Realize Tax Savings with Impact - Charitable Remainder Trusts

WORTH KNOWING®

Note: For those with highly concentrated stock positions that have larger capital gains implications, the approach outlined below offers an even greater benefit.

A lifetime gift to a charitable remainder trust can produce impressive tax and nontax results. A charitable remainder trust is a form of irrevocable trust that involves annual distributions to one or more individuals (the "Beneficiary") for life or for a term of 20 years or less, at the end of which the balance of the trust value goes to charities as designated by the creator of the trust.

The principal advantages of a charitable remainder trust are as follows: (1) the gift qualifies for a charitable income tax deduction equal in value to the charitable remainder interest, (2) the gifted assets within the trust are exempt from federal income taxes, so the trustee can sell any appreciated assets gifted at no tax cost and then reinvest the proceeds in a more diversified portfolio, and (3) distributions from the trust to the Beneficiary will be made over time, thereby providing benefits similar to those of a tax-exempt retirement plan.

Generally, for a high-income earner with a sizable taxable estate, the tax benefits alone make this trust strategy compelling. Moreover, a charitable remainder trust can create a significant charitable impact for organizations that align with the trust creator's values and should be considered as part of any estate planning process that includes a focus on charitable gifting.

EXAMPLE:

To demonstrate a scenario with one of the greatest financial benefits, assume a client has a substantial portion of net worth tied up in one stock with little to no cost basis. This could even include a position in which the client is considered an insider, which would normally restrict the ability to liquidate the position. Once wealth is created, having a high concentration in one stock means that any price fluctuation in the wrong direction could have a dramatic negative impact on the client's net worth.

By establishing and funding a charitable remainder trust with appreciated stock, the client can sell the shares without triggering capital gains tax, which would have otherwise reduced potential reinvestment if the client had sold the shares personally. Further, the trust can be structured so that assets are out of the client's control, meaning any previous stock restrictions would not apply. Following the sale, all of the proceeds can be reinvested in a diversified portfolio.

For the purposes of this example, we will assume that the client is in the top tax bracket and incurring an income tax anywhere from 37% to 50% depending on the state of residence. We will also assume that the client is 62 years old and establishes a charitable remainder trust that pays a 7% unitrust distribution annually over the individual's lifetime. Based on these factors, every $1 million gifted to the trust would result in a charitable deduction of approximately $300,000. Utilizing this deduction would lower taxes owed by $110,000 to $150,000. This is an immediate 11% to 15% return on the gift to the charitable remainder trust.

Further, a 7% unitrust distribution means that, over a lifetime, the client will receive an annual payout equal to 7% of the trust's assets valued as of December 31 of the prior year. Based on general growth assumptions, it should take approximately 20 years for the initial tax savings along with the annual trust distributions to place the client in a financially better position than the client would have realized without utilizing this strategy.

The example above is based on general assumptions and results will vary. Because there are several types of charitable remainder trusts to choose from, the specific terms that the trustor selects when creating the trust will influence results.

While the preceding example focused on the financial benefits to the client, it should not be overlooked that this strategy will also have a meaningful impact on the charitable remainder beneficiaries. As long as the portfolio of the trust grows enough to cover the annual distribution percentage, a sizable gift will be going to the selected charitable organizations at the close of the trust's term.

As illustrated above, a charitable remainder trust could result in significant value to the estate plan for you or a client. To learn more, feel free to reach out to someone within the Personal Planning team. This piece was drafted by Scott Wallace (**SWallace@perkinscoie.com** or 206.359.3729) and Nick Potter (**NPotter@perkinscoie.com** or 425.635.1636) from the Personal Planning group along with Chris Walcott of Perkins Coie Trust Company (**CWalcott@perkinscoie.com** or 206.359.8386). We are also available to field any questions you may have.