

Charitable Remainder Annuity Trust

Planned Charitable Giving
Using a Split-Interest Trust

CRAT Overview

- Lifetime transfer of cash or property in trust in exchange for annuity interest payable over
 - (a) Fixed term of years not to exceed 20
 - (b) Lives of one or more noncharitable beneficiaries
 - Shorter of (a) or (b)
- Fixed-dollar payout determined on the basis of the trust's fair market value at time of funding
- Assets remaining in trust after expiration of annuity interest pass to charity

CRAT Advantages

- Deferral of capital gains taxes on sale of appreciated property transferred to the trust
 - Tax-free portfolio diversification inside CRAT
 - Sales proceeds undiminished by taxes are reinvested by trustee for growth and income
- Fixed-income stream retained by donor and/or family members
- Donor is entitled to income, gift and/or estate tax deductions for value of charitable gift
- Tax-efficient, deferred gift to charity

CRAT Requirements

- Transfer is irrevocable
- Guaranteed annuity payable to noncharitable beneficiaries at least annually
 - Payments must be in cash and/or property only
 - Payments cannot be less than 5% or more than 50% of trust's initial fair market value
 - Probability of exhaustion of trust assets must be $\leq 5\%$
- Actuarial value of remainder interest must be at least 10% of the value of the transfer at time of funding
- Additional transfers to CRAT are prohibited

CRAT Tax Treatment

- Trust is tax-exempt unless unrelated business taxable income is present, in which case UBI is fully taxed
- Annuity payouts are taxed to noncharitable beneficiaries under tiered system, as follows:
 - Ordinary income
 - Short-term capital gains
 - Long-term capital gains
 - Tax-exempt income
 - Corpus
- In-kind distributions may trigger capital gains

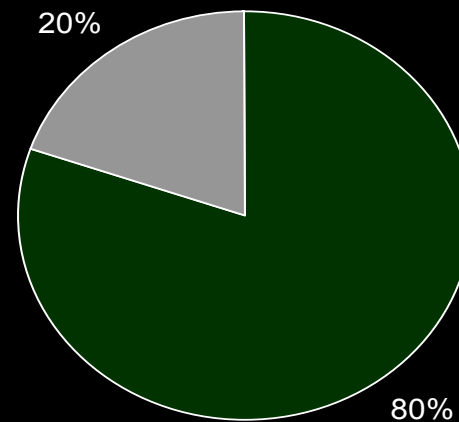
CRAT Tax Deductions

- Charitable income tax deduction equal to value of remainder interest at time of funding
 - Donor can elect to use section 7520 rate for month of funding or either of two preceding months
 - Deductions limited to % of adjusted gross income
 - Unused deductions carry forward for up to five years
- Deduction based on tax basis rather than fair market value if charity is private foundation
- Gift and/or estate tax deduction based on fair market value regardless of charity's character

Charitable Deduction Example

- \$1,000,000 stock transfer
- 20-year CRAT
- Donor age 55
- 5% annual payout
- 2.2% 7520 rate

Actuarial Split at Funding



■ Income Interest
■ Charitable Remainder Interest

CRAT Suitability

- Appreciated property with a motivation to sell
 - Need or desire for portfolio diversification
 - IPO or M&A transaction is contemplated
 - Conversion of nonproductive property to fixed annual income stream
- Prospective donor with charitable intent
 - Irrevocable transfer to charity is required
 - Retained interest is limited to an annual payout based on the trust's initial fair market value
- Testamentary CRAT can shift the IRD tax burden

CRAT Enhancers

- Structuring and timing CRAT implementation for larger charitable tax deductions
 - Lower CRAT payout rate
 - Higher section 7520 rate
- Funding *inter vivos* CRAT with bond portfolio earmarked for partial charitable bequest
 - Set payout rate equal to bond portfolio yield
 - Converts estate deduction to income tax deduction
- Wealth replacement trusts may be used in conjunction with CRATs to maximize wealth

CRAT Plus Wealth Replacement

- Life insurance replaces the lost wealth associated with the charitable transfer
- Policy owned by and payable to an irrevocable trust (a.k.a., wealth replacement trust)
 - Insurance proceeds are excludable from donor/insured's estate
 - Tax savings and income stream from the CRAT can fund insurance premiums
- Wealth replacement trust can be structured as a dynasty trust

