LEGALLY SPEAKING

CHARITABLE REMAINDER TRUSTS

For those individuals with a desire to provide charitable benefits to non-profit organizations, the use of a charitable remainder trust can be a very effective way for a taxpayer to minimize both income and estate taxes, retain the income benefits from contributed property and eventually benefit the taxpayer's favorite charity.

If properly structured, the charitable remainder trust ("CRT") is a vehicle which can accomplish a number of objectives, namely: 1) reduce income taxes through a charitable deduction, 2) create a stream of income, 3) avoid capital gains on appreciated contributed property, 4) remove assets from the taxpayer's estate, and 5) eventually provide financial support for a non-profit organization.

With a CRT, the income is retained for the person(s) who established the CRT (the "donor"), or other individuals selected by the donor, normally for life; and upon the death of the donor or the selected income beneficiaries, the remaining assets in the trust pass to the designated charity. Even though the charity does not actually receive the assets at the time of the contribution to the CRT, the donor still receives an income tax charitable deduction at the time of the contribution equal to the current value of the remainder interest which eventually passes to the charitable organization. This value is based on IRS tables which consider the age of the donor (or the ages of the other individuals who are receiving the lifetime income interest), the amount of the income retained, and the current interest rates.

The amount of the retained income from a CRT depends on the type of CRT established. There are basically two types of CRTs: a charitable remainder unitrust and a charitable remainder annuity trust.

Under the unitrust, the income beneficiary receives a set percentage of the fair market value of the assets of the CRT each year. As an example, if the CRT has $1,000,000 of assets at the beginning of the year, and the document provides that the income beneficiary is to receive 6% per year, then $60,000 is distributed to the income beneficiary for the year regardless of the actual income earned by the CRT during that year. If the value of the CRT's assets increases, then the amount of annual income distributed to the income beneficiary will also increase in following years. The Internal Revenue Code requires that the minimum percentage that the unitrust can pay each year is 5%, and that the minimum present value of the remainder interest that eventually passes to the designated charitable organization is 10% of the value of the assets initially contributed to the CRT. Because of the limitations established by the IRS for a unitrust to qualify as a CRT, it is normally not feasible to establish an unitrust for younger individuals. There are some variations of the unitrust available if the donor/income beneficiary desires to limit his or her initial income from the CRT to the actual income earned by the CRT, or if the CRT initially holds non-marketable assets.

Under the annuity trust, a set dollar amount is paid each year to the income beneficiary regardless of the income earned by the CRT and regardless of the value of the CRT's assets. Under the annuity trust, the amount of annual income paid to the income beneficiary does not change over the term of the CRT. The Internal Revenue Code requires that the amount of the annual payment cannot be less than 5% or more than 50% of the amount of the initial contribution to the CRT. Once an annuity CRT is established, the donor is not able to make any further contributions to the trust.

The use of the CRT is particularly useful in the situation where an individual is holding appreciated property which he or she intends to sell. By transferring the appreciated property to the CRT which then sells the property, the capital gains tax which the taxpayer would otherwise be required to pay can be avoided, and the entire sale proceeds will remain with the CRT and be available to provide a higher income stream for the income beneficiary. There are, however, certain additional

limitations on the amount of income tax charitable deduction available to a taxpayer when appreciated property is contributed to a CRT. However, the benefit from not having to recognize the capital gains on the appreciation of the contributed property normally outweighs the limitation on the amount of available income tax charitable deduction.

If the CRT provides that the principal is distributed to the charity upon the death of the donor/income beneficiary, the estate of the donor will receive a estate tax charitable deduction for the entire value of assets remaining in the CRT. If the CRT is continued to be held for a subsequent income beneficiary (i.e. a child), the donor's estate will receive an estate tax charitable deduction for the present value of the remainder interest that eventually passes to charity; and the estate will be required to pay the estate taxes, if any, on the present value of the income interest provided to the child.

The CRT may also be combined with other estate planning techniques to allow the donor to reduce the effect of the charitable gift on the amount of his or her children's inheritance. In certain instances, the savings from the income tax charitable deduction may be available to be reinvested in an insurance policy. The donor will then use the insurance proceeds to replace the amount of the charitable gift, and allow the donor's children to receive approximately the same amount of inheritance. The insurance should, in that instance, be acquired through an insurance trust which, if properly structured, is excluded from the donor's taxable estate. Therefore, through the proper use of the CRT and an insurance trust, the donor is able to remove an asset from the donor's taxable estate by making a charitable contribution, retain the income from the contributed property for the donor's lifetime, and use the income tax savings from the contribution to acquire an insurance policy which is estate tax free.

While the above structure is permitted by the current Internal Revenue Code and its regulations, the implementation of a CRT is complex. The CRT is not for everyone, and normally the donor should have a particular fact scenario, as well as a charitable intent, in order to fully appreciate the benefits available through a CRT.

Many non-profit organizations actively promote the CRT and will often provide the basic documentation necessary to establish a charitable remainder trust. However, since the charitable remainder trust is irrevocable and cannot be changed once it is implemented, it is important that you consult with an attorney who is knowledgeable in this area to insure that the CRT works in the manner you intend.

CONTACT US FOR ADDITIONAL INFORMATION

The foregoing discussion gives you a brief overview of what a CRT is, the advantages it offers, and how it works. It is a valuable estate planning tool for both donors with taxable estates, and for others who wish to take advantage of the specific benefits a CRT has to offer.

Santerre & Vande Krol, Ltd. devotes a substantial part of its legal practice to estate planning, and if you have questions concerning a CRT or its application to your specific situation, please contact us to discuss your questions.

To contact Santerre & Vande Krol, Ltd. by phone, please call (480) 991-3990.

The offices of Santerre & Vande Krol, Ltd. are located at:

**7920 E. Thompson Peak Parkway, Suite 150
Scottsdale, Arizona 85255**