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The Charitable Remainder Trust-Part 2 (Requires reading Part 1 first)

In Part-1, I discussed the basics of setting up this type of Trust, and reviewed some of the important features of a CRT. Below are some answers to the most popular questions my clients ask about this type of Trust. ($2,000,000 asset for 22 years)

"How does a Charitable Remainder Trust make a difference?"

If they transfer title to the real estate to a CRT, the Trustee will sell it for $2,000,000. But because the Trust does not pay any capital gains tax, the Trustee can reinvest the full $2,000,000. The Trustee invests the proceeds in assets that produce income. Now, the 5% return will generate a yearly income of $100,000. Before taxes, this will give them a total lifetime income of $2,200,000. That's $396,000 more income than if they had sold the property themselves. Plus, they can take a charitable income tax deduction when the property is contributed to the Trust. This will result in additional income savings.

"How much money do we receive as income?"

You can choose to receive money in two ways:

Fixed Percentage: You can choose to receive a fixed percentage of the Trust assets every year. Under this method, the amount of your yearly income will vary based on how well the Trust's investments perform. At the beginning of each year, the Trust will be re-valued to determine the amount of income you will receive. Since the Trust assets grow tax-free, the Trust can quickly increase in value if the Trust is well managed and if the investment market is sound.

Fixed Amount: You can choose to receive a fixed amount of income every year. This means you get the same amount of income, regardless of how much money the Trust earns. As people grow older, they often like to know exactly how much money they will receive.

If the assets donated to the Trust are not readily marketable, the Trust may have trouble paying your income. Your lawyer can set up the Trust so it pays you a fixed percentage of the Trust's assets -- or the actual income earned by the Trust -- whichever is less. Your Trust can also include a provision stating that during years when the income is higher, the Trust can pay you added income to make up for your losses during bad times.

"Who can receive income from our Charitable Remainder Trust?"

You can receive income from the Trust for your lifetime. If you are married, the income goes to you or your spouse, as long as either of you lives.

In addition, the income can go to your children for their lifetimes -- or to any person or entity you wish, as long as the Trust meets certain legal requirements. A charity cannot receive income. Only the remainder interest goes to charity. If someone other than you or your spouse receives the money, you should realize that you are making a taxable gift upon funding the Trust which will use a portion of your lifetime exemption against transfer taxes.

"How much control do we have over the Trust?"

When you set up the Trust, you put instructions into the Trust that the Trustee must follow. Then, for as long as you live, your Trustee controls the Trust assets. If you are not satisfied with your Trustee, you can retain the right to change Trustees. And, of course, you can also choose to act as Trustee yourself. In addition, you may be able to change the charity that receives your assets, without losing your tax advantages.

Even so, the reason you receive so many benefits from the Trust is because after you set it up, you cannot change your mind. The Trust is irrevocable. That's why it's important that you understand the Trust -- and decide, with the help of a Trust Attorney, that this decision is right for you.

"What do we lose by setting up a Charitable Remainder Trust?"

To gain the benefits of the Trust, you give up two things: You give up the asset you put into the Trust (in exchange for many benefits, such as lifetime income). And you give up the ability to revoke the Trust. Still, if the Trustee is not performing to your satisfaction, you can change Trustees. And you can also change the charity that receives your asset. But you cannot cancel or revoke the Trust because a Charitable Remainder Trust is, by definition, irrevocable.

That's why it's important that you understand the Trust and -- with the help of a skilled, experienced attorney -- make sure this decision is right for you. Thousands of people set up Charitable Remainder Trusts each year because they want future lifetime income and the many tax benefits. The decision to set up a Charitable Remainder Trust should not frighten you, but you should realize it's an important decision that will affect you and your family.

Summary

Here's how the Charitable Remainder Trust and the Irrevocable Life Insurance Trust work together.

You start with a highly appreciated asset. Your attorney creates a Charitable

Remainder Trust -- PLUS the Irrevocable Life Insurance Trust. You name a Trustee to manage the Trust. Then you transfer the asset into the Trust -- and the Trustee sells the asset at fair market value. The Trustee then invests the proceeds from the sale, generating income for the Trust, from which you receive income for life.

Tax Benefits: You receive a charitable income tax deduction beginning the year you transfer the asset to the Trust. This reduces your current income taxes. Since your asset is going to charity, the Trustee pays no capital gains tax on the sale. And since you have transferred the asset out of your estate, when you die, your heirs pay no estate taxes on this asset.

From the money you save in taxes, you fund the Life Insurance Trust. The Trustee buys life insurance that will replace the full value of the asset in your children's inheritance. In this way, your children actually receive more money because they do not have to pay capital gains and estate taxes on the asset. Plus, the life insurance proceeds avoid probate, as well as income and estate taxes.

Also, the charity benefits now because it knows it will receive your gift in the future. As a result, it can lay the groundwork for how it intends to use the money, so everything is in place when your gift goes to the charity.

The Charitable Remainder Trust benefits you, your children and your favorite charity. If you own highly appreciated property and would like to convert it to future income, I invite you to call me.

Anthony J. Medico, Esq., *has practiced law for over 27 years. To ask a question regarding this article, send an e-mail to info@medicoandassociates.com or call us at (203) 661-8151. To read more highly informative Estate Planning articles, visit our website at www.medicoandassociates.com, where you can also download our free Estate Planning Survival Guide. Enjoy.*

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