TOPIC: CHARITABLE REMAINDER TRUSTS

If you have a substantial estate and intend that a portion of that estate will ultimately go to charity, and in addition, you hold substantial assets with a low tax basis, then you should consider establishing a charitable remainder trust.

A charitable remainder trust is a mechanism by which you can make a charitable gift currently and receive a current tax deduction while retaining control over an asset and the right to receive all income from the asset. At the same time, through use of a charitable remainder trust, you can diversify tax-free concentrated holdings in one or more low tax basis assets, thereby reducing the risk in an investment portfolio.

For example assume a couple has a large portion if their estate invested in XYZ Company stock. Further assume the stock has appreciated substantially over the years, and the couple is reluctant to sell any of the stock because sales would result in a large capital gains tax. In addition, the couple intends to make substantial charitable gifts upon their death.

In this situation, the couple could establish a charitable remainder trust and gift some or all of the stock to the charitable remainder trust. The trust can provide that as long as the couple is alive they shall receive a set amount of income from the trust. For example, the couple could receive a set percentage (say 6%) of the value of the trust's assets each year (this is called a charitable remainder unitrust) or a fixed unchanging amount each year equal to a percentage of the initial value of the trust (this is called a charitable remainder annuity trust.)

At the death of the couple, the assets of the trust pass to the charity. In the meantime, the couple can act as trustees of the trust and control the investment of the trust assets. Moreover, since the trust is a charitable entity, it pays no taxes. This means the trust can sell the XYZ Company stock and invest in a diversified portfolio without incurring any tax liability.

The couple will also receive a current tax deduction for the value of their charitable gift. The deduction will equal the present value of the charity's right to receive the XYZ stock in the future, and will be some fraction of the gift's current value. The present value will depend upon the life expectancy of the couple, the amount of income they are to receive from the trust, and an assumed interest rate.

CONTRAST WITH THE CHARITABLE LEAD TRUST (CLT)

The charitable lead trust is the opposite of a charitable remainder trust. In a charitable remainder trust the annuity payment goes to the donor, but the remainder interest goes to the charity. In a charitable lead trust this allocation is reversed: the annuity payment goes to the charity and the remainder interest goes back to the donor or heirs.

Whether or not to use a charitable lead trust or a charitable remainder trust depends upon the particular goals the donor is trying to accomplish. However, if all other things are equal, charitable lead trusts will be more favorable during periods of low interest rates, while charitable remainder trusts will be more advantageous during periods of high interest rates. This is because with a charitable lead trust, the current tax deduction is greater the lower the interest rate, while with a charitable remainder trust, the current tax deduction is greater the higher the interest rate.

Also, because with a charitable lead trust the income of the trust is taxable to the donor, the trust <u>may</u> generate an annual tax-liability to the donor even though the donor is not currently receiving any cash. With a charitable remainder trust, the donor is only taxed on amounts actually received from the charitable remainder trust.

In summary, through a charitable remainder trust you (1) can diversify highly appreciated assets without incurring income taxes, while (2) retaining control over the assets, (3) the right to income from the assets, and (4) generating a current income tax deduction. However, it is important to understand that a charitable remainder trust is designed to be a more efficient way of making a charitable gift that you would otherwise make anyway. It is not a way of preserving your estate for your heirs. You have still made a charitable gift which has reduced your net assets.

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