

Benefits of Establishing a Charitable Remainder Trust (CRT)

What is a Charitable Remainder Trust?

A Charitable Remainder Trust (CRT) is a special tax advantaged trust that can provide you with **increased** income for your entire lifetime, or for a term of years, and **significant** tax benefits. At your death or at the end of the term of years, the proceeds you put into the trust will then go to the charity of your choice and thus create a legacy that is yours alone. This type of trust plan allows you to reap gratitude from your favorite charity(ies) for your gift, joy because of giving, elimination of deferral of capital gains tax on assets contributed to trust, income and estate tax deductions, and an annual income level of your choice - partly regulated by your gift amount.



A LIST OF BENEFITS OF A CRT

The Charitable Remainder Trust (CRT) can be a very effective tool for maximizing a financial estate plan. Listed below are some of the ways a CRT can solve difficult financial/estate planning problems:

- Avoid capital gains tax on appreciated assets
- Increase income
- Obtain gift and estate tax deductions
- Designate specific charities to receive assets
- Diversify an investment portfolio
- Protect assets from creditors
- Increase retirement income
- Provide education funds for children/grandchildren
- Transfer a business to children or others

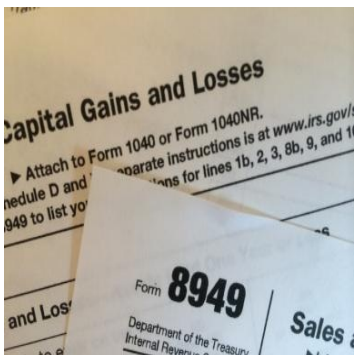
Let's take a closer look at some of these benefits:

- (1) **Capital Gains Tax Elimination.** As an investment appreciates, its earnings as a percent of the total value may *actually decline!* At that point, selling the investment and reinvesting the proceeds becomes a strong consideration, but, not without the problem of capital gains tax. The CRT, however, is in ideal method for a *tax free* investment since its principal is not subject to capital gains tax. Thus, the *full* amount received from the sale, inside the CRT, can be reinvested.

In defining "income" for a charitable remainder trust, you may choose the option of including only the ordinary income earned or the ordinary income plus capital gains realized after the date of contribution. What this means is that if you contribute stock worth \$1,000,000 with a cost basis of \$200,000, and then later sell the stock for \$1,100,000, the \$100,000 of appreciation since date of gift is considered income for distribution purposes, but not the appreciation from the original cost basis to the date of gift.

When one chooses to invest in a Portfolio that has a potential for substantial capital and little or no ordinary income, without defining capital gains as part of the income to be distributed, it would be very difficult to meet the income distribution requirements set forth in the document. For example, if there is an income distribution requirement of 5%, 7% or 8% it would be almost impossible in this day and age to invest assets to attain an ordinary income return of that magnitude. However, when considering the combination of realized capital gains and dividend interest income, a return of that percent is achievable.

Therefore, if you truly desire to have the higher return, we need to include capital gains realized from the date of gift as part of the income. There may be a degree of control as to when these assets are sold and the capital gain realized, so that the individual can control the year that this extra income will be received on a makeup provision.



The down side of selecting capital gains as part of income is in the annual computation of the return that accrues to the individual you must subtract from the value of the total CRT the amount of accrued deficit in income that has not been paid out to the individual from the value of the trust before you compute the annual return available to the individual. This deferral, of course, is limited to a maximum of the unrealized appreciation since date of gift that are part of the assets of the Charitable Remainder Trust.

- (2) **Increased Income.** Since the appreciated assets can be sold and all of the proceeds reinvested in new, higher-earning assets at a value not reduced by capital gains tax, you can quickly increase your income level. Moreover, the increased income earnings passed directly to you *and/or* your family members. Over a period of years, the family members can reinvest the additional income and acquire even greater economic security.

Example of Increased Income Benefit

You have \$100,000 in stock yielding 1% with a cost basis \$10,000 and you want to increase income. If you sell and reinvest at 7%, the results would be as follows:

Proceed from sale of stock	\$100,000
Capital Gains Tax (assume 24% federal, 6% state)	30,000
Net remaining to invest	<u>\$ 70,000</u>
Annual income on net remaining asset at 7%	<u>\$ 4,900</u>

If you put the same stock in a CRT, the CRT sells and invests at 7%. No capital gains tax and the whole \$100,000 is invested.

