CRTs Solve Many Planning Problems

Charles J. McLucas, Jr.

The use of charitable remainder unitrusts can address a wide range of estate planning issues.

The value of using charitable remainder unitrusts (CRTs) as a means of making charitable gifts, as well as a tax tool in financial planning, cannot be overlooked. The CRT provides one of the few true win-win scenarios remaining in financial planning. The client wins by avoiding tax and increasing diversification and income, the charity wins by receiving gifts of substantial amounts, and the planner wins by providing a product at a low cost-per-benefit ratio. The flexibility, tax advantages, and asset protection make the use of CRTs one of the best alternatives in assisting clients in their diverse planning needs. This is especially true for individuals who have a goal of some charitable giving in their planning objectives. This, obviously, is why the laws are set up to permit the use of such trusts.

The CRT is governed by Section 664 of the Internal Revenue Code and has been left virtually unchanged by tax legislation since its inception in 1969. As a matter of fact, the 1993 Tax Act actually enhanced the benefits for many because all appreciated property donated is exempt from alternative minimum tax (AMT) retroactive to January 1, 1993.

Basically, a CRT is an irrevocable qualified trust that pays income to whomever the donor designates. This income stream can be for life, a series of lives, a specified number of years, or a combination of these. At the end of the specified income stream, whatever assets remain in the trust are distributed to one or more exempt charitable beneficiaries.

At the time of the transfer of property to a CRT, a current charitable deduction is generated by the donor. The amount of the current deduction is determined in part by the IRS valuation tables that provide a deduction for the present value of the estimated future contribution of property to the charity. The tables in Exhibit 1 are examples of the percentage of tax deduction available at various payout amounts for various ages. You will note, as an example, that a deduction of 27% of the fair market value of the asset contributed by a couple whose ages are 65 and 60 will be allowed in the year transferred. A $100,000 asset put in trust by this couple would provide a $27,000 current charitable contribution.

The selection of the appropriate percentage of income to be paid from the unitrust to the clients will depend on their needs and financial objectives. Once selected, the percentage cannot be altered. The minimum rate is 5%; there is no maximum. A typical pattern is to establish a rate approximately 4% less than the projected rate of return on the trust assets. The property that is transferred to a CRT is managed as a separate trust fund. This provides for annual growth each year.

Charles J. McLucas, Jr., CPA, is a personal financial specialist in Redding, California.

EXHIBIT 1
Unitrust Tables

Term of 1 to 20 Years

Term	5%	6%	7%	8%	9%	10%
5	0.78	0.74	0.71	0.67	0.64	0.61
10	0.61	0.55	0.50	0.45	0.41	0.37
15	0.48	0.41	0.35	0.30	0.26	0.22
20	0.38	0.31	0.25	0.20	0.17	0.13

One Life

Age	5%	6%	7%	8%	9%	10%
40	0.21	0.16	0.12	0.10	0.08	0.06
45	0.25	0.20	0.16	0.13	0.11	0.09
50	0.30	0.25	0.20	0.17	0.14	0.12
55	0.36	0.30	0.26	0.22	0.19	0.16
60	0.42	0.36	0.32	0.28	0.24	0.21
65	0.49	0.43	0.38	0.34	0.30	0.27
70	0.56	0.50	0.46	0.41	0.38	0.34
75	0.63	0.58	0.53	0.49	0.46	0.42
80	0.70	0.66	0.62	0.58	0.54	0.51
85	0.76	0.73	0.69	0.66	0.63	0.60
90	0.82	0.79	0.76	0.73	0.70	0.68

Two Lives

Ages	5%	6%	7%	8%	9%	10%
40/35	0.11	0.08	0.05	0.03	0.02	0.02
45/40	0.14	0.10	0.07	0.05	0.04	0.03
50/45	0.18	0.13	0.10	0.07	0.05	0.04
55/50	0.23	0.17	0.13	0.10	0.08	0.06
60/55	0.25	0.22	0.17	0.14	0.11	0.09
65/60	0.34	0.27	0.22	0.19	0.15	0.13
70/65	0.40	0.34	0.29	0.25	0.21	0.18
75/70	0.48	0.42	0.36	0.32	0.28	0.24
80/75	0.56	0.50	0.45	0.40	0.36	0.33
85/80	0.64	0.58	0.54	0.49	0.45	0.42
90/85	0.71	0.66	0.62	0.58	0.55	0.51

Note:
Approximate values. Quarterly payments starting at the fourth month.

Unlike an annuity trust, which pays a fixed percentage of a fixed amount for life, the CRT's income grows as the value of the trust grows. Each year, the CRT's assets are revalued, and the grantor receives an amount equal to the trust assets multiplied by the payout percentage.

