

## **CHARITABLE TRUSTS**

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How many of you would be interested in a technique that can reduce both your Federal Income Taxes and Federal Estate Taxes? If your hand is raised then this article is for your benefit. The technique that we are describing is a charitable trust. A charitable trust can be a valuable planning technique for an individual who is charitably inclined and wishes to accelerate future charitable deductions. There are various types of charitable trusts that can be established. Two of the more popular charitable trusts are discussed below.

### **A) CHARITABLE REMAINDER TRUST (hereinafter called "CRT")**

The basic concept of a CRT is to transfer property to a trust, and retain an income interest for your life or the lives of others. When the last beneficiary dies then the remaining proceeds in the trust pass to a charity. The person establishing the trust (hereinafter referred to as "the donor") receives an immediate income tax deduction for the actuarial value of the remainder interest even though the donor is able to receive the income from the investment transferred to the trust. Essentially to qualify as a CRT, the trust must:

1. Pay an amount to at least one non-charitable beneficiary who is living at the time the trust is created; and
2. The sum that is paid each year cannot be less than 5% of the initial net fair market value of the property placed in the trust; and
3. The amount must be payable annually for a term of years or based on a measuring life; and
4. No amounts may be paid to a beneficiary that is not specified in the CRT; and

5. At the termination of the CRT all remaining proceeds must pass to a qualified charity.

A benefit of a CRT is that appreciated assets can be transferred into the trust without the donor having to declare a gain. For example, if you sold stock with a cost basis of \$10,000 and a fair market value of \$50,000, you would have to report a \$40,000 gain. If you were in a 28% tax bracket, you would walk away from this transaction with \$38,800. (\$50,000 less \$11,200 in taxes). On the other hand, if the stock was transferred to a CRT you do not have to recognize the \$40,000 of gain.

In addition, a CRT can also enable a donor to diversify his assets, increasing the donor's income without incurring capital gain cost. For example, a donor may have highly appreciated securities paying a 3% dividend. In order to increase his income, the donor could sell the securities and reinvest the proceeds in higher yielding assets, but the amount reinvested would be reduced by the amount of capital gain tax incurred. If the proceeds were placed into a CRT the donor could specify that he receive a 6% dividend. This would result in the donor receiving an additional income of 3%. No income tax would have to be paid when the assets are placed into the CRT.

An example of the tax benefits associated with a CRT are as follows: Lets assume you transferred \$250,000 to a charity and reserved the right to receive eight percent (8%) interest for a term of fifteen years (15). Lets also assume that the Applicable Federal Interest Rate for the month of the transfer is 7.8%. Accordingly, you or a designated person would be entitled to receive \$20,000 a year for the next 15 years. ( $\$250,000 \times 8\%$ ). You would also be entitled to claim a charitable deduction on your income tax return of \$76,700. If you survived the 15 year term the amount would also be removed from your estate. If you failed to survive the 15 year term then the remainder portion would be removed from your estate.

**B) CHARITABLE LEAD TRUST (hereinafter called "CLT")**

A CLT provides a charity with a fixed amount of income for a term of years or for the life of an individual, and then the remainder passes to the donor's beneficiaries or it can revert back to the donor. The donor can be the sole trustee or a co-trustee. One situation in which a CLT can be used is if you have an unusually high income year but in future years your income and therefore your tax bracket will drop. You can receive an income tax deduction in this the high tax year and pay the tax in the later years at a lower bracket. Another major advantage of the CLT is that it enables a discounted gift to family members. The value of a gift is set at the time the gift is complete. Since the family member must wait until the charities term expires, the value of the gift is discounted for the cost of waiting. If the assets placed in the trust appreciate then additional proceeds can pass tax free.

An example of the tax benefits associated with a CLT are as follows: Lets assume you place \$250,000 into a CLT. The CLT provides that the charity receives five percent (5%) interest for a term of fifteen years (15). Lets also assume that the Applicable Federal Interest Rate for the month of the transfer is 7.8%. Accordingly, the charity would receive \$12,500 per year for the next 15 years. ( $\$250,000 \times 5\%$ ). After 15 years the remainder passes to your specified beneficiary. You would be entitled to an income tax deduction of \$108,313. Furthermore, the present value of the annuity (\$108,313) would be removed from your estate.

**CONCLUSION**

The above-mentioned techniques are two outstanding vehicles that are available for individuals with charitable inclinations. Furthermore, if the proper assets are placed in the trust then the economics associated with the transactions can be very appealing. Some of our clients

have used the benefits from their income tax deduction to purchase a wealth replacement life insurance policy to replace the wealth lost when the property passes to a charity. If you are interested in taking advantage of any of these techniques, please contact our office.