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 <= 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

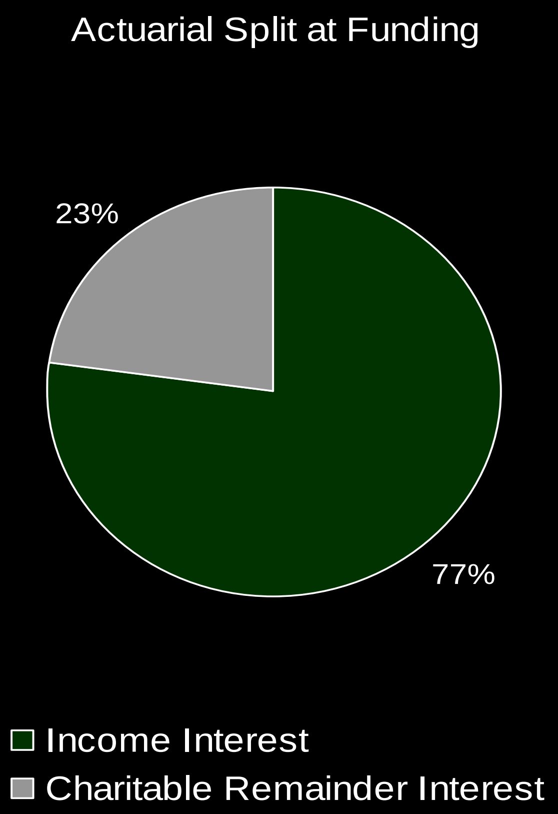
- Trust is tax-exempt unless unrelated business taxable income is present, in which case UBI is fully taxed
- Annuity payouts are taxed to noncharitable beneficiaries under tiered system, as follows:
  - Ordinary income
  - Short-term capital gains
  - Long-term capital gains
  - Tax-exempt income
  - 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 if charity is private foundation, unless gift is qualified appreciated stock
- 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
- 2.6% 7520 rate



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

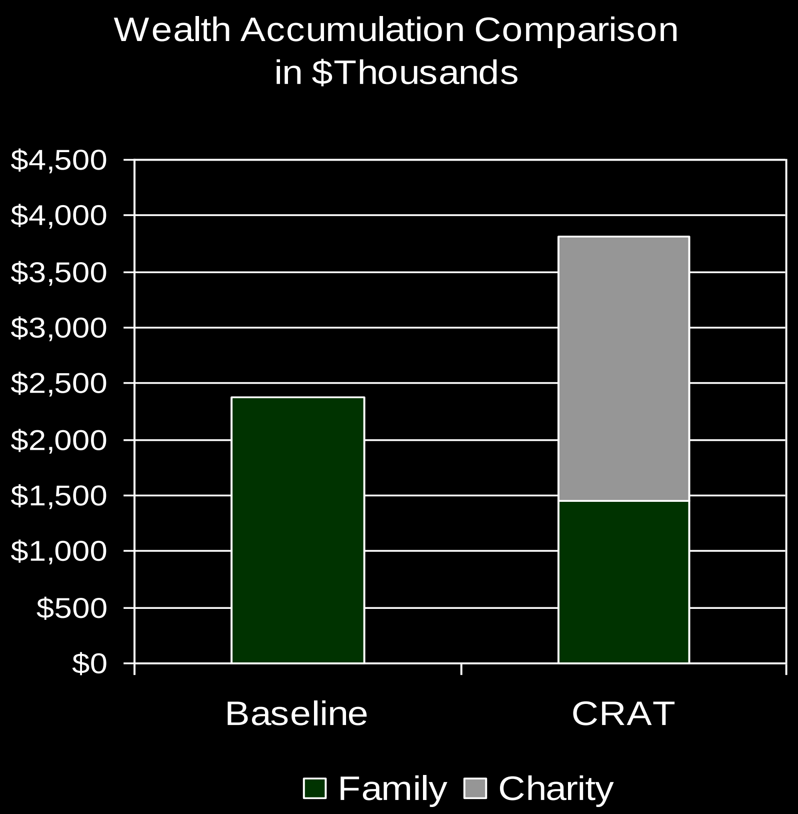
- Life insurance replaces the lost wealth associated with the charitable transfer
- Policy owned by and payable to an irrevocable trust (a.k.a., wealth replacement trust)
  - Insurance proceeds are excludable from donor/insured's estate
  - Tax savings and income stream from the CRAT can fund insurance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

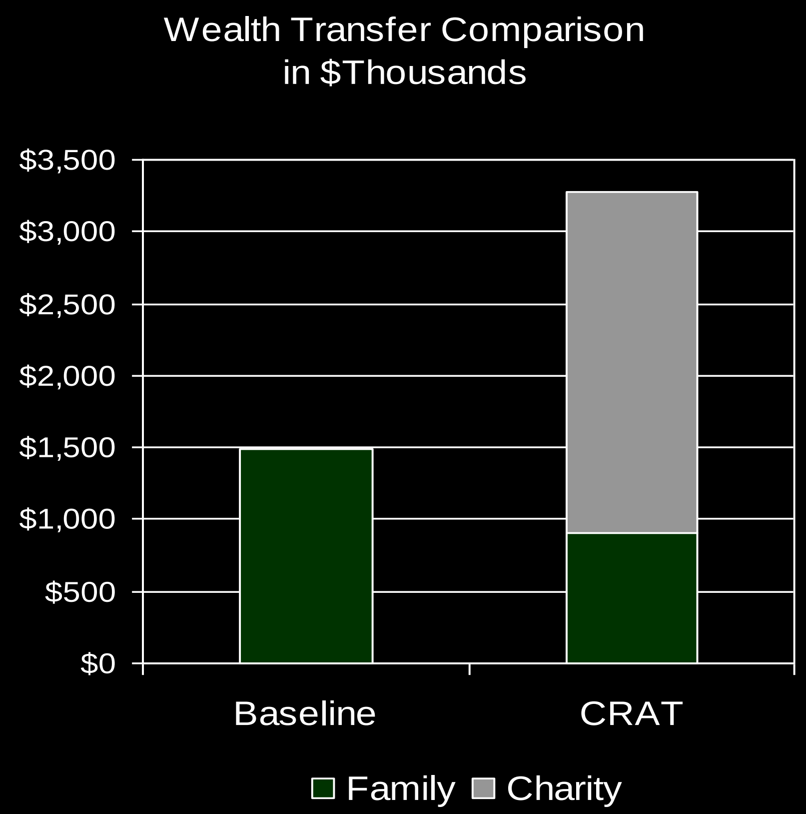
Wealth Accumulation Example

- $ 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
- 2.6% 7520 rate



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
- 2.6% 7520 rate



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