GIVING THROUGH CHARITABLE REMAINDER TRUSTS

[This space may be used for logo
and other contact information.]

Giving... and receiving

Over the years, a number of special financial and estate planning tools have been developed to help you make charitable gifts while you also enjoy a source of additional income, tax savings and other welcome benefits.

The *charitable remainder trust* is an example. Through the use of this popular plan, you may be able to achieve one or more goals:

- Increased income from low-yielding assets.
- Reduction or elimination of taxes that may otherwise be due.
- Diversification of investments and the potential for tax-free growth of assets.
- A source of income for children, parents or other loved ones.
- The enjoyment that comes from making charitable gifts that might not have been possible otherwise.

The role of trusts

What we refer to as *trusts* have developed over time to help manage and transfer property in the future in ways that meet a number of goals and objectives. There are many types of trusts designed to help meet various planning needs.

Trusts may be relatively simple or complex. Trust documents should always be drafted or reviewed by your attorney. You may choose to be the manager (or trustee) of your trust or choose others to do so along with you or instead of you.

Meeting charitable goals

The charitable remainder trust has been used for many years as a way to make charitable gifts after first satisfying other important financial needs.

Congress has provided generous income, gift and estate tax savings possibilities for those who wish to make gifts using this special plan. Recent tax law changes may have made giving in this way even more attractive for some.

How a charitable remainder trust works

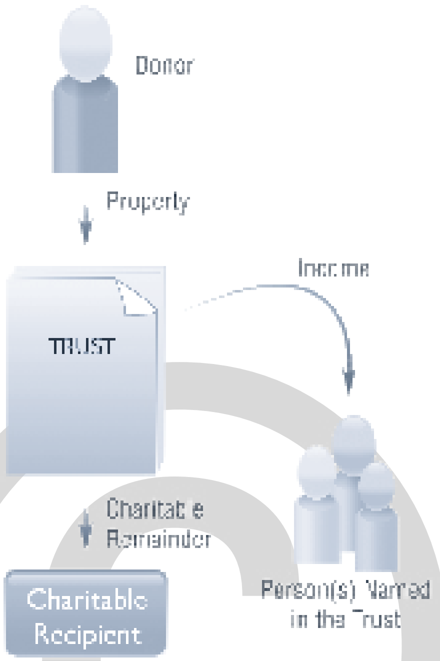
With the help of advisors, you transfer cash or other appropriate property to a trust created under applicable state and federal laws.

You may specify that payments from the trust be made to you and/or others you name for life. It is also possible to provide income for a period of time up to 20 years, or certain combinations of lives and time periods.

When the trust ends, the charitable remainder—the property remaining in the trust—is devoted to the charitable purposes you designate.

Because amounts transferred to the trust will be used for charitable purposes in the future, you are entitled to a federal income tax deduction equal to the value of the gift portion of the trust. These deductions can eliminate tax on a significant portion of one's income for up to six years. They may also make it possible for some to itemize other deductions where it would otherwise not be possible.

How it works



Enjoy additional income

Assets worth more than they originally cost that provide less income than desired can be placed in a charitable trust, sold and the proceeds reinvested in other ways. Because of the charitable nature of the trust, no capital gains tax is due when the assets are sold.

The entire net proceeds of the sale are thus available to grow on a tax-free basis. Any growth in the trust beyond what is necessary to meet payments to trust beneficiaries are devoted to charitable purposes when the trust terminates.

Plan for retirement

Through a charitable remainder trust, you can enhance your retirement income while making a meaningful charitable gift that may not otherwise be possible.

Example: Mr. Hamilton, age 62, is planning to retire in a few years. His assets include securities that have grown in value but yield little income.

He decides to use a portion of these securities to fund a charitable remainder trust. The trust can sell the assets, pay no capital gains tax at the time of sale and reinvest the entire net proceeds in a way that will yield tax-favored payments for him in the future.

Because the full value of the securities will be available to invest, Mr. Hamilton may receive more income each year for the remainder of his life than if he had sold his investments and reinvested the proceeds on his own.

Another benefit he enjoys is the charitable income tax deduction that will be available in the year of his gift. The savings from this deduction can be significant and, when combined with other tax savings, the final cost of making his gift can be greatly reduced.

The amounts placed in his charitable remainder trust will also be removed from his taxable and probate estate and will not be subject to state and/or federal estate taxes and other expenses that could otherwise apply.

Note that Mr. Hamilton has also provided for management of his assets should that be necessary in later years. The assets are set aside so they are permanently reserved to first provide income for him before eventually funding his charitable interests.

Receive income for a period of time

It is also possible to establish a charitable remainder trust for a number of years you choose. This may be done to produce increased income on a temporary basis before funding a charitable gift.

Example: George and Mary, ages 59 and 57, are considering making a significant charitable gift but would like to first provide funds for expenses such as their daughter's wedding and their son's graduate education. They have substantial assets that have grown in value over the years but provide little income.

They are pleased to learn that they can place these assets in a charitable remainder trust that will pay them a generous fixed income each year for the next 10 years.

