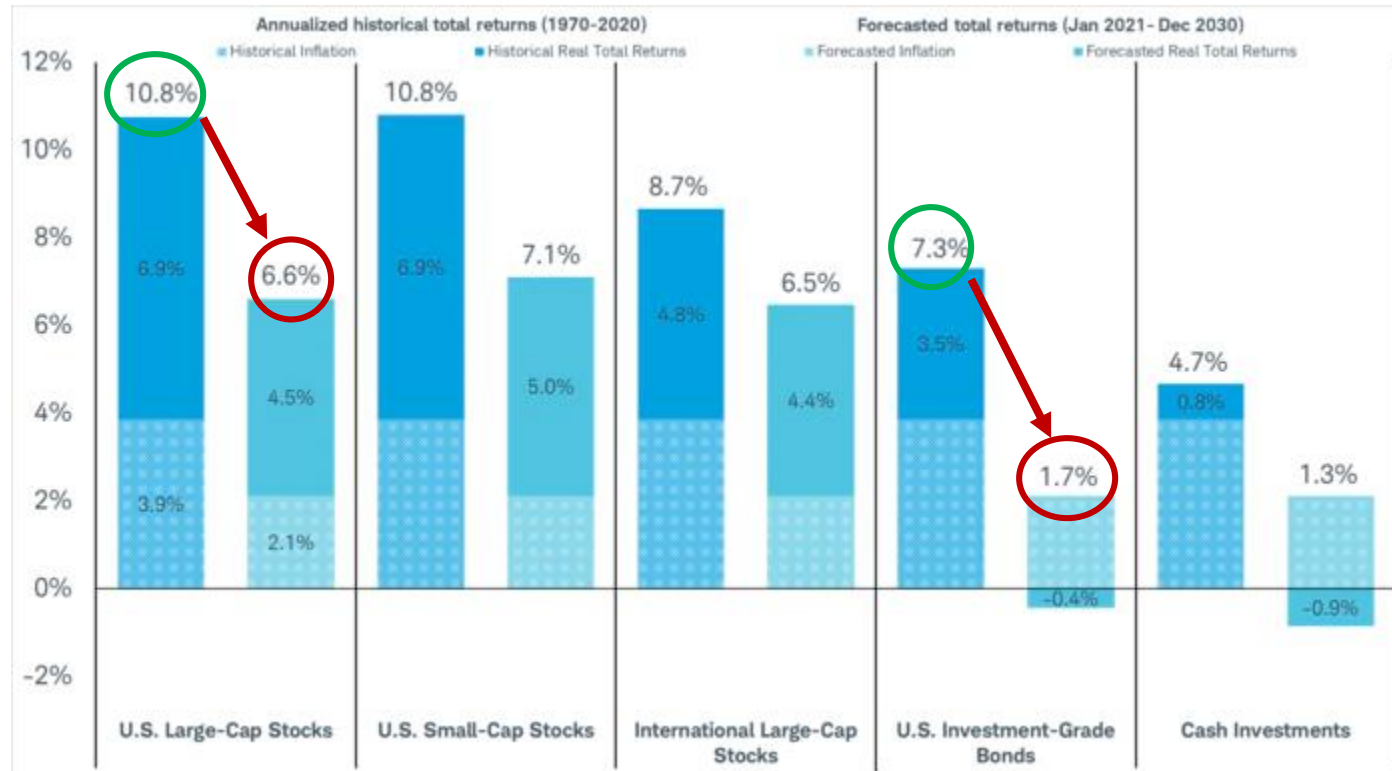
10.6%





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## NOMINAL returns: Past versus Future



Source: Charles Schwab Investment Advisory, Inc. Historical data from Morningstar Direct. Data as of 12/31/2020.



## A CLAT Nominal Return Assumption Linear Illustration

<u>Year</u>	<u>Beginning Principal</u>	<u>6.60% Growth</u>	<u>Annual Payment</u>	<u>Remainder</u>
1	\$10,000,000.00	\$660,000.00	\$1,055,821.27	\$9,604,178.73
2	\$9,604,178.73	\$633,875.80	\$1,055,821.27	\$9,182,233.26
3	\$9,182,233.26	\$606,027.40	\$1,055,821.27	\$8,732,439.39
4	\$8,732,439.39	\$576,341.00	\$1,055,821.27	\$8,252,959.12
5	\$8,252,959.12	\$544,695.30	\$1,055,821.27	\$7,741,833.15
6	\$7,741,833.15	\$510,960.99	\$1,055,821.27	\$7,196,972.87
7	\$7,196,972.87	\$475,000.21	\$1,055,821.27	\$6,616,151.81
8	\$6,616,151.81	\$436,666.02	\$1,055,821.27	\$5,996,996.56
9	\$5,996,996.56	\$395,801.77	\$1,055,821.27	\$5,336,977.06
10	\$5,336,977.06	\$352,240.49	\$1,055,821.27	\$4,633,396.28
Summary:		\$5,191,608.98	\$10,558,212.70	<b>\$4,633,396</b>
		<b>+\$5M</b>		<b>To Heirs</b>





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# Why is 2021 is a Good Time for doing a CLAT?

