The Power of Charitable Remainder Trusts

Do well by doing good

A growing number of individuals and families want to use some of their wealth to support the causes and organizations they care about most. From helping those less fortunate to facilitating scientific breakthroughs, from providing safe habitats for wildlife to sharing the arts, philanthropy is a core value for many.

Of course, it's important to engage in *smart* philanthropy. Using certain tools and strategies can help you have a much bigger charitable impact than you otherwise could—while simultaneously enhancing your own financial flexibility.

In short, philanthropic planning can help you—as the old saying goes—"do well by doing good."

With that in mind, here's a closer look at one philanthropic tool that many charitably minded people and families use: charitable remainder trusts. CRTs can be extremely useful and powerful wealth planning tools that allow you to have a major impact on a charity you value while also providing benefits like lower taxes and a regular income stream.

The ABCs of a CRT

Let's start with some CRT basics and benefits.

- **INCOME STREAM.** You place appreciated assets in a CRT, which then provides an annual income stream. You can designate yourself or other people to receive that income. The income stream can last for your life or the lives of the people you designated. You can also have the income stream last for a term of years (within limits).
- **TAX DEDUCTION.** When you create and fund the CRT, you get an income tax deduction—the size of which is based on the actuarial value of the remainder that the charity should receive.
- **CAPITAL GAINS TAX AVOIDANCE.** You can gift appreciated assets to a CRT without paying capital gains taxes. For example, say you have $1 million worth of stock that you bought 20 years ago for $200,000. You could sell that stock—and pay $160,000 in capital gains taxes (assuming a 20 percent rate)—leaving you with $840,000 to use for your philanthropy. Or you could gift the shares to the CRT and pay no capital gains taxes at all—funding the trust with the full $1 million.
- **TAX-DEFERRED GROWTH.** The assets in the CRT grow tax-deferred. You are taxed only on the income you receive from the CRT.
- **CHARITABLE IMPACT.** Once the term of years is up or the last beneficiary dies, the income stream stops and the assets that remain in the trust go to one or more charities you selected.

TYPES OF CRTs

Charitable remainder annuity trusts. With a CRAT, you or your designated recipient receive a fixed dollar amount from the trust every year. However, once you set the amount, it cannot be changed. Say, for example, you set the annual amount at $15,000. That is all you can receive every year, even if the assets in the CRAT are growing at a tremendous rate. Additionally, you cannot add assets to a CRAT once it's set up and funded.

Charitable remainder unitrusts. With a CRUT, you (or the person you designate) receive a percentage of the current value of the assets in the CRUT. Example: You specify that you want to receive six percent of the assets in the trust annually. Every year, the assets are reappraised and you get six percent of that amount. Another difference: You can add more assets to a CRUT.

CRAT vs. CRUT

Type	Income distributions	Additional contributions
Charitable remainder annuity trust (CRAT)	A fixed amount each year	Not allowed
Charitable remainder unitrust (CRUT)	A fixed percentage based on the assets in the trust, revalued annually, which means income will fluctuate	Allowed, if governing trust instrument permits and unitrust amount takes into account the additional contribution

You can use a wide variety of assets to fund a CRT. Some examples include:

- **Cash**
- **Stocks and bonds**
- **Some types of closely held stock (such as limited liability corporations, but not S corporations)**
- **Real estate**
- **Artwork and collectibles**

NOTE: The more appreciated the assets used to fund the trust, the more advantageous the tax deferral becomes.

Case studies

To see the potential power of a CRT, consider this example of funding a CRT with private stock before selling a business:

> **A business owner in their 40s plans to sell her business this year and anticipates the sale proceeds will be close to $5mil.**
>
> - **Her cost basis is near zero, which means close to all of the $5mil will be subject to long-term capital gains tax.**
> - **If she cashed out, she would have to pay capital gains taxes of 23.8 percent on the $5 million of appreciation—leaving her with a tax bill just shy of $1.2mil.**
>
> **Instead, she and her advisors set up a CRUT, which enables her to add more assets in the future. The CRUT will last the shorter of 20 years or her lifetime. She will receive 12 percent of the assets each year—or just over $600,000 the first year. Over the course of 20 years, using assumptions of a return of 8 percent annually, she will receive approximately $8 million. She will also receive a $500,000 charitable deduction to offset other income. And at the end of the 20-year term, the charitable organization she chose will receive approximately $1.94mil.**

To see the potential power of a CRT, consider this example of funding a CRT with highly appreciated stock with very low basis:

> **A family matriarch has $1.2mil of ten highly-appreciated individual stocks that the family has had for many decades.**
>
> - **The basis is only $200,000 and she does not want to sell the stock and pay the capital gains tax as she is in her 70's.**
> - **In addition, she really wants to diversify out of the ten individual stocks as she does not like their volatility.**
> - **Lastly, she feels 'handcuffed' from selling the stock due to the tax and would really like to get more income from these 'dead assets.'**
>
> **She and her advisors set up a CRAT and fund it with $500,000 of the most highly appreciated stocks. She receives $60,000 per year of annuity income for the remainder of her life and she received a $220,000 charitable deduction to offset other income. In addition, once the stocks are in the CRAT, she can prudently diversify into a globally allocation portfolio with much less volatility. At the end of her life, the charitable organization she chose will receive approximately whatever assets remain in the CRAT.**

Two caveats

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THE RIGHT INTENTION IS CRUCIAL.

If you use a CRT, you must have a genuine charitable intent. The reason: A CRT is an irrevocable trust—once you put assets in a CRT, you cannot get them back.

2

IT'S NOT A PERSONAL PIGGY BANK.

At least 10 percent of the actuarial value of the CRT must go to charity. A CRT that does not meet the 10 percent remainder requirement is not a qualified charitable remainder trust and will lose its tax benefits.

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Founder and CEO

Financial Harvest Wealth Advisors with our professional networks has successfully helped clients in situations described above mitigate taxes, increase income, and maximize charitable impact. If you, a loved one or colleague would like to discuss possible opportunities, please give us a call.

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