George and Mary will be entitled to a federal income tax deduction for over half of the amount placed in the trust and a portion of the income from the trust will be taxed at lower rates than other income. They plan to use their increased income to help fund travel, weddings, education and other expenses. They might also choose to use all or a portion of the income and tax savings to purchase life insurance payable to their loved ones to help replace the assets used to fund their trust.

Their charitable deduction is also large enough to allow them to itemize their other income deductions for several years, thus providing additional tax savings.

Care for parents and others

You can also create a charitable remainder trust that will pay a fixed or variable income to one or more older relatives or friends for the remainder of their lifetimes.

As in the previous examples, a charitable income tax deduction is allowed for a portion of the value of the assets used to fund the trust. The deduction is based on the life expectancy of the income recipient or period of time they will receive income. The older the income beneficiary(ies), the greater your tax savings.

Exploring the options

The trusts described in this booklet can be used at different points in life to meet a variety of personal financial and philanthropic goals. They can provide either fixed or variable payments.

Fixed payments: If you prefer payments that will not change over time, consider a *charitable remainder annuity trust.*

The annual payout amount is determined at the time the trust is created, and that payment continues for the duration of the trust, regardless of the performance of the trust assets.

Variable payments: If you prefer payments that fluctuate with the value of the assets or earnings of your trust, consider a *charitable remainder unitrust.* This type of trust makes payments equal to a percentage of the value of the assets as determined on an annual basis. If you wish, you can stipulate that an amount equal to the actual earnings be paid, if that amount is less than the percentage of the trust assets specified in a given year. Payments less than the required amount can be "made up" in subsequent years.

Flexible timing: As noted earlier, each type of trust described here can be created for one or more people's lives or for a period of time up to 20 years. If you prefer, you may instead provide that the trust will last for one or more lives or up to 20 years, whichever is a longer or shorter period of time.

A charitable remainder trust can be created during your lifetime or through a provision in your estate plan for the benefit of one or more surviving loved ones. Income payments can be received annually or more frequently according to terms specified when the trust is established.

Tax benefits and considerations

Charitable income, estate and gift tax deductions are allowed for a substantial portion of the amount used to fund a charitable remainder trust. Deductions are based on a number of factors, including the assets used to fund a trust, how long the trust is expected to exist, the anticipated earnings of the trust, the amount and timing of payments to beneficiaries and whether the payments are fixed or variable.

Recent tax law changes capped or eliminated mortgage interest, state taxes and other popular deductions, but left the charitable deduction unchanged. The tax treatment of charitable trusts was not affected either.

The assets in the trust may be included in your estate. Because the property in the trust is designated for charitable use, however, its value is generally fully deductible, resulting in no net gift or estate tax liability. Estate or gift tax may be due if income is payable during life or at death to someone other than you and/or your spouse.

Minimizing tax on payments

The tax rate applied to payments from a charitable remainder trust depends on the type of income earned by the trust. For example, taxes on capital gain and dividend income may be significantly lower than taxes paid on salary, interest and other income.

For this reason, many trustees will choose to invest for maximum amounts of capital gain and other tax-favored income.

Trusts offer flexibility

As you can see, charitable trusts can help you achieve a number of planning goals. If you would like more information about gift opportunities that may be helpful as you make your plans, please call, email or write. The following section offers additional information that may be of interest to you and your advisors.

Technical Advisory Section

The following information and references to other resources are provided for those who assist you in your estate and financial planning.

Charitable remainder trusts

There are two basic types of charitable remainder trusts: the annuity trust and the unitrust. (See IRC section 664 for definitions.) Both must qualify as valid trusts under applicable local law, and both must meet other specific requirements. Income may be paid to the donor annually, quarterly or at other intervals.

Annuity trusts: A charitable remainder annuity trust pays out each year a fixed dollar amount at least 5% and not more than 50% of the initial fair market value of trust assets. The annuity payments are paid first out of income and then, to the extent necessary, out of principal. Trust income in excess of the required annuity payout must be accumulated and added to principal or be distributed to a qualified charity. See IRC section 664(d)(1).

Unitrusts: A charitable remainder unitrust makes payments each year, an amount equal to a fixed percentage—at least 5% and not more than 50% as selected by the donor—of the value of trust assets for that particular year. The trust assets are commonly valued, as directed by the trust agreement, on the first business day of each taxable year.

A unitrust may also be designed to pay out whichever is less—its net income for the year or the specified fixed percentage amount. With this commonly called a net income unitrust, the trust agreement may provide that, for years in which trust net income exceeds the specified unitrust amount, the excess income may be used to make up for past years in which trust net income was less than the specified unitrust amount. This type of unitrust is known as a net income unitrust with a makeup (or catch-up) provision. See IRC section 664(d)(2).

A net income unitrust (with or without a makeup provision) is ordinarily used when the charitable remainder trust is to be funded with unimproved real estate or another type of asset that produces relatively little (or no) income.

Flip unitrusts: So-called flip unitrusts are trusts designed to start out as net income or net income with makeup unitrusts, that then flip to become straight-payout unitrusts following some triggering event.

