

The Power of the Charitable Remainder Trust



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As people become better educated about the power and flexibility of the Charitable Remainder Trust (CRT), they are incorporating it more and more as an effective estate and financial planning tool. Everyone with substantial assets should look closely at the way a CRT might help them achieve their financial and charitable objectives.

The Potential Benefits of a Charitable Remainder Trust

- **Avoid or reduce taxes.**

- **Get a current income tax deduction.**

- **Receive a lifetime income.**

- **Leave an inheritance**

- **Benefit organizations to better your community.**

The CRT offers an array of benefits to people who establish one and allows people to achieve their financial and charitable objectives. These include the ability to avoid capital gains tax on the sale of appreciated assets... receive a current income tax deduction... reduce or eliminate estate taxes... increase current income... establish a charitable legacy, thereby creating a better community in which to live... and increase the value of assets passed on to heirs through an irrevocable life insurance trust or more commonly what is called a “wealth replacement trust.”

The CRT is one of the most powerful and flexible estate planning tools available to affluent and charitably-inclined individuals. When the CRT is introduced during the estate and financial planning process, people realize it will solve a variety of estate and financial problems. However, most want to know more about the CRT before they feel comfortable using it as one of their planning tools.

What is a Charitable Remainder Trust?

An irrevocable trust with an income beneficiary and a charitable beneficiary.

A CRT is an irrevocable tax-exempt trust. The split-interest trust has two parts. The first is the income interest — money paid to the person who established the trust (or his or her beneficiaries) for a term of years or the lifetime of the donor.

The second part is called the remainder interest — money that remains in the CRT after the end of the income interest. At that time, the remainder goes to the charitable organizations of the donor’s choice, possibly even a family foundation.

How the CRT Works.

Step

• A person establishes the trust...

Usually a donor establishes a CRT, naming the beneficiaries of both the income interest and the remainder interest. The donor can, and often does, name himself or herself as trustee of the trust as well as the income beneficiary. In this way, he or she retains control of the operation of the trust and the investment strategy. The donor must be mindful that if he is to act as his own trustee, he should employ an organization with specialized CRT administration capabilities.

Step 2

• Gives an appreciated asset to it...

Next, the donor gives to the trust some asset—appreciated stocks, bonds, real estate, mutual funds or even personal property. These assets, if sold outright, would create a capital gains tax to the seller. However, by giving them to the CRT, the assets can be sold by the trust, avoiding capital gains tax. What's more, the charitable gift creates a current income tax charitable deduction.

Step 3

• Then sells the asset and invests the proceeds.

• The donor receives income for life...

The trustee (or donor/trustee, if the same person) then sells the asset tax-free on behalf of the CRT, and invests the proceeds in a suitable investment. The trust then begins to pay an income, based on the selected payout percentage of the assets, to the income beneficiaries for the life of the trust. Meanwhile, if the trust is able to earn more than the payout rate, the trust will continue to grow in value, increasing the future income interest and the future benefit to charity.

Step 4

• And the trust balance goes to charity at the end of the specified term or the second death.

Finally, at the death of the income beneficiary (or the end of some other specified term), the remainder of the trust's assets go to the chosen charities. The not-for-profit organizations utilize the assets to solve problems or expand opportunities to make society better.

The abundant financial benefits of the CRT

The financial benefits of a CRT are abundant:

• Avoidance of capital gains tax

When a person establishes a CRT, a tax-free “environment” is created for the sale of highly-appreciated assets. Why are highly-appreciated assets the most desirable gifts? Because, no capital gains tax is due when the trust sells highly-appreciated assets and diversifies the trust investments.

• Immediate income tax deduction

Giving an asset to a CRT creates an immediate income tax charitable deduction. The amount of the deduction is based on several variables, including the value of the asset given to the CRT, ages of the income beneficiaries, selected payout rate, type of CRT and the IRS discount rate in effect at the time the CRT was funded.

• Reduced estate tax

At the death of all income beneficiaries or at the end of a specified term, the remainder of the CRT’s assets pass directly to charity, creating an estate tax charitable deduction that helps minimize the estate tax. With estate tax rates as high as 50%, this can be a significant savings.

• Increased benefits for heirs in conjunction with a wealth replacement trust

A frequent concern of the donor, who is considering a trust, is that by putting his money in a CRT, he would be giving away his heirs’ inheritance. However, when used in conjunction with a wealth replacement trust, a CRT can replace or actually increase the benefits to the heirs. The wealth replacement trust is normally funded with a life insurance policy on the life of the donor, or a second-to-die policy on the donor and his or her spouse. The policy’s premiums are usually paid out of the CRT’s income tax savings and/or the increased income stream generated by the trust. Thanks to this wealth replacement trust used in conjunction with the CRT, the heirs will receive an inheritance that has not been reduced by estate taxes.

• Increased lifetime income

Since the donor selects the payout rate and the asset given is usually low-yielding, the income received from the CRT often doubles, triples or even quadruples. The income continues for the lifetime of the donor or a term of years, whichever is selected.

The charitable vision of the CRT

... and personal and family significance.

Along with the financial benefits already discussed, a CRT also provides charitable benefits and personal satisfaction. All people want their community to be a better place in which to live. They recognize the many benefits of a positive community environment. Often these people voluntarily support organizations whose work they wish to further. Those organizations can range from churches to children's hospitals to universities to community foundations — and everything in between — as long as they are a qualified charitable organization.

Beyond meeting community needs, many people also feel a personal need to achieve some sort of significance beyond their own lives. They want to “give something back” to the community in which they've grown and prospered, and to help guarantee the longevity of this goodness and community spirit.

