The Power of the Charitable Remainder Trust

AXA EQUITABLE

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 charitable organizations to better your community

The CRT offers an array of possible benefits to people who establish one and allows people to help achieve their financial and charitable objectives. The possible benefits include:

- Avoiding the capital gains tax on the sale of appreciated assets in the year the assets are sold
- Receiving a current income tax deduction
- Reducing or eliminating estate taxes
- Increasing current income
- Establishing a charitable legacy, thereby creating a better community in which to live

In the right circumstances, 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 can 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. This brochure is intended to introduce you to CRTs. Please consult your legal or tax advisors for a complete description of the terms and conditions applicable to CRTs.

IMPORTANT NOTE

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) provides for federal estate and gift tax rate reductions and higher exemption amounts scheduled to take effect gradually from 2002 to 2009, and repeal of the federal estate tax in 2010. However, the law under EGTRRA expires on December 31, 2010. Unless future legislation is enacted to extend the provisions of EGTRRA, the law prior to EGTRRA, including the federal estate and gift tax rates and exemption amounts, will apply beginning on January 1, 2011.

Please be advised that this document is not intended as legal or tax advice. Accordingly, any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed, and you should seek advice based on your particular circumstances from an independent tax advisor.

WHAT IS A CRT?

A CRT is an irrevocable tax-exempt trust. It is also a split-interest trust that has two parts. The first part is the income interest — money paid to the person who established the trust (or his or her beneficiaries) for a term of up to 20 years or the lifetime of the donor and/or other designated individuals, such as the donor's spouse.

A CRT is an irrevocable trust with an income beneficiary and a charitable beneficiary.

The second part is called the remainder interest — money that remains in the CRT after the term of the trust. When the trust terminates, the remainder goes to the charitable organizations of the donor's choice, possibly even a family foundation.

HOW THE CRT WORKS

1. Usually a donor or donors establish a CRT, naming the beneficiary of both the income interest and the remainder interest. The donor can 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 or she is to act as the trustee, he or she should consider employing an organization with specialized CRT administration capabilities.

2. Next, the donor typically gifts to the trust some appreciated assets, such as stocks, bonds, real estate, mutual funds, or other types of property. Generally, these assets, if sold outright, would create capital gains tax to the seller for the year the assets are sold. By gifting them to the CRT, the assets can be sold by the trust so that the donor does not pay capital gains tax on these assets in the year the assets are sold. What's more, the charitable gift may create a current income tax charitable deduction for the present value of the remainder interest given to a charity (subject to the usual limits on charitable deductions).

3. The trustee (or donor/trustee, if the same person) then sells the assets on behalf of the CRT without paying capital gains taxes 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 or for a term of years not to exceed 20. Meanwhile, if the trust is able to earn more than the payout rate, the trust will continue to grow in value, increasing the future benefit to charity, and possibly increase the future income interest.

4. Finally, at the end of the term of the trust, or at the death of the income beneficiaries, 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 POTENTIAL FINANCIAL BENEFITS OF THE CRT

When a person establishes a CRT, a current tax-free "environment" is created for the sale of highly appreciated assets.

The potential financial benefits of a CRT include:

- Avoiding the payment of capital gains tax in the year the assets are sold
- Immediate income tax deduction
- Reduced estate tax
- Lifetime income to the donor or term of years

Why are highly appreciated assets the most desirable gifts? Because they can be sold by the trust and the entire proceeds used to purchase diversified investments without paying capital gains tax in the year the assets are sold. Capital gains that are recognized by the CRT when the assets are sold may be recognized by the income beneficiaries over the term of the trust.

Gifting an asset to a CRT creates an income tax charitable deduction (subject to the limits on charitable deductions). The amount of the deduction is based on several variables, including the value of the asset gifted to the CRT, term of the trust or the ages of the income beneficiaries (if created for life), selected payout rate, type of CRT and the IRS discount rate in effect at the time the CRT was established.

Because the remainder of the CRT's assets pass directly to charity, the value of such remainder is not included in the donor's estate. With estate tax rates that may be as high as 55 percent, this can be a significant savings.

A frequent concern of the donors who consider gifting assets to a CRT is they would be giving away their heirs' inheritance. However, gifting assets to a CRT in conjunction with a wealth replacement trust with their heirs as beneficiaries possibly replaces or increases the benefits to the heirs. The wealth replacement trust is an irrevocable trust that is normally funded with a life insurance policy on the life of the donor, or a second-to-die policy on the lives of both the donor and his or her spouse. The policy premiums are usually gifted by the donor(s) to the wealth replacement trust from the income tax savings and/or the income stream generated by the CRT. Thanks to the wealth replacement trust used in conjunction with the CRT, the heirs may be able to receive an inheritance that is not reduced by the gift to charity.

Since the donor selects the payout rate, and generally the asset gifted to the CRT is usually low-yielding, the income received by the income beneficiaries (typically the donors) from the CRT may be more than the income they received from the asset. The income continues for the lifetime of the income beneficiary (typically the donor) or a term of years not to exceed 20, whichever is selected as the term of the trust.

THE CHARITABLE VISION OF THE CRT

Along with the potential financial benefits already discussed, a CRT also provides charitable benefits and personal satisfaction.

