

The Charitable Remainder Trust

A Gift and an Income



Every charitable gift can bring you personal satisfaction—the joy of knowing that you have helped ensure the financial future of charitable causes you feel are important.

However, certain charitable gifts can provide tangible results as well as intangible ones. With careful planning, a tool known as the charitable remainder trust can provide both a good, solid lifetime income and immediate tax benefits for you and your family.

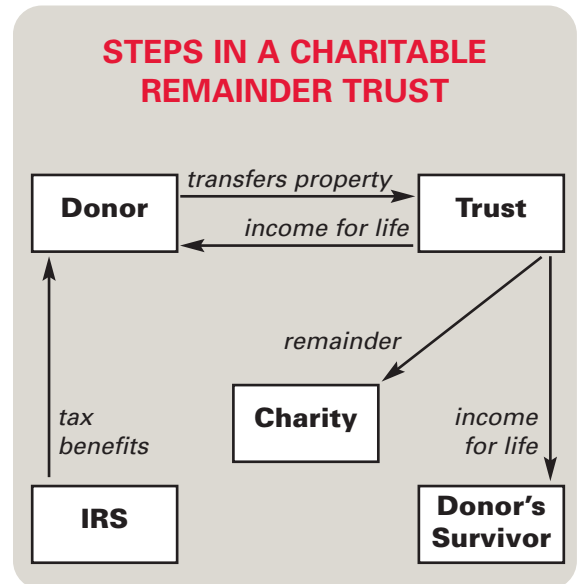
Indeed, you may find that a charitable remainder trust can increase your retirement income, help you escape from a locked-in investment position, and provide more security for you and your family—all this, while still helping to achieve your charitable goals.

Understanding the Charitable Remainder Trust

The charitable remainder trust is a popular and time-tested method of making a generous deferred gift to a charitable organization that you want to support.

You transfer money or property to an irrevocable trust you create with the help of an attorney. You name the beneficiaries of the trust (yourself, your spouse, or someone else important to you). The trust will pay a yearly income based on the value of the assets in the trust (either set at the time you create the trust or varying from year to year). The trustee will make the income payments for as long as you or other designated beneficiaries may live, or for a specific term of years up to 20. Once the trust term ends, the remaining assets in the trust are paid to the designated charitable beneficiary.

The chart shows the four steps in a typical charitable remainder trust.



1. The donor transfers property to the trust and gains several immediate tax benefits.
2. The trustee invests the property and the trust pays an annual income to the donor for life.
3. The donor can choose to direct the trust to pay an income to a second beneficiary after the donor's death.
4. When the income payments end, the trust assets are distributed to benefit our institution.

An Illustration

Mary transfers assets worth \$400,000 to a charitable remainder annuity trust and directs that \$20,000 be paid to her each year for as long as she lives. The assets will be invested by the trustee during Mary's life, and both income and principal may be used to make the annual payments. After Mary's death, the trust will end and the property remaining in the trust will be paid to our institution.

Mary is assured an income of \$20,000 annually from the trust for as long as she lives. Mary gains an immediate and substantial tax savings because she can deduct, as a charitable contribution, the present value of our institution's remainder interest in the trust.

Mary will not incur a current capital gains tax when she transfers appreciated property to the trust, even if the trustee immediately sells the property. In short, she can convert appreciated property to a stream of income without an immediate capital gains tax liability.

CONVERTING AN ASSET TO PRODUCE A HIGH INCOME

Peter (age 76) owns appreciated stock worth \$300,000. The growth stock provides little income, but it has appreciated tremendously in value since Peter bought it some years ago for \$50,000.

Peter could sell the stock, but he would incur capital gains taxes of \$37,500. If he invested the after-tax sales proceeds of \$262,500 in CDs earning 2%, he would realize an income of \$5,250 that year.

On the other hand, Peter can transfer the appreciated stock to a charitable remainder annuity trust that will pay him \$15,000 (5%) a year and also give rise to an income tax charitable deduction of \$167,375.* Peter's charitable deduction will result in a tax savings of approximately \$54,000 in his 33% tax bracket.

The tax savings (by avoiding immediate capital gains and taking a charitable deduction) and the annual lifetime payouts make the charitable remainder annuity trust a smart option for Peter. The fact that what money is left in the trust will go to our organization makes it a generous option as well.

**Example assumes an AFR of 2.4% and an annual payout.*

BENEFIT #1— A Lifetime Income

As noted, a charitable remainder trust provides a lifetime income to the donor or other beneficiaries designated in the agreement. The income can be a fixed sum of money (an annuity trust) or a fixed percentage of the value of the trust as redetermined each year (a unitrust). In most cases, the trust will make payments for the life of the beneficiary, but payments can also span a set number of years, up to 20.

Income payments typically equal 5% of the value of the trust (whether an annuity trust or a unitrust), but the amount is up to you. Within the limits set by federal law, you can choose the amount that will accomplish your personal objectives.

Some donors want an income that will vary with the value of the trust assets. Under the unitrust arrangement, the trust assets are revalued each year and a specified percentage of the value is paid to the donor or other beneficiary. A unitrust can be a hedge against future inflation, but there is the risk that trust assets may decline in value.

Donors who prefer the stability of a fixed-dollar amount of income for as long as they live choose the annuity trust.

BENEFIT #2— An Immediate Income Tax Charitable Deduction

The most obvious tax benefit produced by the charitable remainder trust is a federal income tax charitable deduction. Even though the charitable institution will receive no benefits until the termination of all the income interests, the donor can deduct the present value of the deferred charitable interest, subject to the general limitations of federal tax law.

