

## ***Charitable Remainder Trusts – Part Deux***

In last month's article, the basics of Charitable Remainder Trusts (CRTs) were discussed. This month's article will build upon the example set forth in that article and illustrate the tax savings to the Smiths of their contribution. Additionally, this article will show how CRTs can be used for estate and financial planning purposes.

Recall that the Smiths contributed \$500,000 worth of Smith, Inc. stock and the remainder interest, which passed to charity, was valued at \$197,000. A few more facts about the Smiths are necessary to illustrate the tax implications to the couple of the CRT. Mr. Smith has a pension from Smith, Inc. of \$100,000 per year payable for his life with a \$50,000 annual payment to Mrs. Smith, if she survives him. He and his wife also receive a limited amount of Social Security and, prior to the creation of the CRT, nominal interest and dividends. Most of their \$3 million of net worth was concentrated in Smith, Inc. stock, on which no dividends were paid. Finally, the Smiths marginal federal income tax rate is 30%.

In the year of the contribution to the CRT, the Smiths will be entitled to deduct from their Federal income taxes the value transferred to charity, \$197,000. However, recall from the prior article that their actual deduction will be limited to 30% of their AGI, which is estimated to be \$150,000 (pension of \$100,000, CRT distribution of \$25,000 and miscellaneous other income of \$25,000). Consequently, in the year of the contribution, their deduction will be \$45,000 (30% of \$150,000). The excess contribution of \$152,000 (\$197,000-\$45,000) can be carried forward by the Smiths for up to five years. Consequently, over the course of a little more than four years, the Smiths will be able to deduct the entire contribution.

### **Benefits Can Be Substantial**

At a marginal income tax rate of 30%, the contribution of \$197,000 will save the Smiths over \$59,000 in income tax over the four prior years. Thus, the actual cost to the Smiths of the \$500,000 contributions was approximately \$440,000, an amount that they will get back from the CRT in less than 15 years considering the growth of the CRT. Another benefit of the CRT to the Smiths is that it solves a financial planning need of Mrs. Smith, if she survives her husband, since she would continue to receive 5% of the CRT annually for the balance of her life. Without the CRT, after Mr. Smith's death, Mrs. Smith would have very little income.

### **Insurance Option**

If the Smiths did not have any potential cash flow problems, they could elect to contribute their annual distribution from the CRT to an irrevocable trust for their heirs.

In such a case, an irrevocable life insurance trust is often utilized and life insurance on the Smiths is purchased. Usually the amount of life insurance that can be purchased with the annual trust distribution substantially exceeds the value of the contributed property. Consequently, the Smith heirs receive more upon the death of the survivor of Mr. and Mrs. Smith than they would have if the Smith, Inc. stock was retained. Moreover, the charity receives a substantial benefit. Finally, for the remainder of their lives, the Smiths are receiving income from the CRT.

It is difficult to illustrate numerically the estate tax benefits of CRTs. In the Smith example, without a CRT, the survivor of the Smiths would own the Smith, Inc. stock which, given their net worth, would be taxed at estate tax rates up to approximately 50%. With the CRT in place, the Smith, Inc. stock is gone and their income interest in the CRT terminates at the death of the survivor of them; thus, there is no estate tax. Moreover, had the Smiths contributed the annual distribution to an irrevocable life insurance trust as discussed above, nothing would remain in their estates and their heirs would receive the life insurance proceeds estate tax (and income tax) free!

In this example, a CRT is a very useful planning tool. It saves the Smiths income and estate taxes, solves a financial planning problem and benefits their favorite charity while increasing the amount passing to their heirs. However a CRT is not right for every estate plan. I recommend that you retain competent estate and tax counsel to evaluate your circumstances as there are many variables to be considered.

*The author of this article, Joseph G. Imbriani, Esq., CPA/PFS, practices in the areas of taxation and estate planning and is a partner of the Boston law firm of Taylor, Ganson & Perrin, LLP.*