## September, 2021 versus September, 2006

### Nominal Return Linear Comparison

Charitable Lead					- Average Annual Return Projections				
		Projected Annual Return	1% 7520 Rate			Aver. Annual Return	6% 7520 Rate		
Year	BY Value	6.60%	Zero Out Annuity	EY Value	Year	BY Value	6.31%	Zero Out Annuity	EY Value
2021	10,000,000	660,000	(1,055,821)	9,604,179	2006	10,000,000	631,000	(1,358,677)	9,272,323
2022	9,604,179	633,876	(1,055,821)	9,182,234	2007	9,272,323	585,084	(1,358,677)	8,498,730
2023	9,182,234	606,027	(1,055,821)	8,732,440	2008	8,498,730	536,270	(1,358,677)	7,676,322
2024	8,732,440	576,000	(1,055,821)	8,252,960	2009	7,676,322	484,300	(1,358,677)	6,802,021
2025	8,252,960	544,000	(1,055,821)	7,741,835	2010	6,802,021	429,200	(1,358,677)	5,872,552
2026	7,741,835	510,961	(1,055,821)	7,196,975	2011	5,872,552	370,558	(1,358,677)	4,884,433
2027	7,196,975	475,000	(1,055,821)	6,616,154	2012	4,884,433	308,208	(1,358,677)	3,833,964
2028	6,616,154	436,666	(1,055,821)	5,996,999	2013	3,833,964	241,923	(1,358,677)	2,717,210
2029	5,996,999	395,802	(1,055,821)	5,336,980	2014	2,717,210	171,456	(1,358,677)	1,529,989
2030	5,336,980	352,241	(1,055,821)	4,633,400	2015	1,529,989	96,542	(1,358,677)	267,854