Annual income from CRT	\$ 7,000
Increase in annual income	\$ 2,100

Plus, you will save income taxes from the donation to the CRT which can be invested to produce additional income.

- (3) **Income and Estate Tax Deductions.** Even though the charity(ies) may not receive anything from your gift for many years, the IRS permits the Donor (the person who established the CRT) to receive an *immediate* income tax deduction. This deduction is determined by a formula utilizing (a) the value of the property endowed to the charity via the trust, (b) the donor's age and (c) the income payout amount which he has selected. Moreover, an additional gift/estate tax deduction is generally equal to the amount of the gift and proportionately reduces or eliminates the estate tax liability.



QUESTIONS AND ANSWERS REGARDING CRT'S

1. **What IRS rules govern the Charitable Remainder Trust?** Section 664 of the IRC provides the primary governing rules for the CRT.
2. **Who could benefit from a CRT?** Those with appreciated assets wanting to increase income, reduce their taxes and have charitable interests (or a combination of these) would most benefit from a CRT.
3. **How is the tax deduction calculated?** An IRS formula is used to determine the "future value of a present gift." This formula takes into account the present value of your gift, your age (as a donor) and the income payout you have chosen to receive. That criteria should determine the value of your gift actually received at a time *in the future* by the designated charity.
4. **Can I have the income go to my children or other persons?** Yes. A CRT can provide income for a donor's life plus for a term of years (not to exceed 20) to his children or others, after his death.
5. **Can I be my own trustee?** Yes. A donor can be his own trustee. It may be wise, however, for a donor to institute a co-trustee relationship with another having an understanding of a trustee's intricate duties (accounting, filing, etc.) with a CRT.
6. **What about using other assets besides cash or stocks to fund a CRT?** Almost any asset, without encumbrance, can be transferred to a CRT. Caution and assistance is usually needed, however, in transferring such assets as real estate, closely held stock, art objects, etc., because of special valuations, appraisals and reporting forms that are required.
7. **Can more than one charity be named as a charitable beneficiary of a CRT?** Yes, multiple charities can be named (even after you establish the trust) as beneficiary of a CRT provided they are qualified with the IRS. The CRT can contain an option allowing you to change charitable beneficiaries.
8. **Are there ongoing costs with a CRT?** Generally there is a need for annual filings of tax forms and asset valuations. Also, accurate records are imperative concerning the complex four-tier payout systems for your trust. We offer affordable, low cost services for you to choose from in these areas.
9. **How am I taxed on the income?** The type of income the trust earns is paid out to you in a specific order: first ordinary income, then capital gains, then tax free interest, and finally return of principal. The most common payouts come from ordinary income.
10. **Are contributions to the CRT revocable or retractable?** No. The IRS will allow (i) the avoidance of capital gains tax and (ii) current charitable deductions because there is an irrevocable guarantee that sometime, in the future, a gift will be received by a qualified charity that meets IRS standards.
11. **When will I receive income?** Income payouts can begin almost immediately and can be paid to you monthly, quarterly, semi-annually or annually.

12. **Can I transfer only a part of a particular asset into the CRT?** Yes. The CRT is an "open box." You may choose to fund only a part of your appreciated assets into the trust. At a later time you may transfer additional assets to the CRT, which will increase your income as well as your charitable deduction amount. The CRT can be an excellent vehicle to use for building retirement income by making annual contributions during maximum earning years.
13. **Is the CRT vulnerable to creditors?** No (unless a *fraudulent* transfer occurs). Because the CRT guarantees a future, irrevocable gift to charity, the principal is protected from any creditor claims. This can be important for those with potential nursing home or other possible creditor expenses.

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IRS Circular 230 Disclosure

Pursuant to recently enacted U.S. Treasury Department Regulations and to ensure compliance with the requirements imposed upon us by the United States Internal Revenue Service, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

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