

Estate Planning Strategies Series

Charitable Remainder Unitrusts

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Charitable Remainder Unitrusts (CRTs)

What is a Charitable Remainder Unitrust?

- The Charitable Remainder Unitrust (CRT) is a specific kind of Irrevocable Living Trust. You donate a sizable asset to the trust, in return for which the trust agrees to provide you and your spouse a guaranteed income stream for the duration of your lives. When the last income beneficiary dies, the CRT donates the residual value of the trust to the charity or charities you've designated.
- The Charitable Remainder Unitrust is generally combined with a wealth-replacement trust (such as an Irrevocable Life Insurance Trust, or ILIT - see separate booklet in this series) so that the estate received by your heirs is not diminished by your gift.

What does it do?

- Properly structured, the CRT and ILIT can work together to reduce your estate taxes on the assets involved to zero.
- Properly designed, the cost to you and your heirs will be zero or nearly zero. The ILIT keeps your heirs whole, and the tax and income advantages you've received should be more than adequate to fund the ILIT and pay the legal and accounting costs.
- You can name a trustee, who could be yourself, that you are confident will manage the trust assets well enough to generate the required income stream.
- Your lifetime income is a percentage of trust assets, meaning that as the CRT's assets appreciate, so does your income.
- Since the CRT is, in effect, a charitable entity, both income and capital gains within the CRT are income-tax-free.

What are the major benefits?

- **Tax Savings:** For gifts made during your lifetime you receive an immediate income tax deduction equal to the present value of your future gift, AND you always avoid the capital gains tax on the sale of those assets.
- **Greater Income:** Because no capital gains were paid by the trust on the sale of the donated assets, the entire asset base can be used to generate income, resulting in greater cash flow to the beneficiaries.
- **Income Security:** In return for your gift, the trust **guarantees** you a stream of income, usually for the lifetimes of both you and your spouse.
- **The Gift of Giving:** The charity or charities of your choice will receive a substantial contribution.
- **Asset Protection:** These assets are out of the reach of creditors and litigators.
- **Wealth Preservation:** By using the tax benefits and/or increased income to fund an ILIT, you preserve the value of the estate your heirs receive. In effect, you are making a substantial gift to charity with funds that otherwise would have gone to taxes. The only "loser" in this game is the IRS.

Estate Planning Strategies Series

Charitable Remainder Unitrusts (CRTs)

What are the risks and costs?

- There are several “moving parts” to this strategy, so it needs to be implemented carefully and with top-notch professional advice.
- You do lose access to the principal (i.e. the gift of assets is “irrevocable”).
- Your estate will not enjoy the benefit of any future appreciation of those assets. Your favorite charity does so benefit, however, and you will benefit through the increased lifetime income that appreciation generates.
- There are out-of-pocket costs for the two trusts (CRT and ILIT). However, these will be normally more-than offset by the tax savings. Even when they aren’t, the increased income (see “Benefits”) will more than make up the difference. In total, this strategy ALWAYS delivers more benefits to the family over the long run than almost any other estate-planning alternative.
- If the trust assets, through either poor management or poor markets, do not consistently provide a return at least equal to your stipulated income percentage, then future cash flows to you may be diminished.

How do I go about creating one?

- **Step 1: Get help:** The Charitable Remainder Trust is a sophisticated estate planning tool, and your first step is to make sure you have access to legal, tax and insurance advisors who are very familiar with its creation and use.
- **Step 2: Create the trust document:** Work with your estate attorney to draft the terms and conditions, name the Trustee(s) (you can be one of them, or the only one), decide on the size of the income stream you will require, and determine the charities to whom the trust “remainder” will ultimately be distributed.
- **Step 3: Fund the trust.:** Work with your financial consultant on the best method of funding the trust: the right asset selection will maximize your tax benefits.
- **Step 4: Create the income stream:** The Trustee normally will sell the (appreciated) assets you’ve donated, then work with your financial consultant to re-invest the proceeds in such a way that your income objectives will be met.
- **Step 5: Distribute trust assets:** Upon the death of the last surviving income beneficiary, the trustee distributes the remaining trust assets to the charity or charities named in the trust agreement. [At death second of your and your spouse, your heirs will receive an amount equal to the original donation, free of all taxes, from the ILIT.]