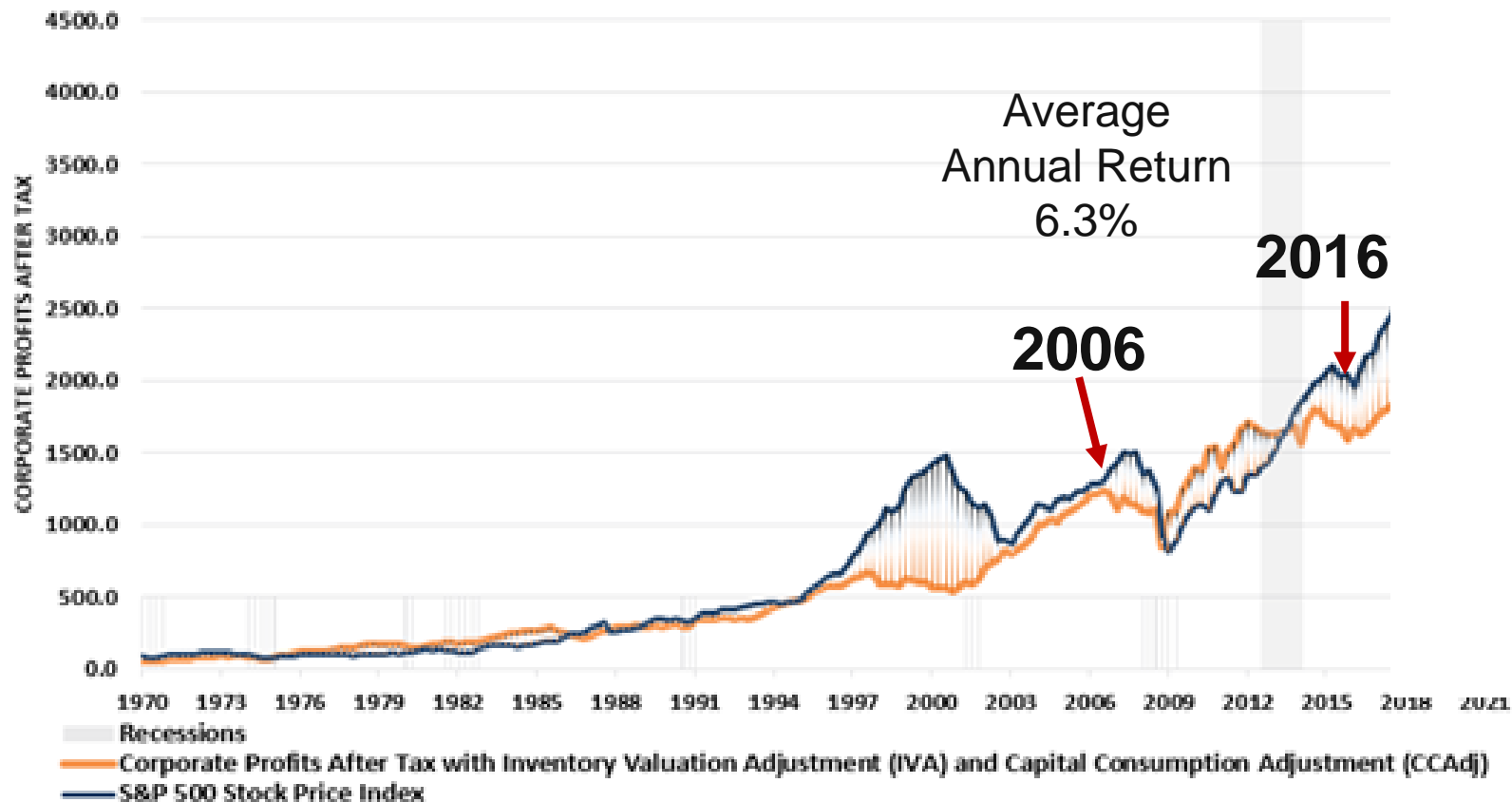
**\$4.6M**

**\$268K**

## Illustration of a CLAT Funded in 2006

### Is a linear average really what should be used?

**S&P 500 vs. Corporate Profits After Tax**





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# 2006 CLAT

## Average Annual Return versus Actual Annual Returns

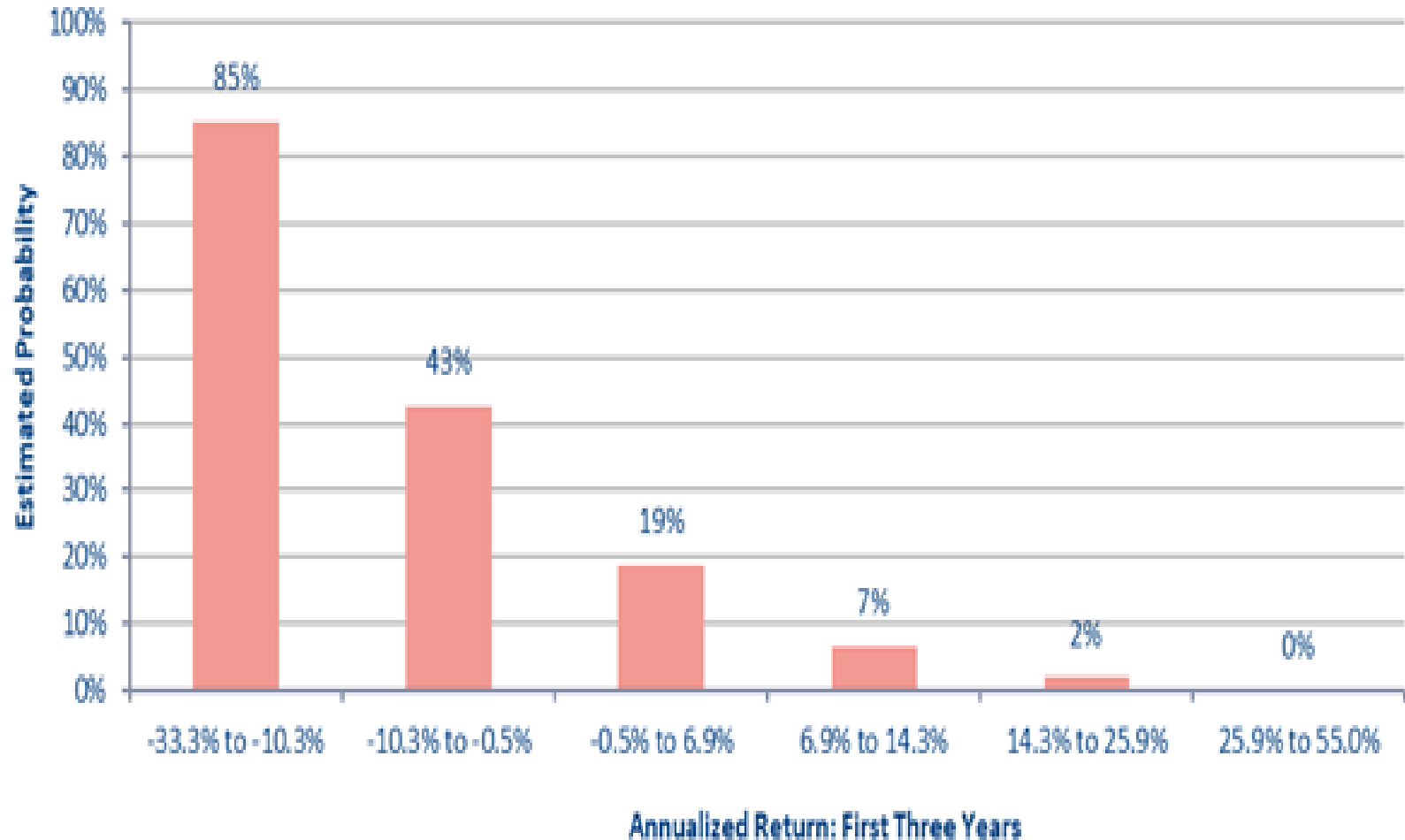
Non-grantor Charitable Lead Annuity Trust - Average Annual Return versus Actual Annual Returns										
Year	BY Value	Aver. Annual Return 6.31%	6% 7520 Rate Zero Out Annuity	EY Value	Year	BY Value	Actual Ret	Earnings/ (Loss)	Zero Out Annuity	EY Value
2006	10,000,000	631,000	(1,358,677)	9,272,323	2006	10,000,000	15.79%	1,579,000	(1,358,677)	10,220,323
2007	9,272,323	585,084	(1,358,677)	8,498,730	2007	10,220,323	5.49%	561,096	(1,358,677)	9,422,742
2008	8,498,730	536,270	(1,358,677)	7,676,322	2008	9,422,742	-37.00%	(3,486,414)	(1,358,677)	4,577,650
2009	7,676,322	484,376	(1,358,677)	6,802,021	2009	4,577,650	26.46%	1,211,246	(1,358,677)	4,430,220
2010	6,802,021	429,208	(1,358,677)	5,872,552	2010	4,430,220	15.06%	667,191	(1,358,677)	3,738,734
2011	5,872,552	370,558	(1,358,677)	4,884,433	2011	3,738,734	2.11%	78,887	(1,358,677)	2,458,944
2012	4,884,433	308,208	(1,358,677)	3,833,964	2012	2,458,944	16.00%	393,431	(1,358,677)	1,493,698
2013	3,833,964	241,923	(1,358,677)	2,717,210	2013	1,493,698	32.39%	483,809	(1,358,677)	618,830
2014	2,717,210	171,456	(1,358,677)	1,529,989	2014	618,830	13.69%	84,718	(703,547)	-
2015	1,529,989	96,542	(1,358,677)	267,854	2015	-	-	-	-	-
		3,854,624	(13,586,770)					1,572,963	(11,572,963)	

