



Understanding Charitable Trusts

People with financial savvy look at wealth on a broad scale. They understand the need to acquire as well as to preserve and recycle their wealth; and they realize the value of putting some of their wealth back into the communities in which they have prospered.

Achieving the first objective, the acquisition and preservation of personal wealth, requires hard work, a sound investment program and the avoidance of taxes to the maximum extent permitted by law.

Taxation is the way most people's wealth is redistributed to society. The problem is that taxation is involuntary, and a taxpayer has no direct control over how his tax obligation will be used for the benefit of society. Very likely, little of it will benefit the local community. Keeping your wealth in the community and under the control of your family can now be accomplished with some smart choices.

A Charitable Trust is a completely voluntary act. You can determine how and where the ultimate donation is to be directed. The planning of a Charitable Trust makes a positive statement about the conviction and beliefs of the donor, and can enhance the donor's prestige and influence within the community.

This estate planning tool was created by Congress in 1969, allowing individuals to establish a trust with specific assets today, while retaining the rights to the management of and income from those assets throughout your life, and that of your spouse. You may also establish a trust with a set term of years, not to exceed twenty (20), for the same purpose. However, the assets must pass to the charities after your death, your spouse's death, or at the end of the set term of years.

Using this planning tool provides numerous financial and tax benefits during life and enables you to make substantial gifts to favorite causes. By voluntarily choosing to use this tool, you can benefit yourself, your family and your community.

What Is A Charitable Trust?

A Charitable Trust is a tool used in tax, retirement, and estate planning. It is a method of converting appreciated assets (stocks, mutual funds, real estate, or a business) into a lifetime of income, a legacy for heirs and a substantial gift to charitable causes of one's choice. This is accomplished by eliminating capital gains taxes on the sale of assets and from estate taxes at the last death of you and your spouse.

Who Is It For?

Traditional thought was that the best prospect for the Charitable Trust was only the elderly and highly charitably motivated. Not so! There certainly needs to be charitable intent when using these vehicles. Most people do have good intentions, however, they just do not know how to be charitable without feeling they are totally giving away all their assets to charities. They do not want to give up control of assets especially if they are still in the "accumulation phase" of life. A Charitable Trust is an option today for:

- Someone with a highly appreciated asset and/or a low yielding asset.
- An owner who is selling a business. Capital gains can be avoided and all proceeds of the sale reinvested.
- Professionals with high incomes who might have over-funded retirement plans, yet still feel they need to accumulate more of a nest egg for the retirement years.
- Anyone who would rather leave his wealth to causes of his own choice in his own community, instead of to the IRS and estate taxes.

What Does A Charitable Trust Do?

A Charitable Trust creates "Social Capital" with dollars which otherwise would have been paid in taxes. In other words, a Charitable Trust helps anyone who owns an appreciated asset to maximize the value of the asset. The function of the Charitable Trust is to create and control retirement, estate and charitable dollars while you, your spouse and in some cases, your children, are living.

How Does It Work?

A Charitable Trust is created by the irrevocable transfer of ownership of the asset to a trust and the naming of one or more qualified charitable organizations to be the final beneficiaries. The trustee (manager) of the trust, with no prearrangement with the Grantor, sells the assets. The trust is Income Tax Exempt. There are NO capital gains taxes to be paid on the sale of an asset by a charity, which includes a charitable trust. The trustee then re-invests the full value of the assets to produce the desired future income level for the income beneficiaries. The creator, or Grantor, of the trust retains a right to receive either a fixed percentage of the initial value of the trust property ("annuity trust") or a fixed percentage of the trust property subject to annual re-evaluation ("unitrust"). If you wish, these annual payments can be made to the Grantor's spouse, after the Grantor's death, for the rest of the spouse's

lifetime, or to your children (or grandchildren) for the remainder of the trust term, when a term of years was established. Upon the death of the income beneficiaries, the value of the Trust is available to the final beneficiaries, the charities you have selected.

Do I Keep Control?