Giving and sharing with others strengthens and renews the donor's body, mind and spirit. In a sense, the donor, through giving, has identified the values important to him in life. The CRT is one of the best vehicles to help the donor focus on the true meaning of his life.

The CRT is your social capital tool

A CRT is a way to establish a legacy of community betterment.

Social capital is the wealth you can't keep...

...but can direct with a CRT.

As you have learned, the CRT is a powerful tool to help you control wealth — including wealth that you created or managed that would otherwise go to taxes. This wealth is called social capital, because it goes to meet the needs of society. Typically, you lose this hard-earned social capital to taxes, which the government then uses to pay for its own priorities.

But by using a CRT to capture, direct and manage your social capital, you, not the government, make the choice as to what causes you want your money to support. That's why we call the CRT a social capital tool: a tool to help you maximize the value and make the best use of the wealth you must ultimately give back to society.

Now that you know some of the basics about CRTs, here is an example of how a typical couple might use one to control their social capital to achieve a number of goals.

How one couple controlled their social capital with a CRT

Charlie and Grace own highly-appreciated stock...

Charlie, 62, and his wife Grace, 60, own highly-appreciated stock originally purchased for \$1 per share. The stock is publicly traded, pays a 2% dividend and is currently valued at \$25 per share. As a result, if they sell this stock, they will be faced with substantial capital gains tax. Charlie and Grace realized that once they retire they will receive an inadequate cash flow from this investment.

They want a lifetime income...

Charlie plans to retire within the year, so naturally he is beginning to consider some estate planning alternatives.

Want to leave something to their children...

Charlie and Grace expect to be in the maximum 50% federal estate tax bracket. Because of this they are concerned about what will be available to their heirs. They wish to pass the maximum amount possible to their children. However, they also want to give a charitable gift to the local college's medical research school.

And want to make a gift to the local college.

To achieve their three goals of sufficient income, an inheritance to their children and a gift to the college, Charlie and Grace first cre-

They establish a trust and name themselves trustees and income beneficiaries...

ated a charitable remainder trust designed to pay them 7% of its value each year. Next, they named themselves income beneficiaries (and trustees as well), and named the medical school as charitable beneficiary. At the same time, they established a second-to-die life insurance trust (wealth replacement trust) outside of the estate to assure their children the amount of the inheritance they wished to leave them.

Then give some stock to the trust...

The next step was to give 50,000 shares of stock to the trust. Acting as trustees, they then sold this stock and invested the proceeds in a suitable investment portfolio. Their yearly payout of 7% would be based on the value of the portfolio; and if the portfolio continued to grow, the payout would increase accordingly. This payout of 7% is considerably more than the 2% dividend income outside of the trust. In round numbers, their income increased from \$25,000 in dividends from their stock to \$87,500 of income from their trust.

Sell the stock and invest the proceeds...

Many other applications

Get an income tax deduction...

Upon transferring the stock to the CRT, they received a charitable deduction of about \$240,000, which should result in federal income “tax savings” of approximately \$93,000. Out of these “savings” and some of their increased income they paid necessary premiums on the life insurance policy so that their wealth replacement trust would, at their death, pay the desired inheritance to their heirs — estate-tax free.

and buy life insurance to fund the wealth replacement trust.

They achieve all their goals.

In the end, the combination of the CRT and wealth replacement trust met all of Charlie and Grace’s goals:

- Avoid capital gains tax on the sale of the stock;
- Reduce estate taxes by removing the stock from their taxable estates;
- Generate an increased lifetime stream of retirement income;
- Leave a larger inheritance by means of a wealth replacement trust; and
- Leave a valuable gift to support the work of the college’s research school.

You can see that the CRT was an excellent tool for turning appreciated assets into retirement income and an increased inheritance to the children — just one of the many uses of this most versatile planning tool.

The CRT can be used by people of all ages.

While in our example Charlie and Grace used a CRT to turn their stock into retirement income, this is by no means the only use of a CRT. Indeed, a CRT can be used by people of all ages, who hold a variety of assets (land, securities, personal property, etc.) and have many different financial circumstances and charitable objectives. For example, a CRT could be used by:

With different kinds of assets...

Different personal circumstances...

- A couple in their fifties with appreciated farmland that they wish to turn into retirement income, without having to pay the capital gains tax that they would have to face in an outright sale and could defer income until retirement.

Different financial objectives...

- A corporate stockholder who wants to diversify to create a more balanced portfolio and then control the income stream through investments, without facing the capital gains tax consequences of a stock sale and large estate taxes at death.

- A person with a large IRA balance or other substantial qualified funds who is concerned about significant income, estate and penalty taxes that will be due at his or her death, leaving only 25 cents on the dollar as an inheritance, and who wishes to control the timing and amount of mandatory withdrawals in order to minimize income tax and leave as much of the IRA as possible to the children.

And, different charitable interests.

- A young professional couple whose qualified pension plans will not provide sufficient retirement income, and who wish to put some of their earnings toward a “supplemental” retirement income and want the flexibility of naming the charities in their wills.

These are just a few of the many ways a Charitable Remainder Trust can be utilized. Because of its great flexibility and the multiple advantages described here, the CRT deserves careful consideration as a part of any long term planning.

As a result of the Tax Reform Act of 1969, the CRT was defined by I.R.C. Section 664 of the tax code.

This publication illustrates, in a general way, how a charitable remainder trust may be used in an estate plan to achieve a number of charitable and financial objectives. However, the information provided to you is neither legal nor financial advice. This publication is for educational purposes only. For specifics on financial, legal and other technical aspects of charitable remainder trusts, such as the one shown here, a qualified financial advisor, an estate planning attorney or other advisor should be consulted.



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