Average annual return  
6.31%



# Monte Carlo Analysis Findings

## Estimated CLAT Failure Probability vs Annualized Return Years 1-3



Source: Paul Comstock Partners, 2021



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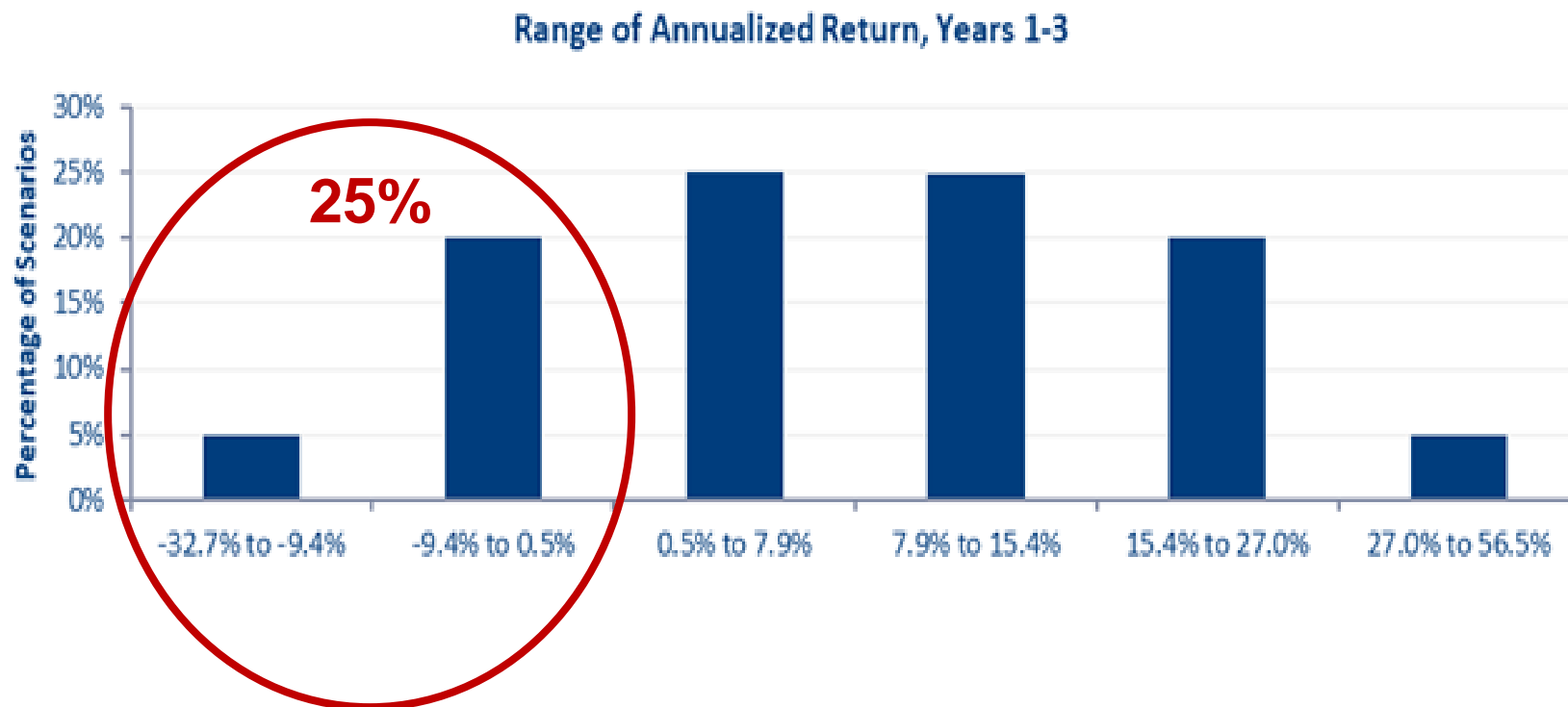
## 2006 CLAT

