



Planning Options for Clients with Charitable Remainder Trusts

Speakers:
Evan Unzelman and Martin Shenkman, Esq.



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House Analogy

- When a client buys a house, they probably don't expect to keep it forever
 - *Kids grow up and move out*
 - *Health changes and a different house serves better*
 - *Cold winters grow old and a warmer state beckons*
 - *A lower-tax state beckons*
 - *Etc.*
- Selling the house years later doesn't mean it didn't work well for the client while they lived in it (i.e., it wasn't a mistake to buy the house in the first place)

House Analogy

- Same logic applies to clients' CRTs
- Circumstances change over time
 - *The CRT was a great solution and worked well for years*
 - *But is it the best possible use of those assets today?*
- Advisors are making their clients with CRTs aware of their secondary planning options

Charitable Remainder Trusts – the Pros

- CRTs are charitable vehicles but charity is rarely the primary driver
- Powerful tax-planning vehicles
 - *Defers capital gain*
 - *Generates an up-front income tax deduction*
- Note that the tax benefits are achieved early in the life of the CRT, usually in the first year
 - *Moving forward, the client's benefit is limited solely to the CRT's income stream (their "income interest" in the trust)*

Charitable Remainder Trusts – the Cons

- Irrevocable
- Usually span decades of clients' lives
- This combination can lead to a misalignment between client's situation and the CRT
 - *When the CRT is created, it's a perfect fit with the client's situation, and most CRTs remain good fits early in the overall lifecycle (the first decade or two). But, as a client's situation changes – they retire, move, have grandchildren, change tax brackets, etc. – their fit with the CRT often wanes because the trust's terms cannot adjust to their changing life.*

The Importance of CRT Reviews

- CRT income interests are capital assets
 - *Rev. Rul. 72-243, 1972-1 C.B. 233*
 - *PLRs (e.g., PLR 2007390041)*
- Yet they are rarely reviewed like other capital assets
 - *Clients left in the dark (“my CRT is a lifetime lockup”)*
 - *Don’t assume clients know*

Options Available

- Gift income interest
 - *Gives the entire trust to charity today*
 - *Client receives a charitable deduction*
- Sell income interest
 - *Income stream sold through a secondary market*
 - *Does not terminate CRT*
- Terminate CRT
 - *Value of income interest determined using IRS formula*
 - *Uncommon because of sale option*
 - *Sale value of income interest usually significantly higher*

Gift Income Interest

- Client doesn't need/want their CRT income
- Client doesn't wish to receive any value for their income interest
- Client situations to look for
 - *Client complaining about paying tax on CRT income*
 - *Client not interested in gifting additional assets to heirs*
 - *"Nuisance" CRTs*
 - Very wealthy client; small CRT

Gift Income Interest

- The Process
 - *Client irrevocably contributes their income interest (a private capital asset) to the charitable remainderman*
 - *Client receives charitable deduction equal to 7520 value of their income interest*
 - Client will need to file a Form 8323 and obtain an appraisal (even if the CRT owns only cash and/or marketable securities) from a qualified appraiser

Sell Income Interest

- Key benefits (not usually drivers)
 - *Ability to sell income interest at a financial premium*
 - *Taxation*
 - *Reduction of mortality risk*
- Main drivers
 - *Flexibility*
 - *Simplification*
 - *Family*
- The Process

Sell Income Interest

- Common situations to look for
 - *Major life events*
 - Divorce
 - Death of a spouse
 - Change in health status
 - *Unforeseen need for liquidity*
 - *Desire to transfer additional assets to heirs*
 - *Frustration with administrative costs/hassles*
 - *NIMCRUTs*

When Taxation *is* a Driver

- CRTs distributing all/mostly ordinary income
 - *Often NIMCRUTs invested in variable annuities*
 - *In effect, sale converts ordinary income into capital gain*
- When the capital gains rate is expected to rise
 - *2012*
 - On 1/1/13, capital gains rate increased from 15% to 20% and 3.8% NII Tax further increased it to 23.8%
 - *2020-2021?*
 - Biden tax proposal: capital gains taxed at the top 39.6% rate on ordinary income for individuals with income of more than \$1 million

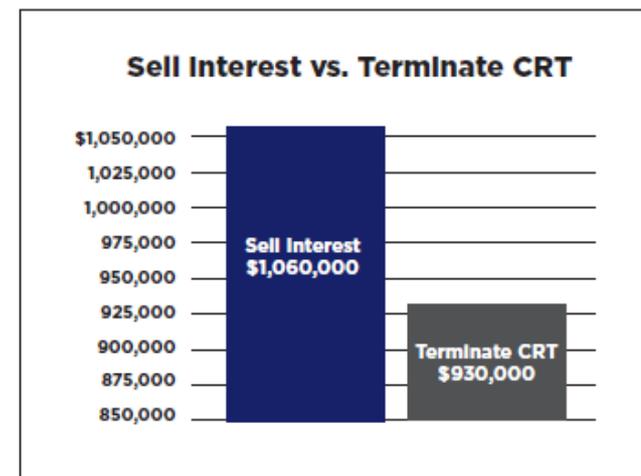
Case Study: Sell Income Interest

- Situation

- *Husband and wife; both 75; CRT distributing \$100,000/yr.*
- *Clients had simplified their lives as they aged and updated most of their planning accordingly*
- *The CRT was the only planning that couldn't adjust to their changing lifestyle*

