

# Charitable Trusts

## **Standard Charitable Remainder Trust**

A guide to one of the most flexible financial planning strategies available today

*Do you own an asset - such as real estate or stock - that you no longer want or need because. . .*

**It produces too little income.**

**It takes too much time and effort to manage.**

**It's too concentrated - and you'd like to diversify your portfolio.**

*Or, is it something you hesitate to sell because. . .*

**Its sale would create a substantial tax liability.**

**It has sentimental value to your family.**

*Would you like to be able to use it to create. . .*

**An ongoing stream of income for yourself and anyone else you name.**

**Significant current and future tax savings.**

**An endowment for a favored charity or foundation.**

*If so. . .*

**You should consider creating a *tax-exempt charitable remainder trust*.**

These trusts were created by Congress as part of the tax code in the late 1960s in order to encourage gifts to religious, educational and community support organizations. They offer numerous benefits and an extraordinary degree of financial planning flexibility.

This brochure describes various types of charitable remainder trusts and how they might enhance your financial plan. However, because these exciting financial vehicles are so flexible - which is why they can be designed to reflect your circumstances and wishes so exactly - we suggest you talk with your financial advisor. He or she can provide the guidance you'll need to select and create the most appropriate trust for you.

## **What Is A Charitable Remainder Trust?**

**When you create a charitable remainder trust you:**

***Receive increased current income*** from a diversified portfolio of investments.

***Protect assets from creditors***, to the extent of applicable law.

***Receive an income tax deduction*** based on the fair market value of your property.

***Avoid capital gains tax*** on your property when it is sold by the trust.

***Create federal estate and gift tax savings*** for your heirs.

***Create an endowment*** for the charity or charities of your choice.

A charitable remainder trust is a separate legal entity, specifically authorized by Congress. It can enable you to simultaneously make a charitable gift, enjoy a tax deduction, remove taxable assets from your estate and generate income for yourself, your family, or anyone else you choose -- for life, or for a specified period.

Upon your death and/or the death of all other beneficiaries, the remaining assets in the trust go to the charity(ies) you named. These may include churches, not-for-profit universities, hospitals and community foundations -- or, you can set up your own family foundation. In addition, you can reserve the right to change the named charities anytime during your life, or by will.

### **Protection from creditors**

There are two main types of charitable remainder trusts; the charitable remainder unitrust and the charitable remainder annuity trust.

#### **Charitable Remainder Unitrust**

This trust pays a percentage of the trust's value every year as income to you or to others you name. You select the percentage when you create the trust. The amount of income must be no less than 5 percent of the fair market value of trust assets, valued annually. You may make as many contributions as you wish to this type of trust. Following the death of the beneficiaries, or at the conclusion of the term of years specified by you in the trust, the trust property goes to the charity(ies) or foundation(s) you named.

#### **Charitable Remainder Annuity Trust**

This trust provides a set dollar amount each year to you and to those you name. The annual payment must be 5 percent or more of the initial value of assets in the trust, and it continues for the life of all income recipients, or for a specific term of years (not to exceed twenty). Then, the remainder goes to the charity(ies) or foundation(s) you named. Unlike the unitrust, charitable remainder annuity trusts allow only one contribution.

### **Benefits Of A Charitable Remainder Trust**

A properly designed trust can help you realize:

#### **Increased income**

By donating an asset to the trust that produces little or no income (land or a low dividend stock, for example), and having the trust then sell that asset and purchase a portfolio of higher yielding assets, you can substantially increase your income as a beneficiary of the trust. Some people use a portion of this additional income to pay for life insurance owned by a life insurance trust. The proceeds from that insurance pass tax-free to heirs, replacing the value of the assets contributed to the trust. The chart below illustrates how the trust generates these benefits.

#### **Diversification**

By contributing one large asset and having the trust purchase suitable investments, you can take advantage of one of the time-tested principles of successful investing: diversification. A diversified portfolio tends to even out returns and lessen volatility, producing more dependable gains and more consistent income.

#### **Protection From Creditors**

Many individuals are justifiably concerned about protecting their assets from creditors. By contributing assets to an appropriately drafted trust, you can receive all of the benefits of a charitable remainder trust and protect your assets from any future claims.