# Average Return versus Actual Annual Returns

Non-grantor Charitable Lead Annuity Trust - Average Annual Return versus Actual Annual Returns										
		Aver. Annual Return	6% 7520 Rate Zero Out Annuity	EY Value			<b>-8.4%</b> <b>1<sup>st</sup> 3 years</b>			
Year	BY Value	6.31%			Year	BY Value	Actual Ret	Earnings/ (Loss)	Zero Out Annuity	EY Value
2006	10,000,000	631,000	(1,358,677)	9,272,323	2006	10,000,000	15.79%	1,579,000	(1,358,677)	10,220,323
2007	9,272,323	585,084	(1,358,677)	8,498,730	2007	10,220,323	5.49%	561,096	(1,358,677)	9,422,742
2008	8,498,730	536,270	(1,358,677)	7,676,322	2008	9,422,742	-37.00%	(3,486,414)	(1,358,677)	4,577,650
2009	7,676,322	484,376	(1,358,677)	6,802,021	2009	4,577,650	26.46%	1,211,246	(1,358,677)	4,430,220
2010	6,802,021	429,208	(1,358,677)	5,872,552	2010	4,430,220	15.06%	667,191	(1,358,677)	3,738,734
2011	5,872,552	370,558	(1,358,677)	4,884,433	2011	3,738,734	2.11%	78,887	(1,358,677)	2,458,944
2012	4,884,433	308,208	(1,358,677)	3,833,964	2012	2,458,944	16.00%	393,431	(1,358,677)	1,493,698
2013	3,833,964	241,923	(1,358,677)	2,717,210	2013	1,493,698	32.39%	483,809	(1,358,677)	618,830
2014	2,717,210	171,456	(1,358,677)	1,529,989	2014	618,830	13.69%	84,718	(703,547)	-
2015	1,529,989	96,542	(1,358,677)	267,854	2015	-	-	-	-	-
		3,854,624	13,586,770					1,572,963	(11,572,963)	

# Looking Forward

## Investing 100% of the CLAT in the S&P 500 Index





# Monte Carlo Nominal Return Analysis

10 year “range” of REMAINDER results

100% invested in the S&P 500 Index

(\$10M/\$1,055,821 Level Annuity Payment)

Straight Annuity	
5%	\$0
25%	\$452,983
50%	\$4,275,993
75%	\$10,289,748
95%	\$24,724,344
75%	
% Depleted	21.6%

