

**Put not your trust in money,
but put your money in trust.**

—OLIVER WENDELL HOLMES

The landmark Tax Reform Act of 1969 defined charitable remainder trusts as a way of charitable giving that has since benefited thousands of educational, charitable and religious institutions and tens of thousands of their donors. Unlike tax shelter investments that seem to have little economic purpose except tax avoidance, these charitable giving plans enable you to make substantial gifts to charitable organization(s) and assure you a life income as well as current tax benefits.

An Extraordinary Plan

The *charitable remainder trust* is an extraordinary plan. You transfer assets to this type of trust in return for income for a period of years or your lifetime. This income may be paid to you, your spouse or another individual. At the death of the surviving beneficiary, the remaining principal in the trust goes to the charitable organization(s) of your choice.

You can design your trust to fit your own special needs. First, you decide how much you'd like to put into the trust. Second, you determine the income you'd like to receive from the donated assets. The rate of income return you select must be at least 5 percent. Usually, the rate selected is 5 percent to 7 percent. The best rate for you will depend upon the number of beneficiaries you select and their ages. Third, you decide whether you want the income *amount* or the income *percentage* to remain constant each year.

There are two types of charitable remainder trusts:

Annuity trust. This type of trust will pay you, year after year, the same dollar amount you choose at the outset. The income payments are fixed, based on the starting valuation.

Example: Peggy transfers \$100,000 to fund her annuity trust and elects to receive \$6,000 a year for life, payable in quarterly installments of \$1,500 each. She prefers having a payout that won't change, regardless of the yield or the value of the trust's investments.

If necessary, some of the distribution can be paid from principal, though this would reduce your ultimate gift to the charitable organization(s). On the other hand, any yield in excess of the required payout is retained by the trust, increasing your contribution.

Unitrust. This type of trust will pay you, each year, a fixed percentage of the fair market value of the trust's assets, as revalued annually. This means your income is variable, because it's based on the trust value. If the value of the fund increases, so does your income and, ultimately, your charitable gift. If the market value decreases, so does your income and our ultimate benefit from the trust. A unitrust must distribute at least 5 percent of the annual market value of the assets in the trust (you can select a higher percentage).

Example: Larry funds a unitrust with \$100,000 and arranges payouts each year equal to 6 percent of the fair market value of the trust assets. The first year, he receives \$6,000 (6 percent of \$100,000). One year later, the assets are worth \$110,000, so Larry receives \$6,600 for the upcoming year (6 percent of \$110,000). Larry realizes that if the fair market value is less at the start of the succeeding year, the payout for that year will be reduced, but he believes that over the years the trust investments will grow.

Annuity Trust or Unitrust?

Whether you choose an annuity trust or a unitrust depends primarily on your economic outlook. With an *annuity trust*, you receive the same fixed amount each year that you choose at the beginning. This is advantageous when you want to be certain of the dollars you'll receive. If you're concerned about the fluctuation of market values, the annuity trust has greater appeal. Although you can't add to this annuity trust later in

order to increase your income, you can always create a new trust for that purpose.

In comparison, a *unitrust* may be a hedge against inflation. If you foresee economic growth resulting in appreciation of the trust's assets, you'll favor a unitrust. The valuation can rise or fall, but over time a well-managed unitrust may offer better protection of your purchasing power than fixed dollar payments. A further advantage is that if you want to enlarge the trust later, you can make additional contributions without the cost of creating and administering more than one trust.

Marvelous Tax Benefits

Now look at the major and wide-ranging tax savings you can realize when you create a charitable remainder trust.

First, when you fund the trust, you immediately obtain the benefit of a sizable income tax charitable deduction. This is equal to the present value of the remainder interest ultimately payable to the charitable organization(s) you choose, based on Internal Revenue Service tables of life expectancy factors. The older the beneficiary, the greater the charitable deduction.

You can fund your charitable remainder trust with cash, securities or other property. Highly appreciated assets that generate low current income are an ideal funding medium. While you'd be reluctant to sell such assets directly because of the tax you would pay on the gain, you can transfer them to the trust without incurring the capital gains tax. The trust could sell the assets without incurring any tax and then reinvest the proceeds in order to secure a higher current income yield.

Perhaps over the years your personal investments have grown handsomely, but you now realize that their yield is grossly inadequate. Unfortunately, if you sell and reinvest in higher yielding securities, you'll lose a large part of your gain to taxes.

The answer? Transfer your appreciated securities to a charitable remainder trust. In return for your gift, you

might get an income two to four times greater than the current dividend from the typical growth stock.

Example: Joan, age 75, owns several stocks with a market value of \$100,000, but they pay dividends of only \$2,000 a year, or 2 percent of market value. She decides to transfer these securities to a charitable remainder annuity trust that will pay her \$7,000 a year, increasing her gross income by \$5,000.

If Joan sold her stocks instead, she would pay an enormous tax on her capital gain. Their cost basis is \$30,000, compared to the current market value of \$100,000, resulting in a gain of \$70,000. At a federal capital gains tax rate of 15 percent, the tax would be \$10,500. This would leave her with only \$89,500 to reinvest, so she would have to find stocks that pay a dividend of more than 8 percent to receive the same \$7,000 her trust can pay her.