All people desire to see that their communities are made better places 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 want to help guarantee the longevity of this goodness and community spirit.

A CRT is a way to establish a legacy of:

- Community betterment and
- Personal and family significance

The donor, through giving, has identified the values important to him or her in life. The CRT is a vehicle to help the donor focus in on the true meaning of his or her life.

THE CRT IS YOUR SOCIAL CAPITAL TOOL

As you have learned, the CRT is a powerful tool to help you control wealth — including wealth 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, are making a choice as to what causes you want your money to support. That's why we call the CRT a social capital tool.

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.

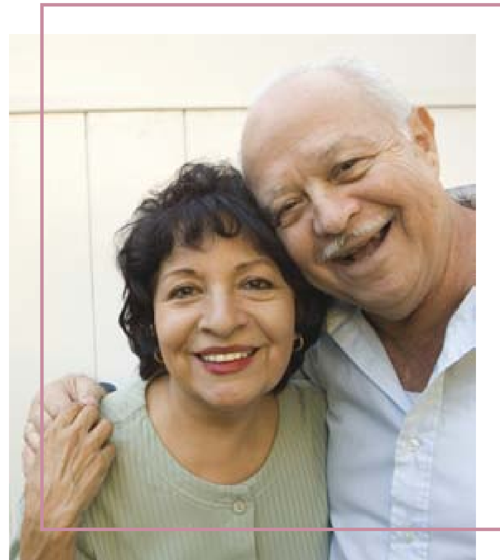
HOW ONE COUPLE CONTROLLED THEIR SOCIAL CAPITAL WITH A CRT

Hypothetical Example:

Charlie, 62, and his wife Grace, 60, own 100,000 shares of stock originally purchased for $1 per share. The stock is publicly traded, pays a two-percent dividend and is currently valued at $25 per share. As a result, if they sell this stock, they will be faced with paying capital gains tax in the year the stock is sold. Charlie and Grace realize that once they retire, they will receive an inadequate cash flow from this investment. Charlie plans to retire within the year, so naturally he is beginning to consider some retirement and estate planning alternatives.

Charlie and Grace expect to be in the maximum 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. To achieve their three goals of sufficient income, an inheritance to their children and a gift to the college, Charlie and Grace first create a wealth replacement trust for their heirs that buys second-to-die life insurance that is outside their estate. This is intended to replace the assets in the CRT in order to assure their children/heirs the inheritance they wish to leave them.

Next, they establish a Charitable Remainder Trust (CRT) designed to pay them seven percent of its value every year. Capital gains that are recognized by the CRT when the assets are sold may be recognized by the income beneficiaries over the term of the trust. They name themselves as the income beneficiaries of the CRT and name the medical school as charitable beneficiary.



The next step is to give 50,000 shares of stock to the CRT. The trustees sell the stock and invest the proceeds in a suitable investment portfolio. Their yearly payout of seven percent would be based on the value of the portfolio; and if the portfolio continues to grow, the income they receive will increase accordingly. Alternatively, if the value decreases, the income stream will decrease. This payout of seven percent is considerably more than the two-percent dividend income from the stock. In round numbers, their income would increase from $25,000 in dividends from the stock to $87,500 of income from the CRT.

Upon transferring the stock to the CRT, they receive a charitable deduction of about $250,000, which should result in federal income tax “savings” of approximately $82,000. This assumes a federal income tax marginal rate of 33%. If they cannot use the entire deduction in this year, they can carry the remaining deduction over for the next five years.

Out of these “savings,” and some of their increased income, they make gifts to the wealth replacement trust. The gifts are used to pay premiums on the life insurance policy, so that the wealth replacement trust will, at their death, pay the desired inheritance to their heirs — estate tax free.

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

- Reduce current income tax with a charitable contribution deduction
- Avoid paying all of the capital gains tax in the year the stock is sold
- Reduce estate taxes by removing the value of the stock from their taxable estates
- Generate an increased lifetime stream of retirement income
- Leave an inheritance to their heirs by means of a wealth replacement trust
- Leave a valuable gift to support the work of the college’s medical research school

You can see the CRT and a wealth replacement trust, as used by Charlie and Grace, are excellent tools for turning appreciated assets into retirement income, a tax-free gift to a charity, and an inheritance to their children — just some of the many uses of these most versatile planning tools.

MANY OTHER APPLICATIONS

While Charlie and Grace, in our example, 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 an advantage for people of all ages who hold a variety of assets (land, securities, other types of property, etc.) and who have many different financial circumstances and charitable objectives.

For example, a CRT can be used by:

- A couple in their fifties with appreciated farm land they wish to turn into retirement income...without having to pay, in the year it is sold, all of the capital gains tax they would have to face in an outright sale, and who could defer receiving income until retirement
- A young professional couple whose qualified pension plans will not provide sufficient retirement income, and who wish to put some of their other assets toward a "supplemental" retirement income
- A corporate stockholder who wants to diversify his or her portfolio without paying all of the capital gains tax in the year the stock is sold, and the large estate taxes at death

These are just a few of the many ways a CRT 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 Section 664 of the I.R.C.

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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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