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Panel 8

Panel 1

Benefits of a Charitable Remainder Trust

- Convert an appreciated asset into lifetime income.
- Reduce your current income taxes with charitable income tax deduction.
- Pay no capital gains tax when the asset is sold.
- Reduce or eliminate your estate taxes.
- Gain protection from creditors for gifted asset.
- Benefit one or more charities.
- Receive more income over your lifetime than if you had sold the asset yourself.
- Leave more to your children or others by using life insurance trust to replace the gifted asset.

adviser, CPA, and/or favorite charity. Be sure an attorney experienced in CRTs prepares the documents.

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Understanding

CHARITABLE REMAINDER TRUSTS

How to Secure a Lifetime Income, Save Taxes & Benefit a Charity

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Panel 2

Panel 3

Since 1969, countless families have used charitable remainder trusts (CRTs) to increase their incomes, save taxes and benefit charities.

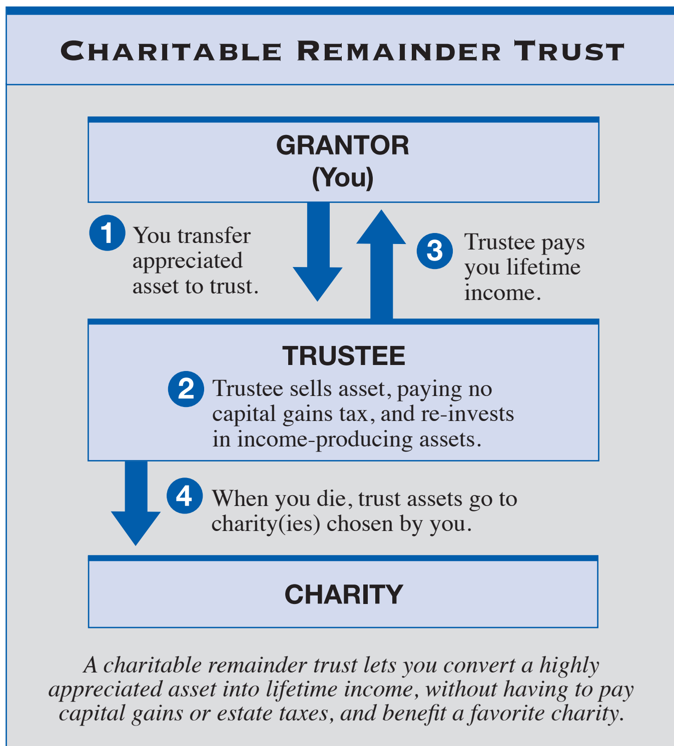
What does a CRT do?

A CRT lets you convert a highly appreciated asset like stock or real estate into lifetime income. It reduces your income taxes now and estate taxes when you die. You pay no capital gains tax when the asset is sold. And it lets you help one or more charities that have special meaning to you.

How does a CRT work?

You transfer an appreciated asset into an irrevocable trust. This removes the asset from your estate, so no estate taxes will be due on it when you die. You also receive an immediate charitable income tax deduction.

The trustee then sells the asset at full market value, paying no capital gains tax, and re-invests the proceeds in income-producing assets. For the rest of your life, the trust pays you an income. When you die, the remaining trust assets go to the charity(ies) you have chosen. That's why it's called a charitable *remainder* trust.



A charitable remainder trust lets you convert a highly appreciated asset into lifetime income, without having to pay capital gains or estate taxes, and benefit a favorite charity.

Why not sell the asset myself and re-invest?

You could, but you would pay more in taxes and there would be less income for you. Let's look at an example.

Years ago, Max and Jane Brody (ages 65 and 63) purchased some stock for $100,000. It is now worth $500,000. They would like to sell it and generate some retirement income.

If they sell the stock, they would have a gain of $400,000 (current value less cost) and would have to pay $60,000 in federal capital gains tax (15% of $400,000). That would leave them with $440,000. (See chart at right.)

If they re-invest and earn a 5% return, that would provide them with $22,000 in annual income. Multiplied by their life expectancy of 26 years, this would give them a total lifetime income (before taxes) of $572,000. Because they still own the assets, there is no protection from creditors and no charitable income tax deduction is available.

What happens if they use a CRT?

If they transfer the stock to a CRT instead, the Brodys can take an immediate charitable income tax deduction of $90,357. Because they are in a 35% tax bracket, this will reduce their current federal income taxes by $31,625.