Even More Tax Advantages

The tax benefits of a charitable remainder trust don't stop with the charitable deduction and avoidance of capital gains tax. Other tax advantages include:

Taxation of annual payments. This depends on what type of income your trust earned during the year (or what was undistributed from prior years). Each payment is treated first as ordinary income to the extent of the trust's ordinary income; second, as capital gains to the extent of the trust's capital gains; third, as tax-exempt income to the extent of the trust's tax-exempt income; and last, as a tax-free return of principal.

Investment policies and performance, as well as the type of trust (annuity trust or unitrust), will determine the taxation of the annual payments. The point is, part of your income may be treated as capital gains or may even be tax free. The trustee will tell you what to report, so you don't have to figure this out yourself.

If you want to receive tax-free income, you can deposit tax-exempt securities, assuming they meet with the trustee's approval for retention by the trust. But the trust instrument may not require that other kinds of

transferred property be converted into tax-exempt securities or that only tax-exempt investments may be made by the trust.

Estate tax savings. Where you are the only income beneficiary, your charitable remainder trust will be free from federal estate tax. Because of the marital deduction, this is also true if your spouse is a U.S. citizen and the only surviving income beneficiary.

If the surviving beneficiary is not your spouse, the life interest of the survivor may be subject to tax, depending on the size of your estate and the available tax benefits remaining in your estate. The value of the survivor's interest is based on that individual's age at your death. But the charitable contribution of the remaining principal, made on a survivor's death, is always tax deductible.

Who Can Benefit? Some Typical Cases

You may wonder if your circumstances match those of others who decided to create a charitable remainder trust. In fact, people of widely varying ages and financial situations do benefit, as these examples illustrate:

An individual nearing retirement. You may have personal investments that are highly appreciated, yet have a low yield. By using these assets to fund a unitrust or annuity trust, you can avoid the capital gains tax trap *and* supplement your income from a qualified retirement plan.

A retired couple or individual between ages 60 and 75. If you have a healthy life expectancy, over a longer term a unitrust can provide a hedge against inflation, assuming the trust investments benefit from a gradually increasing market value that exceeds the usual periodic downturns.

An individual over age 75. For you, an annuity trust has a special appeal. You may be more concerned about receiving a fixed and unchangeable income payment than beating long-term inflation.

A single person over age 80. You might find that

a unitrust with a term of 20 years is attractive. The payout balance of the term extending beyond your lifetime can be distributed to your children, grandchildren or anyone you designate.

Someone supporting an elderly parent. You may be seeking a good way to increase a parent's income and also make a philanthropic contribution. A charitable remainder trust can accomplish both objectives.

These are only a few of the many ways a charitable remainder trust can help you supplement other sources of income while providing exceptional tax benefits.

Choosing the Payout Size

As noted earlier, the tax law sets the minimum size of the annual payments to the income beneficiary of a charitable remainder trust.

For an annuity trust, the fixed dollar amount must be at least 5 percent of its initial net fair market value. For a unitrust, the fixed percentage generally must be at least 5 percent of the trust's net fair market value, as determined each year. You may also choose from three unitrust variations: "net income with makeup," "net income without makeup" and "flip." (We'll be glad to explain their advantages.)

Is there any upper limit on the amount or percentage? A charitable remainder trust must have a payout rate limited to a maximum of 50 percent, and it must have a charitable remainder value of at least 10 percent of the value contributed to the trust.

You probably would like to receive a higher payout than you could obtain from other investments. That's understandable. But the payout should reflect a reasonable expectation of the trust's total return, which is its investment performance as measured by price changes and reinvested earnings.

If the payout size is larger than the trust's total return in future years, the trust's principal will gradually erode, reducing the charitable remainder. The U.S. Treasury rules base the value of the charitable remainder on the

payout rate, so the higher the payout, the smaller the charitable value. And, of course, your anticipated contribution to us will be smaller, as well.

Despite these considerations, you will be pleasantly surprised to see how a charitable remainder trust can increase your income from low-yield investments.

Now Add Up Your Benefits

Unlike other ways of contributing to a charitable organization, a charitable remainder trust allows you to keep the benefits of the donated assets for life.

Look at these personal benefits you can enjoy:

- Increase your income when you give to a trust designed to pay out more than you now earn on the assets you will contribute.
- Receive a money-saving federal income tax charitable deduction.
- Pay no capital gains tax when you transfer unmortgaged appreciated assets to the trust.
- Free yourself from investment worries by securing professional management of the assets you give.
- Gain the enduring satisfaction of having made a major commitment to a charitable organization(s).

Design Your Own Life Income Plan

When making any investment or charitable gift, first consider what is best for you, and keep in mind the options listed in this brochure as you make or review your estate plans. You may find that you can make a much larger contribution than originally anticipated and, at the same time, enhance your current income. With the counsel of your legal and tax advisors, a trust can be tailored to your personal circumstances.

We welcome the opportunity to work with you to achieve your goals. Please call to make an appointment with our representative—with no obligation, of course.

The information in this publication is not intended as legal advice. For legal advice, please consult an attorney. Figures cited in examples are based on current rates at the time of printing and are subject to change. References to estate and income tax include federal taxes only; individual state taxes may further impact results.



YOUR GUIDE TO Charitable Remainder Trusts