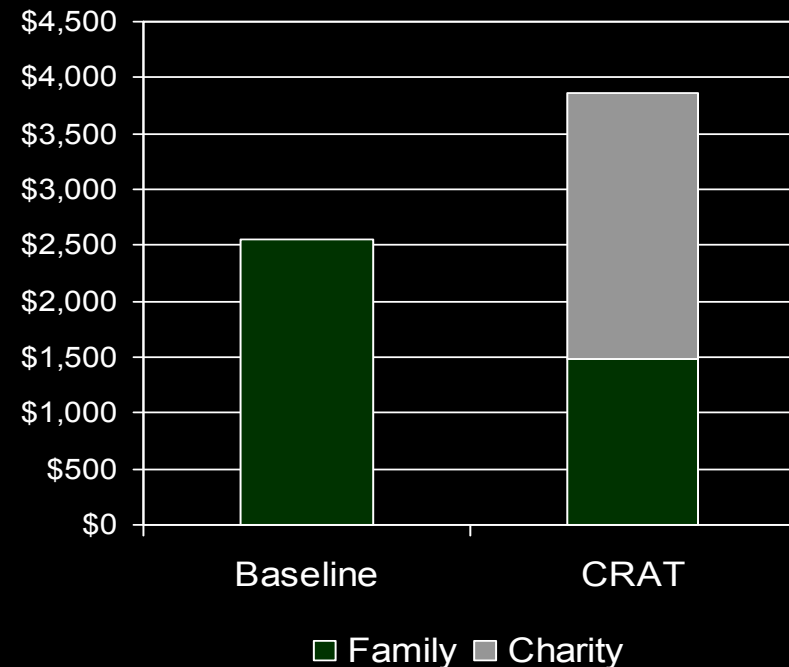
CRAT Drawbacks

- Legal and administrative fees
- Irrevocable transfer is required
 - Only a fixed annuity interest can be retained
 - Donor should have significant charitable intent
- Value of fixed annuity over time is eroded by inflation
- Unrelated business taxable income causes trust to partially lose tax-exempt status for that year
- Transfer of debt-encumbered property can be problematic

Wealth Accumulation Example

- \$ 1,000,000 stock transfer
- \$250,000 tax basis
- 20-year CRAT
- Donor age 55
- 5% annual payout
- Highest tax brackets
- 2% income rate
- 6% growth rate
- 2.2% 7520 rate

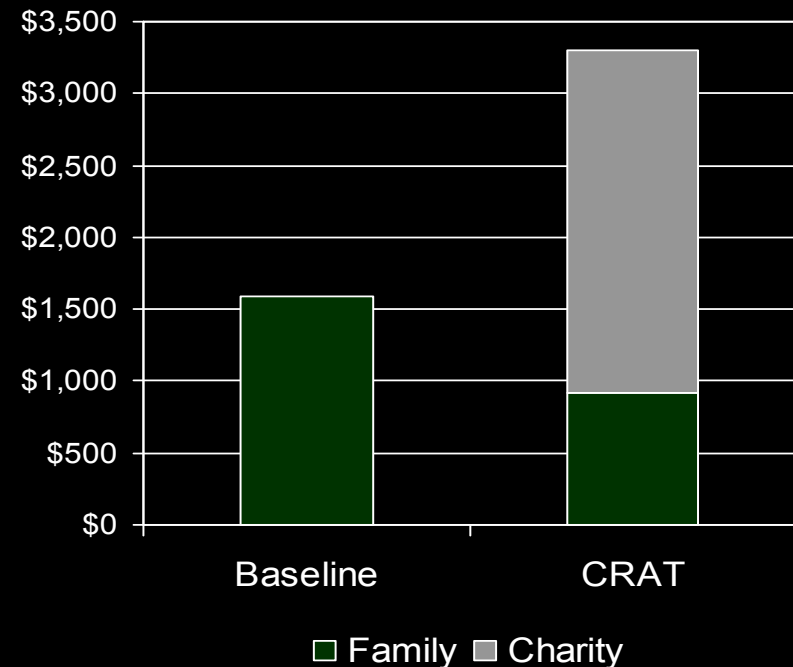
Wealth Accumulation Comparison
in \$Thousands



Wealth Transfer Example

- \$1,000,000 stock transfer
- \$250,000 tax basis
- 20-year CRAT
- Donor age 55
- 5% annual payout
- Highest tax brackets
- 40% federal estate tax rate
- 2% income rate
- 6% growth rate
- 2.2% 7520 rate

Wealth Transfer Comparison
in \$Thousands



Summary

- Planning for the disposition of appreciated property and/or IRD presents challenges and opportunities
- CRATs are efficient planned giving vehicles
 - Current tax deduction = value of remainder interest
 - Tax-free portfolio diversification
 - Convert nonproductive property to income-producing
 - Donor retains fixed-income stream for self and/or other noncharitable beneficiaries
 - Significant, planned, future gift to charity