The trustee will sell the stock for the same amount (see chart at right), but because the trust is exempt from capital gains tax, the full $500,000 is available to re-invest. The same 5% return will produce $25,000 in annual income which, before taxes, will total $650,000 over their lifetimes. That's $78,000 *more* in income than if the Brodys had sold the stock themselves. And because the assets are in an irrevocable trust, they are protected from creditors.

What are my income choices?

You can receive a fixed percentage of the trust assets (like the Brodys), in which case your trust would be called a charitable remainder *unitrust.* With this option, the amount of your annual income will fluctuate, depending on investment performance and the annual value of the trust.

The trust will be re-valued at the beginning of each year to determine the dollar amount of income you will receive. If the trust is well managed, it can grow quickly because the trust assets grow tax-free. The amount of your income will increase as the value of the trust grows.

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Comparison of Income After Sale

	Without CRT	With CRT
Current Value of Stock	$ 500,000	$ 500,000
Capital Gains Tax*	- 60,000	0
Balance To Re-Invest	$ 440,000	$ 500,000
5% Annual Income	$ 22,000	$ 25,000
Total Lifetime Income	$ 572,000	$ 650,000
Tax Deduction Benefit**	$ 0	$ 31,625

**15% federal capital gains tax only.*
(State capital gains tax may also apply.)
***$90,357 charitable income tax deduction times 35% income tax rate.*

Sometimes the assets contributed to the trust, like real estate or stock in a closely-held corporation, are not readily marketable, so income is difficult to pay. In that case, the trust can be designed to pay the *lesser* of the fixed percentage of the trust's assets or the actual income earned by the trust. A provision is usually included so that if the trust has an off year, it can make up any loss of income in a better year.

Can I receive a fixed income instead?

Yes. You can elect instead to receive a fixed income, in which case the trust would be called a charitable remainder *annuity* trust. This means that, regardless of the trust's performance, your income will not change.

This option is usually a good choice at older ages. It doesn't provide protection against inflation like the unitrust does, but some people like the security of being able to count on a definite amount of income each year. It's best to use cash or readily marketable assets to fund an annuity trust.

In either (unitrust or annuity trust), the IRS requires that the payout rate stated in the trust cannot be less than 5% or more than 50% of the initial fair market value of the trust's assets.

Who can receive income from the trust?

Trust income, which is generally taxable in the year it is received, can be paid to you for your lifetime. If you are married, it can be paid for as long as *either* of you lives.

The income can also be paid to your children for their lifetimes or to any other person or entity you wish, providing the trust meets certain requirements. In addition, there are gift and estate tax considerations if someone other than you receives it. Instead of lasting for someone's lifetime, the trust can also exist for a set number of years (up to 20).

Do I have to take the income now?

No. You can set up the trust and take the income tax deduction now, but postpone taking the income until later. By then, with good management, the trust assets will have appreciated considerably in value, resulting in more income for you.

How is the income tax deduction determined?

The deduction is based on the amount of income received, the type and value of the asset, the ages of the people receiving the income, and the Section 7520 rate, which fluctuates. (Our example is based on a 3.0% Section 7520 rate.) Generally, the higher the payout rate, the lower the deduction.

It is usually limited to 30% of adjusted gross income, but can vary from 20% to 50%, depending on how the IRS defines the charity and the type of asset. If you can't use the full deduction the first year, you can carry it forward for up to five additional years. Depending on your tax bracket, type of asset and type of charity, the charitable deduction can reduce your income taxes by 10%, 20%, 30% or even more.

What kinds of assets are suitable?

The best assets are those that have greatly appreciated in value since you purchased them, specifically publicly traded securities, real estate and stock in some closely-held corporations. (S-corp stock does not qualify. Mortgaged real estate usually won't qualify, either, but you might consider paying off the loan.) Cash can also be used.

Who should be the trustee?

You can be your own trustee. But you must be sure the trust is administered properly—otherwise, you could lose the tax advantages and/or be penalized. Most people who name themselves as trustee have the paperwork handled by a qualified third party administrator.

However, because of the experience required with investments, accounting and government reporting, some people select a corporate trustee (a bank or trust company that specializes in managing trust assets) as trustee. Some charities are also willing to be trustees.