In most cases, it is advisable to have a provision in the trust that allows for the make-up of income for any year in which the trust does not earn income equal to the unitrust percentage established.

Eliminate Capital Gains Tax on Sale of Asset

Probably one of the most significant benefits, and the one that gets the most attention by the client, is avoidance of all capital gains from the sale of an asset placed in the trust. Since the unitrust is not a taxable entity (unless an unrelated business taxable income, or UBTI, issue arises), it can be used to entirely avoid tax on capital gains, and the trust will have that much more to reinvest. In most cases, the value of the increased income stream will greatly exceed the actual value of the asset contributed. This is an important point to communicate to clients considering selling appreciated assets. Real estate and common stocks are standard assets that are used to fund the CRT.

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As an example, a client who is age 55 and has a piece of land worth $800,000 with a cost basis of $100,000 would pay $196,000 in federal tax if he or she sold the asset outside the trust (plus state tax if the client is living in a state that taxes capital gains). In addition to paying no tax on the sale, the client will save $55,724 in current tax savings from an allowable charitable deduction of $199,016. Exhibit 2 illustrates the benefits to the family and the charity using the CRT during the expected life of 29 years. You can use the table in Exhibit 3 to estimate the benefits to your client by using a nontaxable sale compared to a taxable one.

Diversification and Asset Management

With the increasing importance of proper asset allocation to ensure safety and maximum investment returns, many people are turning to professional asset managers. The use of CRTs provides the vehicle to sell stocks or other assets to achieve diversification without incurring tax costs.

There are a variety of reasons that make asset management an important benefit of the CRT, but perhaps the following four are most important. The basic reasons individuals choose an asset management trust are:

- To ensure that an individual or group of individuals will be provided for as long as needed.
- To ensure that the principal will not be lost or squandered by the income beneficiary.
- To preserve the value of the trust so it cannot be reached by creditors.
- To ensure that state or federal benefits that accrue to a person because of disability or incompetency are not lost because of the value of assets not in trust.

The three situations where an asset management trust makes the most sense are:

- A person without much experience in managing money now has that responsibility and the person setting up the trust believes that others may take advantage of them.
- A person has been known as a reckless spender and the grantor setting up the trust wants to make sure that the money is not squandered away.
- An individual is disabled and/or incompetent and is qualified to receive funds or services from state or federal programs.

This last situation requires specialized language that does not disqualify a person from his or her state or federal benefits. Funds from the trust cannot be used to provide nonsupport items. This type of trust is commonly known as a luxury trust.

Alternative to Qualified Pension Plans

One of the biggest challenges of estate financial planning today deals with assist-

EXHIBIT 2
Asset Sale Vs. Unitrust

Gross tax: 0.0653
Net tax: 0.0528

	Sale		Unitrust		Family Investment	
	Principal	Income	Principal	Income	Principal	Income
1	$604,000	$43,488	$800,000	$46,080	$55,724	$4,012
2	647,488	42,281	816,000	43,085	105,816	6,910
3	689,769	45,042	832,320	43,946	155,811	10,174
4	734,811	47,983	848,966	44,825	209,932	13,709
5	782,794	51,116	865,946	45,722	268,465	17,531
6	833,910	54,454	883,265	46,636	331,718	21,661
7	888,365	58,010	900,930	47,569	400,016	26,121
8	946,375	61,798	918,949	48,520	473,706	30,933
9	1,008,173	65,834	937,328	49,491	553,159	36,121
10	1,074,007	70,133	956,074	50,481	638,772	41,712
11	1,144,140	74,712	975,196	51,490	730,964	47,732
12	1,218,852	79,591	994,699	52,520	830,186	54,211
13	1,298,443	84,788	1,014,593	53,571	936,918	61,181
14	1,383,231	90,325	1,034,885	54,642	1,051,669	68,674
15	1,473,556	96,223	1,055,583	55,735	1,174,985	76,727
16	1,569,780	102,507	1,076,695	56,849	1,307,446	85,376
17	1,672,286	109,200	1,098,229	57,986	1,449,672	94,664
18	1,781,487	116,331	1,120,193	59,146	1,602,322	104,632
19	1,897,818	123,927	1,142,597	60,329	1,766,100	115,326
20	2,021,745	132,020	1,165,449	61,536	1,941,755	126,797
21	2,153,765	140,641	1,188,758	62,766	2,130,087	139,095
22	2,294,406	149,825	1,212,533	64,022	2,331,949	152,276
23	2,444,231	159,608	1,236,784	65,302	2,548,247	166,400
24	2,603,839	170,031	1,261,519	66,608	2,779,949	181,531
25	2,773,870	181,134	1,286,750	67,940	3,028,088	197,734
26	2,955,003	192,962	1,312,485	69,299	3,293,763	215,083
27	3,147,965	205,562	1,338,734	70,685	3,578,145	233,653
28	3,353,527	218,985	1,365,509	72,099	3,882,483	253,526
29	3,572,512	233,285	1,392,819	73,541	4,208,108	274,789

