

# CHARITABLE REMAINDER TRUSTS

## WHY MAKE CHARITABLE GIFTS

Many people like the idea of charitable giving. So why don't more people make charitable gifts?

The majority of the population does not believe they have the resources to give to charity without suffering themselves. Others feel they would be neglecting their duty to family members by giving their assets away.

Charitable Remainder Trusts ("CRTs") provide a tool which enables people to provide gifts to charity without decreasing their standard of living, or neglecting commitments to family members.

## HOW CHARITABLE REMAINDER TRUSTS WORK

There are many different forms a Charitable Remainder Trust may take. Basically, a Charitable Remainder Trust allows a Grantor to put an asset into trust for the eventual benefit of a certain charity. The trust then provides the Grantor, and possibly the Grantor's spouse and children, with an income stream for life or a specific period of time, not to exceed 20 years, with the remainder of the trust passing to the charity at the death of the last beneficiary.

The Grantor has the benefit of taking a charitable income tax deduction at the time the Charitable Remainder Trust is created and funded.

## WHAT ASSETS CAN BE USED TO FUND THE TRUST

The trust need not be funded with cash. The Grantor may transfer real estate, securities, or an interest in a closely held corporation. The most beneficial assets to transfer are highly appreciated or income-generating assets.

The trustee of the Charitable Remainder Trust could sell the appreciated asset and fund the trust, or

hold the income generating asset to fund the annual payment to the beneficiaries. If the trustee sells an appreciated asset, the trust does not incur the capital gains tax that would have been incurred by the Grantor, if he or she had sold the asset himself or herself.

## WHO MAY SERVE AS TRUSTEE

Often times, a Grantor will select a corporate trustee, such as a bank or trust company, to be the trustee of the Charitable Remainder Trust. The advantages of banks and trust companies are that they specialize in managing trust assets and have experience with investments and the accounting required for the trust. However, the Grantor may be his or her own trustee if he or she feels that he or she has the ability to handle the trust assets and to provide the best benefit to the beneficiaries.

## TAX AND ESTATE PLANNING ADVANTAGES

From a tax and estate planning viewpoint, the Charitable Remainder Trust has significant advantages. As mentioned above, most Charitable Remainder Trusts are funded with highly appreciated or high income-generating assets. The long term effect is that this asset has been taken out of the Grantor's estate, thereby reducing the possible estate tax due at the Grantor's death. Also, if the trust is funded with a significantly appreciated asset, the Grantor has converted this asset into an income stream for life without incurring capital gains tax on the sale of the asset.

Note that if the Charitable Remainder Trust is established to provide income to the Grantor's children for life, or for a specified period of time not to exceed 20 years, there may be a gift tax due when the trust is created. The gift tax will be assessed on the value of the income stream that will pass to the children. However, the gift tax may be avoided if the Grantor retains the right to revoke the interest passing to the children prior to the Grantor's death.

## ADVANTAGE OVER SELLING AND REINVESTING

The following chart illustrates the advantages of creating a Charitable Remainder Trust over selling the asset and reinvesting. Assume Mr. and Mrs.

	Current Result	Sale and Reinvest	8.00% CRT
Value of Real Estate	\$200,000	\$200,000	\$200,000
Less Tax on Sale	0	46,800	0
Remainder to Reinvest	200,000	153,200	200,000
Annual Return	0%	8%	8%
Annual Income	\$0	\$12,256	\$16,000

Grantor own a piece of real estate worth \$200,000, with a basis of \$20,000.00. The real estate is presently not generating any income. At most, it is appreciating at 1% per year.

If Mr. and Mrs. Grantor sell the property for \$200,000, they will incur a gain of \$180,000. They will have to pay capital gains tax of approximately \$46,800 (20% federal capital gains + 6% state capital gains). This will leave Mr. and Mrs. Grantor with only \$153,200 in proceeds to reinvest. Assuming that they reinvest at 8%, their annual return will be approximately \$12,256 before taxes.

If Mr. and Mrs. Grantor create a Charitable Remainder Trust and transfer the real estate to the trust, the trustee will sell the property for \$200,000. They will incur no capital gains tax. The trustee will have the full \$200,000 in proceeds to reinvest. Assuming that the trustee reinvests the proceeds at 8% and the trust pays Mr. and Mrs. Grantor 8% annually, Mr. and Mrs. Grantor will receive approximately \$16,000 per year before taxes, with \$200,000 of principal remaining intact to be transferred to a charity.

## CHARITABLE DEDUCTION

In the example above, Mr. and Mrs. Grantor will receive an immediate charitable income tax deduction. Note that if Mr. and Mrs. Grantor sell the property and reinvest, they will not receive a charitable income tax deduction.

The charitable income tax deduction is calculated by looking at the net fair market value of

	Current Result	Sale and Reinvest	8.00% CRT
Charitable Deduction	\$0	\$0	\$33,550*

the property at the time it is transferred to the Charitable Remainder Trust, less the present value of the payment stream to be received by the non-charitable beneficiaries of the trust. The present value of the payment stream is calculated with tables prescribed by the IRS using such variables as the age of the beneficiaries, the amount of the annual payment, and the current applicable federal rate of interest ("AFR").