The Bottom Line

A Charitable Remainder Unit Trust in conjunction with an adequately funded Irrevocable Life Insurance Trust allows you to decide that an organization other than the government is your favorite charity.

At no net cost to you or your heirs, a large chunk of money that would otherwise go to taxes is contributed instead to a cause you believe in more wholeheartedly.

Estate Planning Strategies Series

Charitable Remainder Unitrusts (CRTs)

Case Study

To see the CRT in action, let's look at the estate of John and Karen Client.

John and Karen have assets in their estate worth \$1,000,000. They have charitable inclinations and would like to see that their children see a sizeable inheritance, but their first priority for their assets is to provide a reliable source of retirement income.

This situation is ideal for applying the Charitable Remainder Unitrust strategy. Here is how it works, and what benefits it had for John and Karen, their children, and their favorite charities.

The Choices

Strategy 1: Sell the property and invest the after-tax proceeds for income:

- Their current strategy alternative is to sell the assets outright and invest the (after-tax!) proceeds in a portfolio with a planned total return of 8%, all of which they plan to spend. The original principal (zero growth!) remains in their estate.
- Upon their death, approximately 50% of the estate will go to the IRS, and their children will inherit the remaining 50%

Strategy 2: Gift the assets to a CRT and create wealth-replacement ILIT:

- John and Karen establish a CRT and donate the assets to it. The Trust sells the asset (paying no capital gains taxes) and invests the proceeds for the same 8% return.
- The CRT is set up so that John and Karen will receive 8% of the trust asset value in income each year for the rest of their lives. As with Strategy 1, it is assumed that it is all received and spent, although with THIS strategy, it is actually possible to defer distributions so as to improve the long-term benefits received.
- You set up an ILIT, which purchases \$1,000,000 of second-to-die life insurance with your children as beneficiaries. This will replace the value of gift in your children's estate.

Comparing the results

Using the charts on the following pages, follow along as we see how these two strategies compare as they're put into action.

Estate Planning Strategies Series

Charitable Remainder Unitrusts (CRTs)

Strategy 1.

Event 1: John and Karen sell their \$1,000,000 in assets, and immediately lose \$250,000 to capital gains taxes.

Event 2: They invest the remaining funds in a portfolio with an 8% annual return. Because their investment base is now only \$750,000, this results in \$60,000 per year in income per year

Event 3: The second of them dies. Estate taxes of \$375,000 are due on the \$750,000 estate, leaving their heirs with an inheritance of \$375,000 of the original \$1,000,000.

Bottom line: \$1,200,000 in lifetime benefits to John and Karen, \$370,000 goes to the children, and the IRS has benefitted to the tune of \$625,000 in total.

Strategy 2.

Event 1: John and Karen donate their \$1,000,000 in assets to a Charitable Remainder Unitrust. The CRT then sells the assets, and being a charity, pays NO capital gains taxes. In fact, using a complex formula, the IRS actually gives them a \$34,335 income tax deduction for the future gift to the charity!

Event 2: The CRT then invests the entire \$1,000,000 in a portfolio with a 8% annual return. Because there was no loss to capital gains taxes, John and Karen receive \$80,000 in income per year (30% more!).

Event 3: John and Karen set up an Irrevocable Life Insurance Trust, and that trust purchases a \$1,000,000 second-to-die policy on John and Karen, with the children as beneficiaries. They pay the \$131,400 in premiums over their lifetimes out of the extra income they are receiving from the CRT.

Event 4: The second of them dies. Since there are no assets in the estate, no estate taxes are due. Instead, the children receive the ILIT death benefits tax free. At the same time, the charity acquires full use of the \$1,000,000 in CRT assets for its own benefit.

Bottom line: \$1,502,935 in lifetime benefits to John and Karen (even after paying the ILIT premiums), the children receive \$1,000,000 (equal to the original size of the estate!), the charity receives \$1,000,000 in new assets (vs. zero in Strategy 1), and the IRS gets absolutely nothing, nada, zip.

