CHARITY BEGINS AT HOME

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HOW TO DO WELL FOR YOURSELF BY DOING GOOD FOR OTHERS

Americans are some of the most generous givers on the face of the planet. They reach into their pockets and take out their checkbooks on behalf of others more often than any other industrialized nation.

It's quite possible that tax breaks are one reason why. According to a study by the Washington D.C.-based Independent Sector, tax breaks are important, both to the givers and the receivers. For example, the study clearly shows that giving goes up dramatically when a tax break is available to the donor. People who itemize their tax returns give an average of 3.5 times more to charity than those who do not itemize. And itemizers who intend to claim a charitable deduction give 6.1 times more than those who don't intend to claim the deduction.[1]

Nationally, charitable contributions make a thunderous plunk in the collection plate. In 2017, individuals were the largest source of charitable giving, contributing a total of $286.65 billion. [1] American corporations followed suit, and gave a total of $20.77 billion.

The recipients of this largesse depend heavily upon American generosity. There are approximately 1.6 million tax-exempt organizations in the United States. Public charities reported in excess of $1.73 trillion of total revenues in 2015, with a large percentage of that total coming from contributions, gifts and grants. [2]

So, there's a lot at stake for all concerned when it comes to encouraging charitable giving in America. And the Charitable Remainder Trust is one of the most popular ways Americans can donate to their favorite cause while doing well for themselves and their families.

HOW THE CHARITABLE REMAINDER TRUST WORKS

Whether you are a budding philanthropist looking for the best way to contribute to society, or an investor looking for strategies to maximize income and tax breaks, the Charitable Remainder trust offers a powerful solution to your needs. It combines current charitable income tax deductions and future estate tax deductions with the opportunity to avoid capital gains tax on a highly appreciated asset. It then goes one step further to provide you with a new source of income.

A Charitable Remainder Trust delivers best results when benefactors have a highly appreciated asset—such as real estate or stocks—that provides little or no income.

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[1] https://www.nptrust.org/philanthropic-resources/charitable-giving-statistics
Giving USA 2016, *The Annual Report on Philanthropy for the year 2016*

[2] https://www.urban.org/sites/default/files/publication/72536/2000497-The-Nonprofit-Sector-in-Brief-2015-Public-Charities-Giving-and-Volunteering.pdf (2015)

Owning such an asset is a double-edged sword. You can't sell the asset without experiencing the costly bite of state and federal capital gains taxes. On the other hand, if the asset is still in your estate when you die, it will increase your estate taxes.

Of course, you could donate the asset directly to charity and gain an immediate charitable income tax deduction. In one fell swoop, you'd reduce the value of your estate—and thus future estate taxes—as well as avoid capital gains taxes. But you'd miss out on an opportunity to maximize your income.

The Charitable Remainder Trust neatly overcomes these problems.

When you create your Charitable Remainder Trust, you transfer your highly appreciated asset to your trust. The asset is usually sold, with the proceeds used to buy income-producing investments. Then, each year for the rest of your life, you'll receive income from your Charitable Remainder Trust. When you die, your designated charity will receive whatever remains in your trust. Hence the name: Charitable Remainder Trust.

The incentives for using the Charitable Remainder Trust include:

- An immediate charitable income tax deduction based upon the fair market value of the asset given away (reduced by your received interest—or future income and subject to normal percentage limitations applied to itemized deductions);

- An opportunity to put the full value of your appreciated asset to work for you and avoid the costly impact of capital gains taxes;

- A new source of income;

- And a charitable estate tax deduction on the full fair market value of the asset you've donated to the charity when you die.

It may sound like the Charitable Remainder Trust is a complex legal tool. But just the opposite is the case. Working with your estate planning attorney, you can set one up in fairly short order.

After deciding which charity you want to support, you then decide who will serve as trustee. The trustee can be you, a bank or trust company, or anyone else of your choosing. The trustee will assist in the valuation of the asset you contribute and will follow your precise directions laid down in your trust documents.