- Solution

- *Sold income interest*
 - Some proceeds to heirs
 - Rest to investment advisors



CRT Rollover

- Client wants to change something about their CRT
 - *Add income beneficiaries*
 - *Change the type of CRT*
- Rollover uses income interest in existing CRT to form a new CRT reflective of desired changes
- Most common fact pattern
 - *Client not reliant on income their CRT forces them to take*
 - Client often adverse to paying taxes on unneeded income
 - *Client interested in getting additional wealth to heirs*

Case Study: CRT Rollover

- Situation
 - *63-year-old widow; surviving beneficiary of 5% CRUT*
 - *Didn't need income; tax-adverse*
 - *Focus is transferring maximum assets to daughters*
- Solution
 - *Roll to NIMCRUT, structured for deferral*
 - Mom defers income during remaining lifetime
 - Trust grows tax-free for 19 years (mom's life expectancy)
 - At mom's death, daughters collect income for their remaining lifetimes

Case Study: CRT Rollover

- Outcome
 - *In effect, client converted \$2,075,000 of highly-taxable income into \$5,200,000 of future income for her daughters*
 - *Client avoids paying taxes on the \$2,075,000 of converted income*
 - *Client garnered an immediate income tax deduction of \$135,000*

No Action

Tax Deduction	None
Expected Duration	19 Years
Income to Client	\$2,075,750
Income to Children	\$0

Yr.	Beginning CRT Value	Growth (5%)	Payout (5%)	Ending CRT Value
1	2,185,000	109,250	109,250	2,185,000
2	2,185,000	109,250	109,250	2,185,000
3	2,185,000	109,250	109,250	2,185,000
4	2,185,000	109,250	109,250	2,185,000
5	2,185,000	109,250	109,250	2,185,000
6	2,185,000	109,250	109,250	2,185,000
7	2,185,000	109,250	109,250	2,185,000
8	2,185,000	109,250	109,250	2,185,000
9	2,185,000	109,250	109,250	2,185,000
10	2,185,000	109,250	109,250	2,185,000
11	2,185,000	109,250	109,250	2,185,000
12	2,185,000	109,250	109,250	2,185,000
13	2,185,000	109,250	109,250	2,185,000
14	2,185,000	109,250	109,250	2,185,000
15	2,185,000	109,250	109,250	2,185,000
16	2,185,000	109,250	109,250	2,185,000
17	2,185,000	109,250	109,250	2,185,000
18	2,185,000	109,250	109,250	2,185,000
19	2,185,000	109,250	109,250	2,185,000

CRT Rollover

Tax Deduction	\$135,000
Expected Duration	46 Years
Income to Client	\$0
Income to Children	\$5,202,359

Change in Income
 ← (\$2,075,750)
 ← \$5,202,359

In effect, rollover converts \$2.1M of client's income into \$5.2M of income for her children

Yr.	Beginning CRT Value	Growth (5%)	Payout (Variable)	Ending CRT Value
1	1,525,000	76,250		1,601,250
2	1,601,250	80,063		1,681,313
3	1,681,313	84,066		1,765,378
4	1,765,378	88,269		1,853,647
5	1,853,647	92,682		1,946,329
6	1,946,329	97,316		2,043,646
7	2,043,646	102,182		2,145,828
8	2,145,828	107,291		2,253,120
9	2,253,120	112,656		2,365,776
10	2,365,776	118,289		2,484,064
11	2,484,064	124,203		2,608,268
12	2,608,268	130,413		2,738,681
13	2,738,681	136,934		2,875,615
14	2,875,615	143,781		3,019,396
15	3,019,396	150,970		3,170,365
16	3,170,365	158,518		3,328,884
17	3,328,884	166,444		3,495,328
18	3,495,328	174,766		3,670,094
19	3,670,094	183,505		3,853,599
20	3,853,599	192,680	192,680	3,853,599
21	3,853,599	192,680	192,680	3,853,599
22	3,853,599	192,680	192,680	3,853,599
23	3,853,599	192,680	192,680	3,853,599
24	3,853,599	192,680	192,680	3,853,599
25	3,853,599	192,680	192,680	3,853,599
26	3,853,599	192,680	192,680	3,853,599

Client defers income over remaining lifetime

Client's children receive income for remaining lifetimes

Additional Resource & Questions

- CRT Secondary Planning Resource Handbook
 - *Includes articles, case studies, legal and tax analyses, guides for advisors, and more – all on the secondary planning options that are available to clients with CRTs*
 - *For a free copy, e-mail CRT@SterlingFoundations.com*
- Questions
 - *Contact Evan*
EUnzelman@SterlingFoundations.com or 703-677-8747