\* The charitable deduction shown above (\$33,550) was calculated assuming a \$200,000 Charitable Remainder Trust, grantors aged 60 and 58 at the time of the gift, an 8.00% annual payment, and an AFR of 7.6%.

## ESTATE TAX CONSEQUENCES

Another significant aspect of the example of Mr. and Mrs. Grantor's possible gift to charity will be the estate tax consequences. As is illustrated in the following table, by utilizing the Charitable Remainder Trust, Mr. and Mrs. Grantor reduce their estate by \$200,000 and avoid approximately \$80,000 in estate taxes.

Note that although the estate taxes are reduced

	Current Result	Sale and Reinvest	8.00% CRT
Included in Estate at death	\$200,000	\$158,000	\$0
Estate Tax (40% marginal Rate)	\$80,000	\$63,200	\$0

if Mr. and Mrs. Grantor choose to sell and reinvest, when netted with the capital gains tax that they will incur when they sell the asset, the total taxes for this scenario will be in excess of \$100,000.

**TYPES OF CHARITABLE REMAINDER TRUSTS**

There are several different types of Charitable Remainder Trusts. Much of the decision making regarding which type of trust to create will depend on the Grantor’s preference for a guaranteed income stream versus an income stream that may vary annually.

A **Charitable Remainder Unitrust** will return a *fixed percentage* of the trust assets each year. The trust assets will be valued annually to determine the payment to be distributed to the non-charitable beneficiaries.

The beneficiaries’ return will increase or decrease depending on the performance of the investments. Some Grantors feel this type of trust is more advantageous because it provides a hedge against inflation; income grows as the trust assets grow.

However, if there is a concern that the asset transferred to the trust may be unproductive, the trust may provide for the payment of the lesser of the *trust income* or the *fixed percentage*, with a provision allowing for any deficiencies to be made up in the future, in a year in which there is ample income to satisfy the deficiency. Also, the unitrust may allow for additional contributions to the corpus of the trust.

A **Charitable Remainder Annuity Trust** is very similar to the Charitable Remainder Unitrust in most respects. The basic difference is that the Annuity Trust returns a *fixed dollar payment* based on a specific percentage of the *initial value* of the trust assets, where the Unitrust return fluctuates based on the value of the assets *each year*. Also, additional contributions may not be made to an

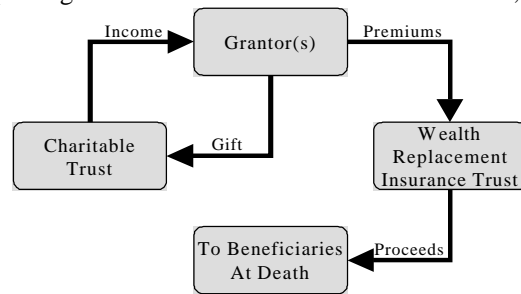
Annuity Trust.

With the Annuity Trust, the annual payments to the beneficiaries will remain the same regardless of the performance of the investments. Some Grantors feel that the risk involved with this alternative is that the trust corpus may decrease too drastically in years in which the investments do not produce as much.

The Annuity Trust, however, is usually the best option for older Grantors because it provides the security of receiving a definite annual income.

**REPLACEMENT OF LOST WEALTH**

If a Grantor is hesitant to create a Charitable Remainder Trust because it will decrease the assets passing to the children at the Grantor’s death, an



Irrevocable Life Insurance Trust may provide reassurance. This strategy is generally referred to as **Wealth Replacement**. Wealth Replacement is a method of replacing values passing to charitable beneficiaries by using savings from the charitable income tax deduction to purchase life insurance. This allows the Grantor to maintain the values passing to the Grantor’s children.

As illustrated in the above flowchart, a Grantor may use a portion of the annual income from the Charitable Remainder Trust, along with the benefit of the charitable income tax deduction, to fund an Irrevocable Life Insurance Trust. The Life Insurance Trust will then purchase an insurance policy on the Grantor’s life equal to the value of the assets transferred to the Charitable Remainder Trust.

The children will be the beneficiaries of the Life Insurance Trust and the proceeds of the life insurance will not be included in the Grantor’s taxable estate because policy is owned by the Trust.

The proceeds of the life insurance will replace the assets that are being given to charity at the Grantor’s death. Also, since the life insurance proceeds will pass through the Life Insurance Trust to the children, rather than going through the Grantor’s estate, probate is avoided.

**SEEKING ADVICE**

If you feel that a Charitable Remainder Trust may be a useful vehicle for you to achieve your charitable giving goals and to provide a steady income for retirement, you should speak with your estate and tax planning professionals for advice as to the type of assets you should use, etc.

A Charitable Remainder Trust is an irrevocable trust. You must be sure that you are satisfied with the provisions and the documents *before* you sign. Make sure that an experienced attorney prepares and reviews the necessary trust documents.



# Charitable Remainder Trusts

For more information, or to speak with someone about a Charitable Remainder Trust, contact:

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