



## When Thinking Lead Trusts, Don't Forget State Taxes

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Charitable lead trusts, as we know them today, were created in the Tax Reform Act of 1969. It didn't take long after that for sophisticated estate planners and planned giving officers to recognize that charitable lead trusts offered wealthy donors a great way to provide for heirs, make a generous charitable gift, and potentially save a lot of taxes in the process.

Conceptually, a lead trust is the opposite of a charitable remainder trust. During a lead trust's term, the trust makes payments to one or more charities specified by the donor in the trust agreement. As with a charitable remainder trust, the payments can be for either a fixed amount (a lead annuity trust) or a fixed percentage of the trust's value as revalued each year (a lead unitrust). When the lead trust ends, whatever remains goes to heirs named by the donor.

This form of charitable lead trust is called a "non-grantor" lead trust. It is the most common form of charitable lead trust because the assets in the trust are considered owned by the trust and not part of the donor's estate. The removal of these assets from the donor's estate enables the trust to reduce the donor's estate taxes. The "grantor" form of charitable lead trust does provide the donor with a charitable deduction, but it does not remove the assets from the grantor's estate.

When the Tax Reform Act of 1969 was passed, the federal estate tax exemption was just \$60,000. Any estate larger than \$60,000 would owe federal estate tax. For estates over \$10 million, the top rate was 77%! As recently as 2003, the federal estate tax exemption was "only" \$1 million, and the top estate tax rate of 49% kicked in for taxable estates over \$2 million. Donors with estates worth more than \$2 million, and there were quite a few

donors in this category, were looking for ways to save estate taxes. That's where the charitable lead annuity trust (CLAT) could be very helpful.

At the beginning of 2003 a donor could fund a 20-year CLAT with a 7.1% payout rate and earn a 100% gift tax deduction. In other words, a donor could fund this trust with any amount of money and not owe any gift tax. What's more, once those funds were in the trust they were out of the donor's estate and would pass to the donor's heirs' estate-tax free, including any growth in the assets during the trust term. The more a donor put into the trust, the more taxes the donor could save. Today, it requires a 7.75% payout rate for the donor of a 20-year CLAT to earn a 100% gift tax deduction.

Fast forward to 2026. The federal estate tax exemption is now \$15 million per person, \$30 million per married couple. Fewer than one in 1,000 estates closed in 2026 will owe any federal estate tax. The few that do will pay a 40% tax on taxable amounts that exceed their exemption. For these estates, the charitable lead trust still offers a way to reduce federal estate tax. What about the other 999 estates? Can the charitable lead trust provide them with any tax benefit?

As with many things in life, it depends!

[Seventeen states have their own estate tax or inheritance tax.](#) An estate tax is paid by the estate based on the value of the taxable estate. An inheritance tax is paid by the beneficiary based on the value of the property received.

The top estate tax rate varies among these states but is almost always far lower than the 40% federal rate. The most common top rates are 16% and 20%. Do donors who live in these states have even less to worry about with state estate taxes than with federal estate taxes? Not necessarily. Not necessarily because the exemption amount from these taxes is typically much lower than the \$15 million federal exemption.

In Massachusetts, for example, the estate tax exemption is \$2 million, and the estate tax rates range from 7.2% on assets above \$2 million up to 16% on assets a little over \$10 million. A Massachusetts donor with a \$5 million taxable estate does not need to worry about federal estate taxes but would owe nearly \$300,000 in state estate taxes. Reducing the taxable estate by funding a CLAT would save the estate significant taxes at the state level.

Here's another example. New Jersey assesses an inheritance tax of 11%-16% on property inherited by someone who isn't the decedent's spouse, parents, or lineal descendant. For a New Jersey donor interested in supporting a charitable organization, a CLAT

presents a way to make a generous donation and pass assets to all their heirs, regardless of lineage, free of inheritance tax.

The rules governing estate and/or inheritance taxes vary significantly from state to state. The particulars can and should be left to the donor's tax advisors. That said, do not dismiss the possibility that a charitable lead trust could save a donor estate or inheritance tax even if the donor does not expect to owe any federal estate tax. For donors who live in any of the seventeen states with an estate or inheritance tax, a charitable lead trust could be a great way to make a gift, pass assets to heirs, *and* save taxes.