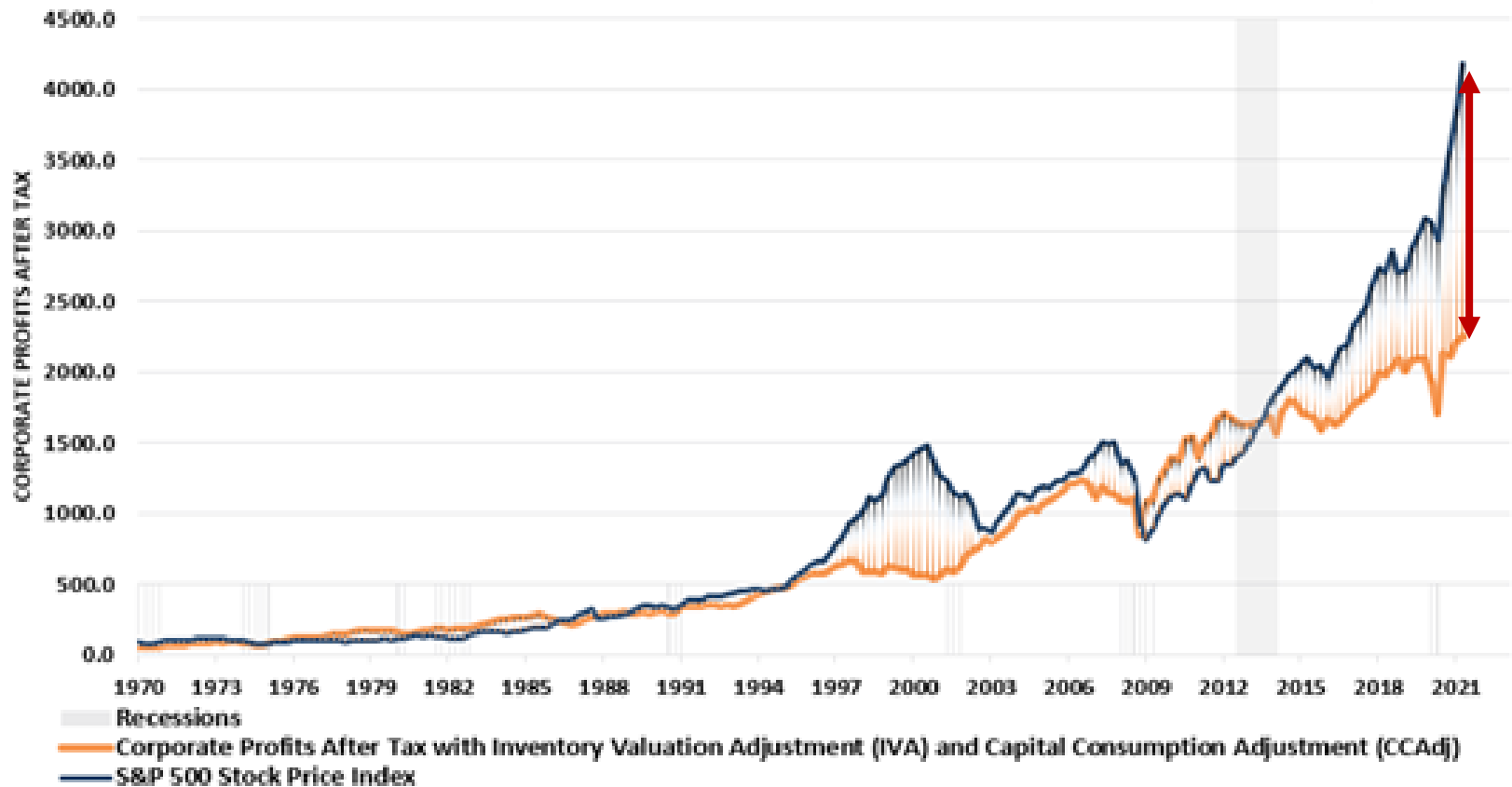
Source: Paul Comstock Partners, 2021



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# Why NOW is a challenging time to fund a CLAT

S&P 500 vs. Corporate Profits After Tax







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## Planning Tip

Reduce the impact of downside market risk in the early years

Remainder Value Comparison of Three Annuity Payment Options

Level Annuity Payment						Progressive Annuity Payment						Shark Fin Annuity Payment					
Year	BY Value	Return %	Return \$ Value	Level Annuity Payment	EY Value	Year	BY Value	Return %	Return \$ Value	Progressive Annuity Payment	EY Value	Year	BY Value	Return %	Return \$ Value	Shark Fin Annuity Payment	EY Value
1	10,000,000	4.00%	400,000	(1,055,821)	9,344,179	1	10,000,000	4.00%	400,000	(412,568)	9,987,432	1	10,000,000	4.00%	400,000	-	10,400,000
2	9,344,179	20.20%	1,887,524	(1,055,821)	10,175,882	2	9,987,432	20.20%	2,017,461	(495,082)	11,509,811	2	10,400,000	20.20%	2,100,800	-	12,500,800
3	10,175,882	1.60%	162,814	(1,055,821)	9,282,875	3	11,509,811	1.60%	184,157	(594,098)	11,099,870	3	12,500,800	1.60%	200,013	-	12,700,813
4	9,282,875	-6.50%	(603,387)	(1,055,821)	7,623,667	4	11,099,870	-6.50%	(721,491)	(712,918)	9,665,461	4	12,700,813	-6.50%	(825,553)	-	11,875,260
5	7,623,667	13.00%	991,077	(1,055,821)	7,558,923	5	9,665,461	13.00%	1,256,511	(855,502)	10,066,469	5	11,875,260	13.00%	1,543,784	-	13,419,044
6	7,558,923	19.20%	1,451,313	(1,055,821)	7,954,415	6	10,066,469	19.20%	1,932,761	(1,026,602)	10,972,629	6	13,419,044	19.20%	2,576,456	-	15,995,500
7	7,954,415	-6.50%	(517,037)	(1,055,821)	6,381,557	7	10,972,629	-6.50%	(713,221)	(1,231,922)	9,027,486	7	15,995,500	-6.50%	(1,039,708)	-	14,955,793
8	6,381,557	24.10%	1,537,955	(1,055,821)	6,863,692	8	9,027,486	24.10%	2,175,621	(1,478,307)	9,724,803	8	14,955,793	24.10%	3,604,346	-	18,560,139
9	6,863,692	-8.30%	(569,686)	(1,055,821)	5,238,184	9	9,724,803	-8.30%	(807,154)	(1,773,968)	7,143,676	9	18,560,139	-8.30%	(1,540,492)	-	17,019,647
10	5,238,184	14.80%	775,251	(1,055,821)	4,957,615	10	7,143,676	14.80%	1,057,261	(2,128,762)	6,072,178	10	17,019,647	14.80%	2,518,908	(11,046,221)	17,019,647

\$412,568

\$2,128,762

\$11M

## 75% of the time the laddered payouts provided \$1M or more of remainder value

	Straight Annuity	25% Escalation	100% Escalation	All Y10 ('Sharkfin')
5%	\$0	\$0	\$0	\$0
25%	<b>\$452,983</b>	<b>\$953,426</b>	<b>\$1,485,854</b>	<b>\$1,808,515</b>
50%	\$4,275,993	\$5,635,732	\$7,129,096	\$7,847,351
75%	\$10,289,748	\$12,946,335	\$15,586,705	\$16,867,962
95%	\$24,724,344	\$30,148,172	\$35,437,267	\$37,673,329