Sale option after 29 years:	$3,572,512
Value to charity:	$1,392,819
Value to family:	$4,208,108

ing individuals who are preparing for retirement. Although people look forward to the years when their time is not devoted to a job or business, they still want to enjoy their current income level and standard of living. In recent years, qualified retirement plans have been a popular means of saving money for retirement years. The deductibility of contributions, a tax-free environment in which the funds can accumulate, liability protection, and tax-favored lump-sum withdrawals at retirement made the qualified retirement plan an excellent planning vehicle.

Recent legislation, however, has taken away many of the benefits. Increased limitations on the contributions that can be made to a plan, the escalating costs associated with maintaining the plans, the inability to discriminate between employees, the

EXHIBIT 3

Comparison of Immediate Income Tax Benefit of Wealth Accumulation Trust to Taxable Sale of an Appreciated Asset

	Taxable Sale vs.	Nontaxable Sale
1. Current market value	$______	$______
2. Minus your cost basis	______	______
3. Equals gain	______	______
4. Tax (gain x bracket) __%	______	0
5. Tax deduction	0	______
6. Tax refund (deduction x bracket)	0	______
7. Total amount available for investment	$______	$______

Calculating Your Current Deduction

The following deduction factors are based on the wealth accumulation trust providing a 7.5% payout for the lives of one or two beneficiaries. To calculate the approximate deduction, find the age or ages of beneficiaries and multiply the corresponding factor by the fair market value of the asset.

Individual		Couple	
Age	Factor	Age	Factor
45	0.17	45/45	0.085
50	0.21	50/50	0.116
55	0.27	55/55	0.16
60	0.33	60/60	0.21
65	0.40	65/65	0.27
70	0.47	70/70	0.34
75	0.55	75/75	0.42
80	0.63	80/80	0.51

removal of the estate tax exclusions and the reduction in tax-favored withdrawals at retirement have caused the qualified retirement plan to lose a lot of its luster.

For clients for whom the qualified retirement plan has lost some of its appeal or who would like to make larger contributions than their qualified plan will allow, the planner should consider the charitable retirement trust (a creative use of the CRT). The charitable retirement trust is similar to an IRA or qualified retirement plan in that it is exempt from income tax and can enable the investor to obtain tax-free growth on investment assets within the trust. In addition, the charitable retirement trust is easier and cheaper to maintain. Many charities will manage these trusts without a fee if the charity is named as a beneficiary. It can be discriminatory; there is no limit or minimum on the amount of yearly contributions. The investor can begin taking income before age 59½ without penalty and can contribute property other than cash. The charitable retirement trust receives an estate tax deduction and can produce tax-free or tax-favored income at retirement.

For some people, the qualified retirement plan does have three significant advantages over the retirement CRT. Loans cannot be taken from a CRT, only the value of the future gift to charity is deductible, and the principal must eventually go to one or more charities. However, if it is a client's desire to benefit charity with a portion of the estate anyway, the advantages will greatly overwhelm these disadvantages.

Sale of Business

Selling a business has never been easy, but with the current tax laws it can also be expensive. The tax laws and our society encourage free enterprise and many individuals have been able to start with nothing or very little and turn it into a thriving business. The problem then becomes how to sell an asset (the business) with 99% appreciation.

Another issue that affects the price of a business is the tangible value that is placed on the assets of the business versus the intangible value of goodwill. The buyer will want to attribute the highest possible figure to the business assets because he or she will have more tax deduction for depreciation. The business owner, however, will want a lower price attributed to business assets because of the depreciation recapture. The 1993 Tax Act has complicated the issue further by setting forth the period in which intangible assets may be amortized.

If the hard equity in a client's business is being spent on taxes, the planner should consider the sale-of-business CRT. By transferring the corporate stock instead of assets of the business to a CRT and then having the CRT sell the business, the client can avoid the capital gain on the sale. This can save up to one third of the value of the business, allowing the client to attribute more of the business price to the assets. He or she may be able to get a higher purchase price because of the future depreciation deductions the buyer will receive. This transaction does require careful timing and follow-through to avoid the private foundation rules, so competent advice is vital when setting up this trust.

Education Cost Funding

The costs of a college education have risen much faster than inflation during the past 10 years. Yet, the need for a college education to achieve the career that many want for their children has never been greater. Money placed in a savings account for college costs is taxed each year reducing the account's value, so that in most cases, it does not even keep up with inflation. If the money is given to a trust account for the children, it is still taxed heavily until they reach age 14. Then, in some states, when children reach age 18, they may do whatever they please with the money, which might not be to fund college. If parents plan to pay college costs with money that is earned each year, they will do so with after-tax dollars, and there is no tax deduction for college expenses.