### **A personal or family legacy**

A charitable trust can serve as one of the key elements of a successful charitable and estate plan. As the creator of a charitable remainder trust you can enjoy personal satisfaction and recognition for contributing to a worthy cause in your community, your house of worship, or a favored college or university -- without giving up the benefit of lifetime income from the wealth you have produced. And a charitable remainder trust often can be tied to testamentary family foundations, which your children or other family beneficiaries can manage for years to come.

### **Tax Benefits**

One of the prime benefits of a charitable remainder trust is tax savings.

For example, a charitable remainder trust will generally provide tax benefits in the following areas:

#### **An income tax deduction**

Contributions to organizations which qualify as 501(c)(3) organizations under the Internal Revenue Code are usually tax deductible. Contributions to most foreign charities are not deductible. The amount of the tax deduction depends on several factors: the value of the trust property, the amount of income or the percentage of principal paid annually by the trust, the age of those receiving trust-generated income, and discount rates set monthly by the IRS.

#### **No immediate capital gains tax**

Assets contributed to the trust can be sold free of any income taxes to you. This is especially important if you have a highly appreciated asset in your portfolio. A highly appreciated asset may include stocks, bonds, mutual funds, real estate, collectibles, or artwork which was purchased or inherited some years ago. You can usually take a tax deduction based on the asset's full market value. Hence, not only do you avoid paying capital gains tax, but the size of your tax deduction is equal to a percentage of what you paid for the asset *plus* its increased value.

#### **Federal estate and gift tax savings**

A charitable remainder trust can save you substantial amounts of estate and gift taxes (which can be as high as 55 percent). Assets in the trust are not subject to estate and gift taxation.

#### **How the tax advantage works**

John Smith, age 59, owns non-dividend paying stock which he received from a trust at the death of his mother. The stock is worth \$100,000, but has a tax cost basis of \$10,000. John and Mary, his wife, also age 59, wish to diversify their portfolio, increase their income, and create tax deductions. They are in the 36 percent federal tax bracket.

John donates the stock to a charitable remainder unitrust with a 5 percent payout for their joint lives. Based on their ages and the payout rate, John and Mary would receive a charitable income tax deduction of \$29,615, which would reduce their taxes by \$10,661 in the year they create the trust. Further, assume the trust sells the stock and invests in a high quality growth and income fund earning a total return of 10 percent. John and Mary will receive a growing stream of income, compounding at better than 5 percent, which should outpace inflation.

Alternatively, if John donates the stock to a charitable remainder unitrust with a 5 percent payout for his life, they would receive a tax deduction of \$40,857, which would reduce their taxes by \$14,709 in the year they create the trust. The income flows and appreciation of trust principal would be the same. John could use a portion of the income to purchase life insurance for Mary's benefit should he predecease her.

*NOTE: The tax deductions in the above example will vary depending on the ages of the donor(s), their life expectancy(ies) and the IRS discount rate, which is reset monthly.*

## **Where Do You Begin?**

1. First, you need to determine whether you're a good candidate for a charitable trust. Factors to consider include your age, net worth and the level of income you expect in the years ahead. Any financial goals you have in mind for children or other beneficiaries should also be considered.
2. Next, you'll want to consider several important questions before you decide how to make your gift and to whom. For example, you must decide whether you will donate appreciated property, such as securities in your portfolio, or cash.
3. As mentioned, to avoid pitfalls for the unwary, you'll need to be aware of the intricacies surrounding the area of charitable contributions.
4. And finally, you'll need to select a trustee to administer your trust who has specific experience and expertise in charitable trusts -- so that as time goes on, your trust will remain fully qualified and continue to meet your objectives.

### **Start with your advisor**

Perhaps you'd like to enrich the organizations that share your philosophical, social or religious beliefs. Maybe you'd like to create new programs that will meet specific needs in your community. Or perhaps you'd like to receive the recognition, business advantages or personal satisfaction that can come from making a deferred gift during your lifetime.

These and many other goals can be achieved with a charitable remainder trust. But a charitable remainder trust is not a do-it-yourself project. Complicated, ever-changing tax laws have made the process of charitable giving somewhat complex for even the most sophisticated.

That's why it's so important to utilize the services of a professional financial advisor. With the kind of experienced help your financial advisor can provide, you will be able to design a trust that will meet your needs.