Eaton Vance

Higher Stock Values Create Potential for Greater Benefits of a U.S. Legacy Income Trust (LIT)

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AUTHOR

EILEEN TAM
Director of
Philanthropic Solutions
Eaton Vance

Robust economic growth and weakening fears of a recession are fueling U.S. markets, with the S&P 500 posting its best six months gains since 2019. What sounds like great news for stock investors also means higher appreciated positions. Current market conditions have created potential opportunity for investors who contribute a higher value stock into a charitable planned-giving instrument established by a tax-exempt public charity that can offer a tax deduction and a lifetime income stream.

A Legacy Income Trust (LIT), offered by U.S. Charitable Gift Trust, a tax-exempt public charity sponsored by Eaton Vance Management, provides donors contributing acceptable securities (or cash) the opportunity to: avoid recognition of capital gains on contributions of appreciated assets; receive a federal income tax deduction based on the charitable remainder portion of the contribution value; provide monthly distributions of tax-advantaged income for life to up to 10 income beneficiaries; and make grants to qualified charitable organizations selected by the donor or their designee following the death of the last-surviving income beneficiary.

We believe now is an ideal time to contribute a higher value stock to a LIT, as delaying contributions in anticipation of a higher distribution rate may lead to materially lower cash flows over the course of a trust account's lifetime. Based on historical daily volatility, a LIT's net asset value (NAV) is likely to decrease by approximately 5.22%, which increases the annual distribution rate to 6.71%.[1] The expected volatility of a single stock is likely higher than the expected volatility of a LIT, and, as a result, a LIT's annual distribution rate.

Our hypothetical example demonstrates the potential benefit of contributing highly appreciated stock, at or near all-time highs. We calculated the daily volatility of a LIT's NAV since inception to be 17.8%,[2] and, for the same time period, calculated the median daily volatility of S&P 500 Index constituents to be 34.1%.

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[1] Information based on U.S. Legacy Income Trust III.2 (Trust III.2) as of 6/30/2024.
[2] Information based on Trust III.2 as of 6/30/2024.

HYPOTHETICAL EXAMPLE
Contribute 10,000 shares of ABC Stock

	SCENARIO 1	SCENARIO 2
Stock Price	$100	$90
Total Contributed Value	$1,000,000	$900,000
LIT Distribution Rate	6.38%[3]	6.71%[4]
Estimated Life Expectancy	30	30
Annual Tax Advantaged Income	$63,800	$60,390
Total Income Distribution Over the Life of the Income Beneficiary	$1,914,000	$1,811,700

Result

Assuming a 30-year lifecycle for the client's trust account, the difference in timing of contribution between Scenario 1 and Scenario 2 amounts to ($102,300) of tax-advantaged income forfeiture (in addition to a lower upfront tax deduction amount).

Takeaway

The expected volatility of a single stock is likely higher than the expected volatility of LIT's NAV, and, as a result, LIT's annual distribution rate. Delaying contributions in anticipation of a higher distribution rate may lead to materially lower cash flows over the course of a trust account's lifetime.

A LIT is organized as a pooled income fund[5] and invests through a common trust fund in which each trust participates. The proprietary equity income strategy of a LIT offers significant potential advantages, including: the opportunity to realize higher total return, and higher and more consistent distributions; an opportunity to increase distributions over time with inflation when portfolio companies raise their dividends; and improved income tax treatment of distributions. Distributions to income beneficiaries are expected to consist primarily of qualified dividend income (QDI), currently subject to individual federal income tax at rates up to 23.8% compared to maximum rates of 40.8% for ordinary dividends and taxable interest income.

Bottom Line

We believe high stock values are creating an opportunity for donors to attain greater cash flows over the course of a trust account's lifetime. Now is an opportune time to talk to your financial and tax planning advisor about the potential of contributing stock to a LIT.

[3] Distribution rate is based off the Trust III.2 distribution rate as of 6/30/2024.

[4] A 10% share price decline equates to (based on historical daily volatility) a 5.22% decrease in LIT's net asset value (NAV), which increases the annual distribution rate to 6.71%.

[5] As described in Section 642(c)(5) of the Internal Revenue Code.

Risk Considerations: As charitable giving vehicles, pooled income funds should not be treated as, and are not designed to compete with, investments made for private gain. An intention to benefit from a U.S. Charitable Gift Trust (Gift Trust) should be a significant part of the decision to contribute. The tax consequences of contributing to a pooled-income fund will vary based on individual circumstances. Prospective donors should consult their own tax advisors. Distributions to income beneficiaries are not guaranteed by any party and are subject to investment risk. See the LITs'.

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In addition, Eaton Vance Distributors, Inc. is a paid solicitor of certain LITs and the Gift Trust, receiving compensation as described in the Information Statements and Gifting Booklet.

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