% Depleted

21.6%	19.6%	17.9%	17.2%
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% Below Straight

8.5%	9.5%	10.5%
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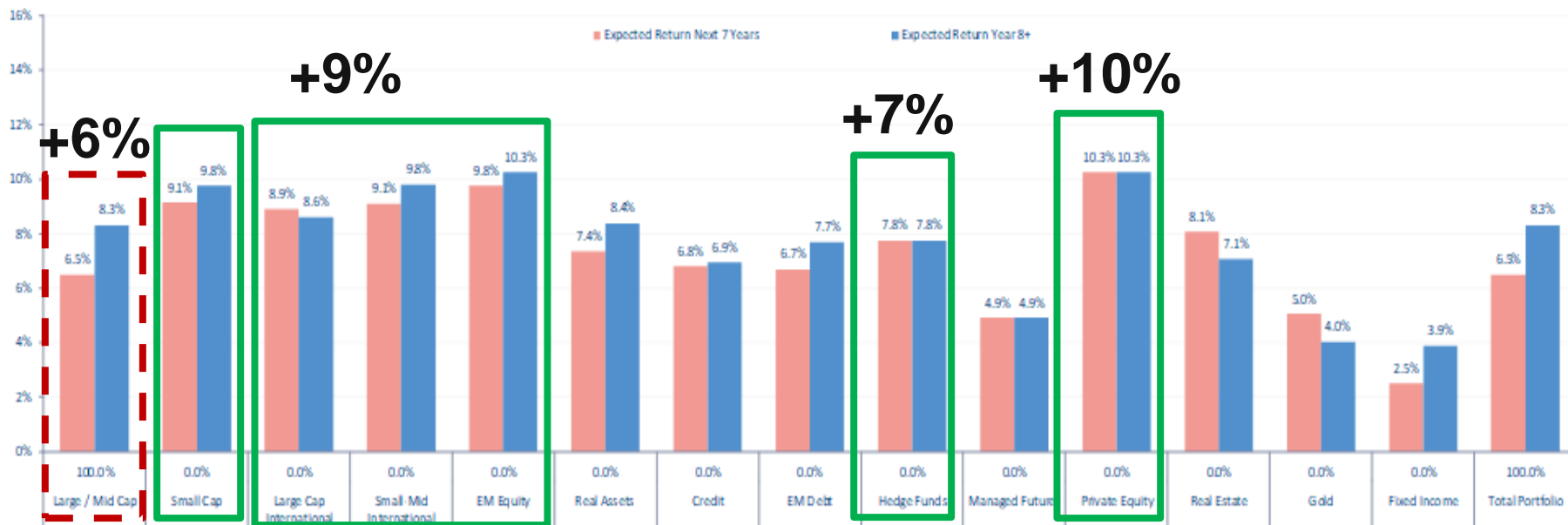
Source: Paul Comstock Partners, 2021



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## Planning Tip

### Seek highest return potential assets



Assets that can be transferred at a **discount to NAV**

- Hedge funds with “lock-up” provisions remaining
- Early Stage Private Equity Funds

Source: Paul Comstock Partners, 2021



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## Current Asset Allocation for Funding a 10 Year CLAT

CLAT Funding Valuation	w/Discounted PE	10,000,000	100%
Cash	1st 3 years payments	1,500,000	15%
Stocks	Diversified/ Low basis	5,000,000	50%
PE/Hedge Funds @ Appraised Value	65% of Reported NAV	3,500,000	35%
PE	Reported NAV	5,384,615	
PE/HF Excess Earnings Value		1,884,615	

- Pay attention to **Accredited Investor** and **Qualified Investor** rules when including private issue securities
- Caution should be taken when funding a CLAT with PE to be aware of potential **UBI** distributions that may occur