Before naming a trustee, it's a good idea to interview several and consider their investment performance, ser

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vices and experience with these trusts. Remember, you are depending on the trustee to manage your trust properly and to provide you with income.

Do I still have some control?

Yes. For as long as you live, the trustee you select—not the charity—controls the assets. Your trustee must follow the instructions you put in your trust. You can retain the right to change the trustee if you become dissatisfied. You can also change the charity (to another qualified charity) without losing the tax advantages.

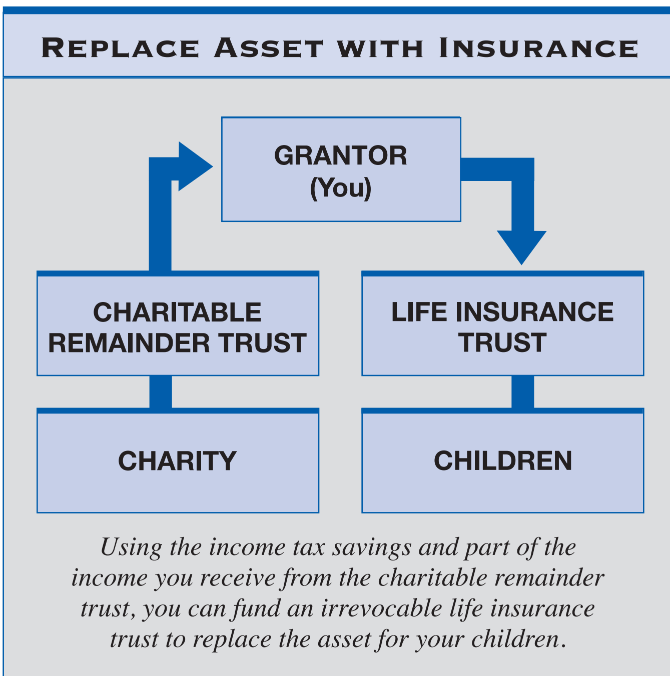
Can I make any other changes?

Generally, once an irrevocable trust is signed, you cannot make any other changes. Be sure you understand the entire document and it is exactly what you want *before* you sign.

Sounds great for me. But if I give away the asset, what about my children?

If you have a sizeable estate, the asset you place in a CRT may only be a small percentage of your assets, so your children may be well taken care of. However, if you are concerned about replacing the value of this asset for your children, there is an easy way to do so.

As the illustration below shows, you can take the



Using the income tax savings and part of the income you receive from the charitable remainder trust, you can fund an irrevocable life insurance trust to replace the asset for your children.

income tax savings, and part of the income you receive from the charitable remainder trust, and fund an irrevocable life insurance trust. The trustee of the insurance trust can then purchase enough life insurance to replace the full value of the asset for your children or other beneficiaries.

Why use a life insurance trust?

With a trust, the insurance proceeds will not be included in your estate, so you avoid estate taxes. You can keep the proceeds in the trust for years, making periodic distributions to your children and grandchildren. And any proceeds that remain in the trust are protected from irresponsible spending and creditors (even spouses).

Life insurance can be an inexpensive way to replace the asset for your children. (Every dollar you spend in premium buys several dollars of insurance.) Insurance proceeds are available immediately, even if you and your spouse both die tomorrow. And, in addition to avoiding estate taxes, the proceeds will be free from probate and income taxes.

So what's the catch?

There really isn't one. Combining a charitable remainder trust with an irrevocable life insurance trust is a winning formula for everyone—you, your children and the charity.

You convert an appreciated asset into lifetime income, and because you pay no capital gains tax when the asset is sold, you receive more income than if you had sold it yourself and invested the sales proceeds. You receive an immediate charitable income tax deduction, reducing your current income taxes. And by removing the asset from your estate, you reduce estate taxes that may be due when you die.

With the life insurance trust replacing the full value of the asset, your children receive much more than if you had sold the asset yourself, and paid capital gains and estate taxes. Plus the proceeds are free of income and estate taxes, and probate.

Finally, you will make a substantial gift to a favorite charity. And because the charity knows it will receive the gift at some point in the future, it can plan projects and programs now—benefiting even before receiving the gift.

Should I seek professional assistance?

Yes. If you think a charitable remainder trust would be of value to you and your family, speak with a tax-planning attorney, insurance professional, corporate trustee, investment

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