Computing the charitable deduction depends in part on the particular applicable federal rate, or AFR, in the month of the gift and the two preceding months. Generally speaking, the higher the AFR, the larger the charitable deduction for a charitable remainder annuity trust. We can provide you with the exact figures for a proposed gift.

BENEFIT #3— Avoidance of Capital Gains Tax

Under today's tax laws, a charitable remainder trust can be especially rewarding if you fund it with appreciated property. You will not have any capital gains tax liability either when you transfer the property to the trust or when the trustee sells the property. When the trust makes its annual income payout, part of that payout may be taxed as capital gain depending on how the trustee invests the assets.

Perhaps you own securities that provide little or no income, but have appreciated significantly in value. You can transfer the securities to a charitable remainder trust that will pay you a high income for your lifetime and you may not pay capital gains tax, even though, in most cases, your charitable deduction will be based on the property's full fair market value.

The ability to convert a low-income producing asset into a high-income producing asset without incurring a capital gains tax is a distinct benefit.

Planning Your Charitable Remainder Trust

Although the tax benefits of a charitable remainder trust can be very advantageous, it is important to determine whether the trust will fit into your broad estate, tax and financial plans. Fortunately, the charitable remainder trust is extremely flexible.

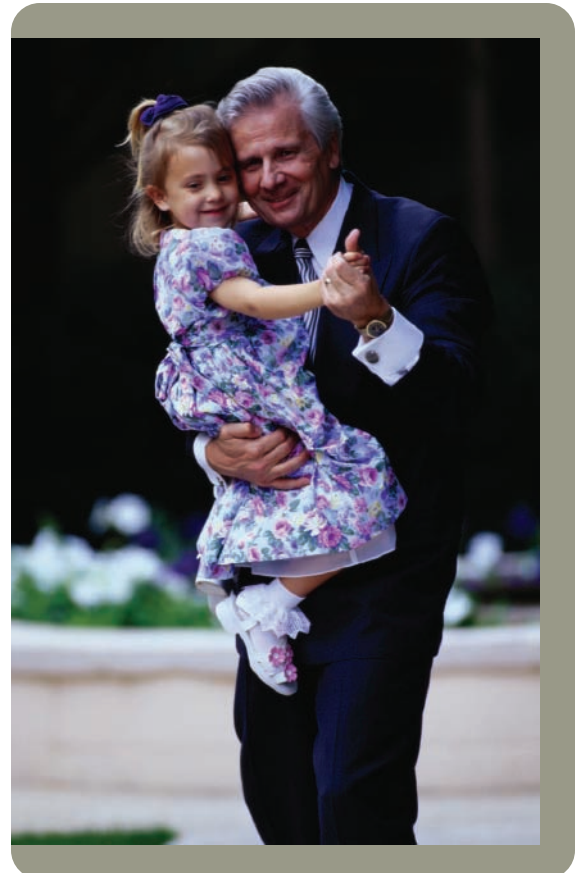
You name the income beneficiaries. You can name yourself or anyone you wish as the income beneficiary of the trust, as long as the calculated value of the charitable remainder interest is at least 10%. If you like, you can

direct that the income benefits be paid to you for your life and then to your spouse for his or her life, or you can name one or more of your children as beneficiaries.

Caution: Naming a third party (other than your spouse) as beneficiary may have gift tax consequences. Donors should always consult their tax advisors.

You set the exact percentage that will be paid each year. A donor typically sets the percentage of the annual trust payout. According to federal tax law, the percentage must be at least 5% and no more than 50%.

You elect a fixed or variable income. While we have focused on the fixed-dollar income (annuity trust), you may very well prefer a variable income (a unitrust) that can keep pace with inflation. You can set up some unitrust arrangements to effectively defer the annual payments until retirement, when you want additional income and you may be in a lower tax bracket.



A HIGH INCOME FOR RETIREMENT

Richard transfers undeveloped real estate worth \$500,000 to a charitable remainder unitrust that will pay him, for his lifetime, 5% of the value of the trust, or trust income, whichever is less.

Because Richard is 55 and does not need immediate income, the trustee will retain the real estate that has great growth potential but produces no income inside the trust.

Ten years from now, the property is expected to be worth much more. At that time, the trustee will sell the real estate and invest the proceeds in high-yielding securities. Richard will begin to receive 5% of the value of the trust each year.

This annual payment will be a very substantial addition to his retirement income when he reaches age 65. He also gains an immediate tax deduction, which significantly reduces his current income tax liability.

Furthermore, he is delighted that his trust arrangement will provide a major gift to a charitable institution he has long supported.

You select the property transferred to the trust. There may be real advantages to funding your trust with appreciated property, especially if the property currently produces little or no income. But there may also be advantages to funding your trust with cash, certificates of deposit, closely held stock or other properties. We can explain the tax consequences that will result from the choice of properties transferred to the trust, but the decision is yours to make with your attorney.

You name the trustee. You can name the trustee—your bank, your attorney, a family member, etc.

A Final Word

The charitable remainder trust is flexible—you can tailor it to meet your individual needs and objectives. It can be a vital and rewarding part of your financial, retirement and estate planning. It can be a means of increasing your own spendable income or providing a reliable income for another person while carrying out your philanthropic objectives.

We will be pleased to give you further information about the tax benefits and flexibility of the charitable remainder trust. There is, of course, no cost or other obligation. Feel free to contact us at your convenience.