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## Planning Tip

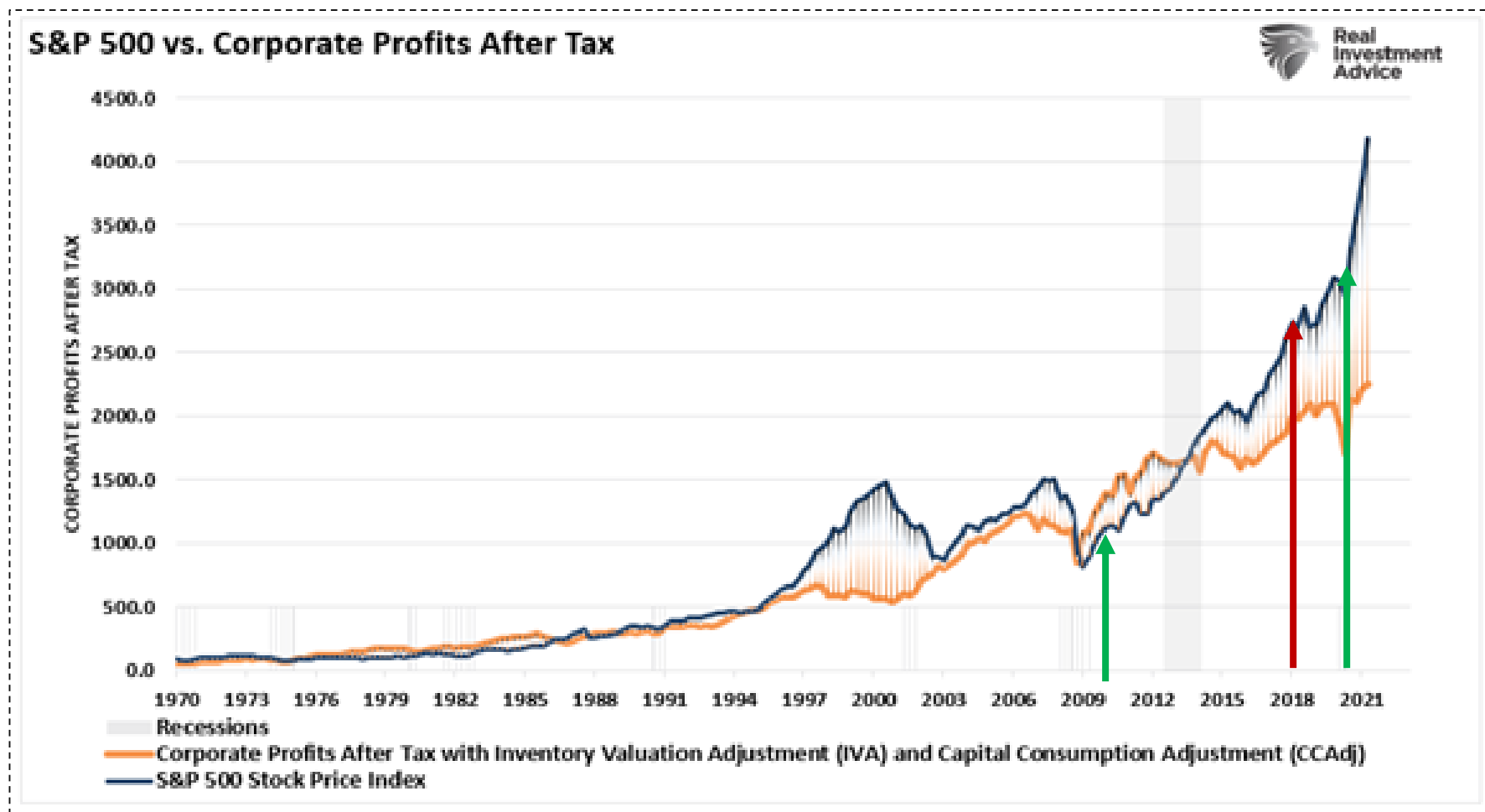
### As Maturity Approaches DERISK Annuity Payments

Example of Immunizing Remaining Payments			
Valuation 11/10		9,529,596	
Total Payments to Charity		10,832,292	
Updated Valuation	12/31/2017	7,170,581	
Annuity Payout Summary			
Annual Paid #1 (4 Months)	12/23/2010	362,066	(122 days)
Annual Paid #2	12/5/2011	1,083,229	
Annual Paid #3	12/10/2012	1,083,229	
Annual Payout #4	12/18/2013	1,083,229	
Annual Payout #5	12/12/2014	1,083,229	
Annual Payout #6	12/16/2015	1,083,229	
Annual Payout #7	12/7/2016	1,083,229	
Annual Payout #8	12/19/2017	1,083,229	
Annual Payout #9	12/31/2018	1,083,229	
Annual Payout #10	12/31/2019	1,083,229	
Annual Payout #11 (8 months)	9/1/2020	721,164	(243 days)
Balance Due to Charity	<b>Moved to short duration bonds</b> →		2,887,622
Current Remainder Value		4,282,959	

**in 2018**

## Planning Tip 5

# Be market cycle patient, don't be greedy





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## Summary of Tips that improve CLAT outcomes

- Establish REALISTIC and SUPPORTABLE outcome expectations with your client prior to the trust being established
- During periods of high market valuations, look at structuring escalating annuity payments,
- Create an “advantaged for success” trust portfolio
  - Override UPIA statute for diversification requirement when drafting the document
  - Fund the 1<sup>st</sup> 3 years of annuity payments from a cash reserve allocation
  - Select assets with the highest forward potential returns
  - Consider funding, in part, with marketable securities having a low cost basis in order to have additional sources of annual realized income to take advantage of the full charitable deduction.
  - Include private investments that can be appraised at a discount to their current NAV but are expected to liquidate over the term of the CLAT
- In the CLAT’s later years, examine the risk / reward for both beneficiary classes and move to a duration-matched fixed income position for the charitable payments while maintaining an acceptable asset appreciation potential for the remainder beneficiaries



## For more information:

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