Enter the education CRT to save the day. The education trust is a CRT set up for a term of years with the express purpose of funding a child's or children's education expenses. Because the CRT only lasts for a short length of time, the donor receives a large current income tax deduction and the income received by the children will be taxed to them in their tax brackets. At the termination of the CRT, the principal can go to the college as a scholarship fund in the family's name. Appreciated property such as corporate stock or real estate can be contributed with the following advantages: There will be no capital gain on the transfer of stock or real estate to the CRT, the income coming from the trust will be taxed to the children in their tax brackets, there will be no shelling out for college expenses from current income each year, the parents will receive a sizable charitable tax deduction, and, because of the significant gift eventually going to the college, the school may entertain the idea of freezing or lowering the children's tuition for as long as they attend. All this and a scholarship fund established at the college, which will be a source of pride and satisfaction for years to come.

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Estate Tax Avoidance

Because the remainder income beneficiary in most cases is the surviving spouse, the unlimited marital deduction eliminates estate taxes on the first death. In addition, since the beneficiary upon the second death is a charity, a deduction is allowed for the estate for the full value. Accordingly, no estate tax is paid on CRT assets. In addition, it passes the probate process altogether so no additional fees or costs are incurred.

Using Irrevocable Life Insurance Trusts

Perhaps the most significant drawback for most people when considering the various forms of the CRT is the fact that the principal must ultimately go to charity instead of their children or other heirs. This disadvantage can be reduced or eliminated through the use of a wealth replacement trust.

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Each transfer of property or cash to a CRT will produce a current income tax deduction for the donor. If the tax savings is transferred to an irrevocable insurance trust that has the children as beneficiaries, the donor can achieve the following advantages: The trustee of the insurance trust will use the tax savings to purchase an insurance policy on one or both spouses, which in some cases may even exceed the value of what has been gifted to the CRT. In this way, the donor is able to make a significant gift to charity without depriving his or her children. The insurance proceeds at death go tax-free to children and are not part of the estate, so there is no estate tax or probate.

The transfer to the insurance trust can be accomplished without gift tax problems through the use of a "crummy power" in the trust. The crummy power states that for a period, each beneficiary has the right to withdraw his or her portion of any transfer to the trust. This makes the gift a current interest and allows it to be covered by the annual gift tax exclusion.

As long as the beneficiary does not withdraw the amount within the specified time, the trustee will then have the funds available to purchase the life insurance.

The wealth replacement trust can be combined with any type of CRT where the donors wish to replace the value of the asset given away. Care should be taken to make sure that the donor is insurable before establishing either trust if the replacement trust is a significant factor in the overall financial plan.

Asset Protection

In today's litigious atmosphere, many people are concerned about protecting their assets. A CRT is a perfect vehicle to accomplish asset protection while still maintaining control over the assets. Since the assets of a CRT are not subject to the claims of the donor, they may not be touched by any creditor, including the IRS. The assets are exempt from even a bankruptcy filing.

If a person, or couple, with modest means has a desire to leave his or her assets to charity, the CRT is a perfect vehicle to use. Individuals can even be on Medicaid and their assets will go to their favorite charity and not the government. The transfer of assets may be done within the 30-month waiting period and still in many cases not disqualify the application for Medicaid or other state programs. In other circumstances, there is a 60-month waiting period.

Since the donors may act as their own trustees, they can control the investment of all of the assets. If income is not needed in the present, the investments can be directed to generate deferred income. Zero coupon bonds or growth mutual funds are types of investments that can be used to accomplish that goal. The income that is not currently paid out can be made up in later years if needed.

Administration and Costs

The costs to establish and maintain a CRT are usually nominal as compared to the benefits. Most significant charities have deferred-giving departments. They are willing, in most situations, to provide trust documents for a potential donor at no cost. Many of the charities' deferred-giving departments have computer programs provide various scenarios that are helpful in determining the best type of CRT to use depending on a donor's objectives.

There are typically four tax returns that need to be filed annually. In addition, a Form 8283 needs to be filed with the individual tax return for each year that property is put into the CRT. A Form 709 (gift tax return) should be filed in the year of the gift. The trustee is responsible for the filing of these returns. As a planner, you may provide these services to your clients. The donors can serve as their own trustees and retain a CPA firm to prepare the tax returns. There are also independent trustee firms that take care of all the investment and filing requirements at reasonable fees. In addition to these options, the deferred-giving department of some charities handles all of the administrative responsibilities at no cost to the donor. The choice of which form of administration to use depends on the degree of control the donor desires to exercise over his or her CRT. ■