Next, you decide who will receive income from your Charitable Remainder Trust and for how long. This isn't optional; it's mandatory. According to the IRS, at least one beneficiary other than

the charity must receive income each year. So, determine if you will be the only beneficiary, or if your spouse or children will receive income after you die. Lastly, you decide how you want to receive your income, and how much you will receive each year.

GIVE AND YOU WILL RECEIVE

Your answers to these last questions will prove critical in determining exactly what type of Charitable Remainder Trust you choose. Which one will depend on your temperament as an investor?

For instance, conservative investors who want a predictable income year after year may prefer the Charitable Remainder Annuity Trust—or CRAT for short. You may make only one contribution to your CRAT, which will provide you a fixed annual income, regardless of the investment performance of your asset. Because your tax deductions and income are based on the value of the asset as of the day it was transferred to the trust, the CRAT is probably better suited to assets you suspect will lose value in the years ahead.

Regardless of the economic winds, your income is guaranteed. So, if your asset doesn't earn enough to pay your annual income, the principal will be used to make up the difference. On the other hand, if the markets turn bullish and your asset outperforms your expectations, the surplus will be added to the principal.

With a CRAT, you will be paid an annual income equal to at least 5%, and no more than 50%, of the asset's fair market value, determined on the day it was transferred to your trust. So, if you donated a stock portfolio valued at $250,000 on the day it was transferred to your Charitable Remainder Trust, your annual income would be a minimum of $12,500. There's an upper limit to how much you can receive each year, but it isn't as simply stated. It has to do with your lifespan (as well as the life spans of any other beneficiaries) and other factors. Your estate planning attorney will help you determine exactly how much your annual income from a CRAT may be each year.

The chief drawback of the CRAT is also its strength; it protects the donor against swings in the financial markets. In a stagnant or declining market, the donor comes out ahead. But in a strong market experiencing investment growth, it's the charity that will ultimately benefit the most. That's why donors who hold more bullish views on investing will prefer the Charitable Remainder Unitrust.

The Charitable Remainder Unitrust (CRUT) offers a couple of advantages over the CRAT. First, unlike the CRAT, you may make as many contributions as you like to your CRUT. And for the sake of determining annual income, it is the asset's current fair market value—not its value on the date it was transferred to the trust—which is used in the calculations.

As for its income opportunities, the CRUT allows the benefactor to ride the financial markets and enjoy the investment performance of the trust assets. That means, of course, that in some years you may receive less, other years more. When lean years keep you from receiving your full due, a "make-up provision" can allow for additional income in future years to make up for the shortfall.

The CRUT requires that the donor receive a minimum income of 5% of the asset's current fair market value, and not more than 50%. You can also opt to receive your chosen percentage or the trust's net income, whichever is less.

Clearly, donors who want income from their charitable contribution and who don't mind riding the winds of economic change will find plenty of appeal in the CRUT.

WHAT ABOUT YOUR HEIRS?

So far we've focused on the ample benefits that the Charitable Remainder Trust offers you. But what about your heirs? After all, you've given away a piece of their legacy in order to gain income and tax advantages for yourself today.

One frequently employed solution is the *Irrevocable Life Insurance Trust*. When used in concert with the Charitable Remainder Trust, it provides your heirs with an income-tax-free legacy equal to the full value of the asset you donate to charity. Here's how it works.

After you establish your Irrevocable Life Insurance Trust, your trustee then purchases a life insurance policy on your life with your heirs as beneficiaries. Usually, the death benefit of this policy is equal to the value of the asset you've given away. The cost of the policy can be offset by income generated by your Charitable Remainder Trust or the charitable income tax deduction you receive. Upon your death, your heirs will receive an income-tax-free death benefit.

Why do it this way, rather than just owning the policy outright? Because the proceeds of a policy owned in your name at your death will be included in the value of your estate for estate tax purposes. Considering that estate taxes kick in at a 40% rate, life insurance policy could expose your estate to a sizable tax bite. (For more information, see the Academy report, *The Irrevocable Life Insurance Trust*.)

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.

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