The triggering event generally must be an event outside the control of the trustee or any other person. Permissible triggering events include marriage, divorce, birth or death. The sale of an unmarketable asset is also a permissible triggering event. Impermissible triggering events include the sale of a marketable asset or a request from the donor or any other person or entity that the trust flip. The flip occurs as of the first day of the taxable year following the year in which the triggering event occurs. See Reg. section 1.664-3(a)(1)(i)(f).

Trustee: The donor will select an appropriate trustee to manage their charitable remainder trust. An individual or a corporate fiduciary having experience in the management of charitable remainder trusts may be a good choice. The donor, with certain limitations, may alternately name himself or herself as trustee or co-trustee.

Reformation of defective trusts: Many "defective" charitable remainder trusts, which would not otherwise qualify for favorable tax treatment, may be reformed and transformed into qualified trusts. See IRC section 2055(e)(3).

Specimen provisions: To aid drafters of testamentary and lifetime charitable remainder trust agreements, the Internal Revenue Service has issued specimen provisions to be included in such agreements. Many of these can be found in the August 2003 Internal Revenue Bulletin 2003-31, which contain eight charitable remainder annuity trust specimen documents (Rev. Proc. 2003-53 through Rev. Proc. 2003-60). In 2005, the IRS released eight new charitable remainder unitrust specimen documents (Rev. Proc. 2005-52 through Rev. Proc. 2005-59).

Charitable remainder trusts for a term of years: An annuity trust or unitrust may be set up for a specified number of years (not to exceed 20). See IRC section 664(d). It is possible to establish a trust for one or more lives or for a period of time up to 20 years, whichever is a longer or shorter period of time. It is not possible to provide for a trust to last for the life of one or more individuals plus 20 years.

Tax considerations: When a qualified charitable remainder trust is created, a current tax deduction is allowed for the value of the charitable remainder interest (except in certain situations involving funding the trust with tangible personal property). See IRC section 170(a)(3). The method of computing the deduction is described in Reg. section 1.664-4.

The *Taxpayer Relief Act of 1997* added the requirement that the initial present value (as determined under IRS guidelines) of the charitable remainder interest be no less than 10% of the value of the assets contributed to fund the trust. The IRS had previously determined that no deduction would be allowed if it determined that the terms of a trust would lead to a 5% or greater probability that the trust assets would be exhausted prior to the termination of trust. The so-called 5% probability test is laid out in Rev. Rul. 77-374.

If an individual establishes a charitable remainder trust for his or her life only, the trust assets will be included in his or her gross estate under IRC section 2036. The amount included, however, will "wash out" as an estate tax charitable deduction under IRC section 2055. A surviving spouse's interest in a qualified charitable remainder trust qualifies for the estate tax marital deduction. See IRC section 2056(b)(8). Note that the marital deduction is lost if there is any non-charitable beneficiary of the trust other than the donor and the donor's spouse.

Assets sold by a charitable remainder trust are exempt from capital gains tax, as the trust itself is a tax-exempt entity (unless it has any unrelated business taxable income for the year). This can be very advantageous for donors who wish to fund such a trust with highly appreciated, low-yielding assets. The trust will retain the entire net proceeds of the sale of such assets, which can then be reinvested in higher-yielding investments.

There is a four-tier system of attributing ordinary income, capital gain, tax-free income and corpus to the trust payout. See IRC section 664(b). This provision may be very favorable in situations where appreciated assets have been used to fund the trust, as distributions deemed to be trust corpus will be reported by the donor as capital gains income until all capital gain realized by the trust has been paid out. This is especially attractive to donors who pay tax on capital gains at significantly lower rates than the tax on other income.

Under the four-tier system, it can be possible to report dividend income from a charitable remainder trust at lower tax rates than would be payable on other ordinary income. In addition, income earned by a charitable remainder trust from tax-exempt bonds can be received free of tax by a trust beneficiary.

Mortgaged property: In Letter Ruling 9015049, the IRS ruled privately that a trust cannot be a qualified charitable remainder trust if any trust income (which includes realized capital gain) is used to pay a mortgage debt on which the donor is personally liable. There are, however, ways to use property subject to such a mortgage to establish a charitable remainder trust. The most common way is for the donor to pay off the mortgage before transferring the property to the trust.

Testamentary trusts: Some people use charitable remainder trusts in their wills to provide income for a survivor. In the case of a life interest left to a spouse followed by a charitable disposition of the property, a combination of the charitable deduction and the marital deduction can effectively eliminate all tax at the federal level. See IRC section 2056(a).

Wealth replacement trust

A common technique that can be used in connection with charitable remainder trusts is for the donor to replace the asset he or she gives away by buying life insurance on his or her life.

Insurance can be purchased using the income received from the gift plan, the immediate tax savings generated by the gift plan or some combination of both. In many cases, the life insurance is owned by, and payable to, an irrevocable insurance trust—a so-called "wealth replacement trust." This can help ensure that the insurance proceeds will be free from estate taxation.

The tax code and regulations governing charitable remainder trusts change frequently. Check for new developments before completing such arrangements.

[This space as well as the front cover may be used for logo and other contact information.]