You can keep control for as long as you and/or your spouse wish. YOU, not the charity, control the assets in the trust. You can appoint co-trustees or change administrators, money managers, etc. at any point in the future. You can accelerate gifts to charities during your lifetime. If you wish to retain your family's control of the trust after you are gone, you can do so by establishing a Family Foundation as the charity to receive the remaining benefit of the trust.

What About My Children?

Deciding the amount of inheritance to leave children is a personal choice, and a conscious decision is better than one by default. By law, you and your spouse are each allowed to pass a maximum of \$2,000,000, free of estate taxes, to your children. If your total estate exceeds \$4,000,000 it will be subject to estate taxes, at a rate of 45%. If you have created a Charitable Trust, assets that you transfer to it are removed from your taxable estate. This also means they are removed from the estate passing to your children. However, you can "replace" the value of these assets for your children very efficiently.

The money generated from the tax savings generated by the donation to the Trust can be used to "gift" an amount of cash to a separate Life Insurance Trust, sometimes referred to as a Wealth Replacement Trust. The trustee of that trust then purchases a Survivorship (or "Second-To-Die") life insurance policy on you and your spouse. This creates a substitute tax-free inheritance for your children, or grandchildren. Life insurance is the least expensive way to replace the wealth that was transferred to the trust. Beneficiaries of the life insurance contract receive the full cash benefits without probate, and it's completely free of (1) income, (2) gift, and (3) estate taxes.

The insurance purchased by the trust can be paid for with the IRS allowed annual gift limit of \$12,000 per child, per calendar year by both you and your spouse.

Why Use A Wealth Replacement Trust?

It is important that a separate Wealth Replacement Trust be the "owner" of the insurance. This keeps the Proceeds out of your estate and avoids additional estate taxes.

THIS IS THE "EDGE" AMERICA'S WEALTHIEST FAMILIES HAVE USED FOR YEARS.

You Could Gain The Ability To:

- Retain dollars during your lifetime that you would otherwise pay to IRS in income, capital gains, and estate taxes...and put them to work for the benefit of you and your family.
- Choose the charities or causes that, at your death, would benefit from those dollars that you and your family benefited from during life, and would have otherwise paid in taxes.
- Receive a current income tax deduction for your donation. This is immediate in the year the gift is made and can be carried over up to five (5) more years.

What Kind Of Charitable Trust Is Best For Me?

There are many varieties of Charitable Trusts, all with some common characteristics. Without an analysis of your circumstances and goals, it is impossible to say which trust is best for you. Trust design, special investments, administration capabilities, and strategies vary from client to client. A competent estate planning attorney can design a trust unique to your circumstances.

Although the transfer of the asset(s) is irrevocable, this trust allows you flexibility and control over the investments. You can begin drawing an immediate income or you may elect to postpone income allowing the investments to compound and grow tax—deferred. You can vary the amount of income you receive, and the unused money can remain in trust and at the last death goes to your choice of charities, or to a Family Foundation. However, the payout to you or your spouse can never be so high as to obliterate the interest passing to charity.

Anyone considering a charitable trust must consider the disadvantages to the charitable trust. First, payments to you and your spouse are limited to the fixed percentages set forth in the trust document. No extra payments or distributions can ever be made to you or your spouse, even if your needs for income increase. Second, after both you and your spouse are deceased, the property left in trust passes to the charity, not to your children or other heirs. Also, the charitable trust must file income tax returns with the federal government, and in some cases, the state where you live.

Charitable trusts can be set up and funded during your lifetime (*inter vivos*) or can be set up to take effect at your death, receiving lump sum death benefits from your IRA or retirement plan. Funding the charitable trust with tax deferred retirement funds can provide a lifetime income for your spouse or children, while avoiding immediate income taxes and minimizing or eliminating federal estate taxes.

In order to determine if a charitable trust is right for you, consult a competent estate planning attorney. The potential and income estate tax savings can have many benefits to you, to your family and to charitable causes of your choice.

This article was prepared by Midgett & Preti PC and is intended to provide general advice only. For answers relating to a specific situation, you should consult a competent estate-planning lawyer.