The comparison

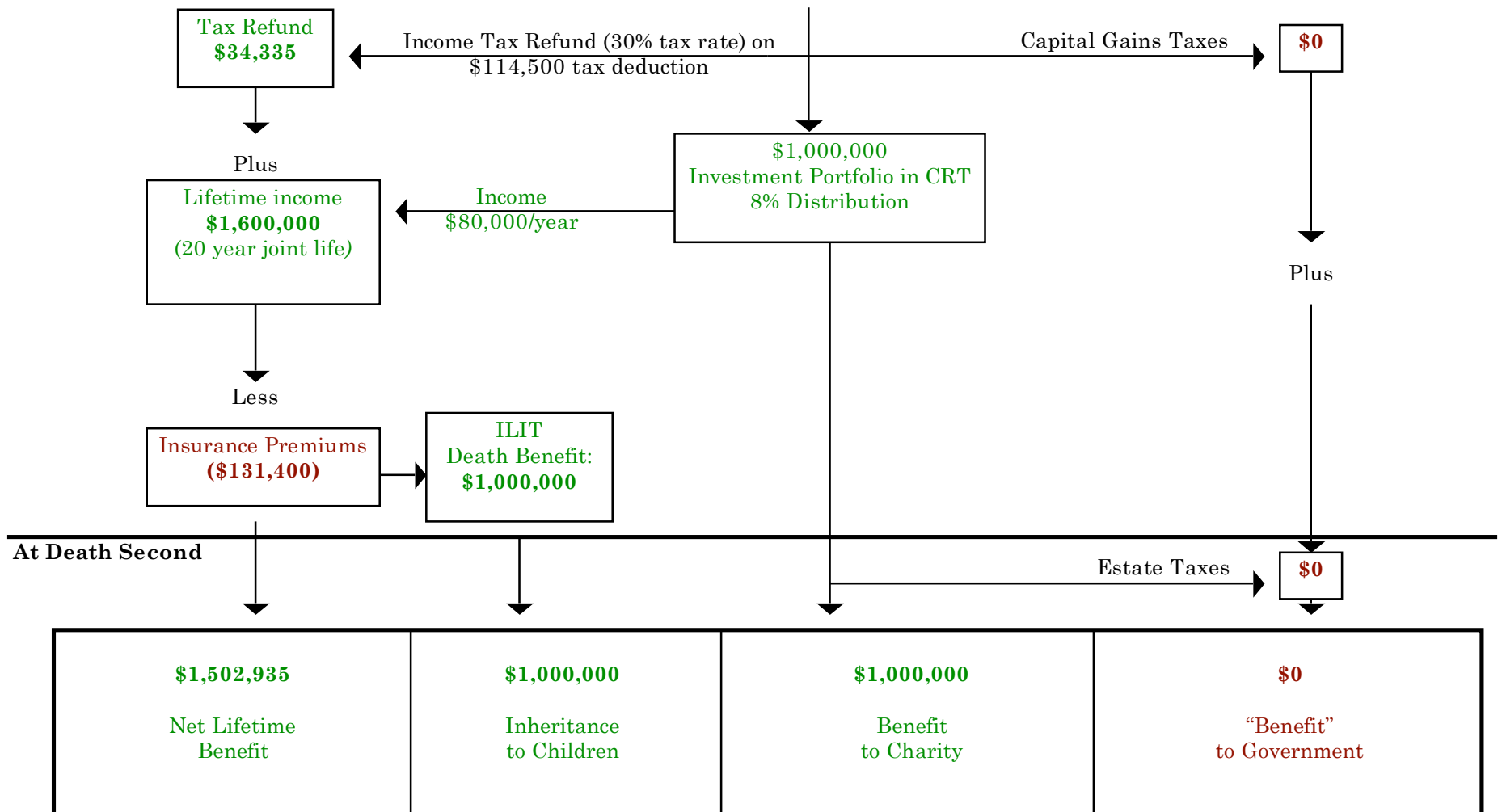
Strategy 1: Total benefit to family: \$1,575,000. Benefit to IRS: \$625,000

Strategy 2: Total benefit to family: \$3,502,935. Benefit to IRS: Zero

The CRT/ILIT strategy delivers more than double the benefit!

Strategy 2: Gifts to Charitable Remainder Trust (CRT) and Irrevocable Life Insurance Trust (ILIT)

\$1,000,000



Graphical Summary: The CRT/ILIT Strategy

- Lifetime Benefit to you
- Benefit to Children
- Benefit to Charity
- Taxes to IRS

