

CHARITABLE REMAINDER TRUSTS

Killing Several Birds with One Stone

Provided by Timothy C. Hucks, CEP, President, Rising Tide, Inc.

In planning for your retirement, you may face several financial issues. Maybe you'd like to generate retirement income, but don't want to pay capital gains tax on investments you've held for several years. Perhaps you'd like to minimize your income taxes during retirement. You also might like to reduce the size of your taxable estate so more of your money goes to your heirs. Finally, you may wish to create a legacy or support a cause, church or charity that is close to your heart.

A Charitable Remainder Trust may help you realize all these objectives.

How does a CRT work?

A CRT is a tax-exempt irrevocable trust. You can transfer cash and highly appreciated assets to the trust, and in return, you may arrange to receive income for life or a specified stretch of time (not to exceed 20 years). Income may potentially be paid out of the CRT not only during your lifetime, but also over the lifetimes of your heirs. Eventually, a percentage of the assets in the CRT go to charities or non-profits of your choice.¹

In brief, the CRT gives you a chance to

- gain a current income tax deduction
- avoid estate taxes on the gifted assets
- create an income stream
- achieve tax-free compounding of assets (until withdrawn from the CRT)
- sell assets with a low cost basis without incurring capital gains taxes²

The transfer of assets to a CRT qualifies as a charitable contribution, thereby allowing you to take an income tax deduction based upon the estimated present value of the remainder interest that will eventually go to charity.¹

As a CRT is an irrevocable trust, assets transferred into it are no longer included in your taxable estate - though you do retain an interest in the gift or transfer.³

A CRT does have some disadvantages.

The word to keep in mind here is "irrevocable." When you set up a CRT, you are signaling to the Internal Revenue Service that those assets will have one of two destinies. Either they will go to your heirs and charity when you die, or you will withdraw them before you die and pay the resulting taxes on the withdrawal. In the meantime, you need to make sure that you have enough money outside the trust to provide for any needs you may have.

A second disadvantage in using a CRT is that the income tax deduction for charitable giving does have limits. These limits may prevent the entire amount from being used to lower your income tax.

What about your heirs?

On the surface, a CRT would seem to present a family with one huge disadvantage. After all, it tells the IRS that you plan to leave a bunch of your money to charity - and that money is also removed from your estate.

So the question naturally comes up: "If I do this, am I going to disinherit my kids?"

There's a way around that.

A good CRT strategy actually involves two trusts. Besides the CRT, you can set up a parallel wealth replacement trust funded with life insurance.

Through this irrevocable life insurance trust, your heirs may receive a proper inheritance. The wealth replacement trust is ideally administered so that its death benefit is at least equal to the value of the gifted assets. So when you pass away, the CRT transfers its assets to charities and your heirs receive tax-free life insurance proceeds.^{3,4}

To use life insurance, however, you'll need to be insurable. Furthermore, you'll want to make sure the benefits of the CRT outweigh the costs of the life insurance premiums.

Timothy C. Hucks, CEP, is a Certified Estate Planner, Registered Investment Advisor and President of Rising Tide, Inc. He may be reached at www.risingtideinc.com, 919-968-8675, or tim@risingtideinc.com. Securities offered through [Capital Investment Group, Inc.](http://www.capitalinvestmentgroup.com) Corporate Office: 17 Glenwood Avenue, Raleigh, NC 27603 • 919.831.2370. Member [FINRA/SIPC](http://www.finra.org).

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