Benefits of Good Planning

The Charitable Trust and Real Estate

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"Over and over again, courts have said that there is nothing sinister in arranging one's affairs so as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced extractions, not voluntary contributions."

If the above sounds like a wonderful political platform in this election year, I hate to disappoint you by informing you that the author is not running for any elected office. The statement was penned by Circuit Judge Learned Hand in his opinion in the case of *Commissioner of Internal Revenue vs. Newman*-handed down on February 20, 1947. It would seem that the message of Judge Hand's opinion has been lost on some during the last 57 years.

If implemented properly, this concept will save you and your family hundreds of thousands (if not millions) of dollars during your lifetime. The beauty is that the strategy is blessed and endorsed by the IRS. The following illustrates how a charitable remainder trust works.

A charitable remainder trust is a trust from which a fixed percentage (not less than five percent) of the net fair market value of it's assets, valued annually, is to be paid, not less than annually, to one or more persons (and in the case of individuals, only to an individual living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual(s). At the expiration of the set period or upon the donor's death, the trust becomes the property of the charity. In the case of a ranch, the ranch is donated to the charitable remainder trust and then sold by the trust. The proceeds are professionally invested and the income agreed to (5 percent or more) is paid to the beneficiary-normally the owner of the ranch-usually for his or her lifetime. Since the ranch is now effectively owned by a charity, there is no tax paid on the sale and the full proceeds are invested. Since a charitable donation has been made, some of the income to the donor is sheltered for up to five years. The size of the donation is based on the actuarial value of the ranch calculated on the anticipated life span of the donor and the percentage paid out each year. Some donors buy enough life insurance to replace the asset in their estate-using the extra income they receive as a result both of being able to invest the entire proceeds of sale and of having the benefit of a charitable donation to shelter some of this income.

There are many financial benefits to using the charitable trust:

- A charitable remainder trust has a unique ability to sell appreciated assets without exposing the asset to the erosion of the capital gains or ordinary income tax. The trust then provides the trustor with an income stream based on what the asset sold for. An outright sale would expose this same transaction to both capital gains and ordinary income tax and could mean up to a 30 percent difference in total money received. For many individuals, this one benefit creates the motivation necessary to establish a charitable remainder trust.

- An individual/family may own a highly appreciated and valuable asset (such as a ranch or farm) that is generating little to no income. This asset may look great on a balance sheet, but may not be paying the bills. The ability to sell a low-income producing asset (that is appreciated and valuable) without the exposure to the above-mentioned taxes enables the charitable trust to generate more income for the recipients.

- Working much the same as a conservation easement, a gift to a charitable remainder trust provides the donor with an income tax deduction that can be used to offset all forms of income. It is usable in the year of the gift, with a five-year carry over.

- The charitable remainder trust enables the individual/family to lessen the impact of estate taxes. Assets transferred to a charitable remainder trust are generally not subject to estate taxes-taxes that can end up costing your family 55 percent or more of your estate.

- Your retirement years should be ones of relaxation and enjoyment. Asset management responsibilities can significantly decrease your relaxation and enjoyment. The charitable remainder trust provides a way to dispose of management intensive assets (your ranch or farm). At the same time, it supplies professional asset management during these retirement years when it may be most needed and desired.

- Your heirs also can benefit from this strategy. Using a portion of the cash flow created by the charitable remainder trust to implement what is commonly referred to as a Wealth Replacement Trust, you will be able to provide a wonderful legacy with the charitable trust without disinheriting your family. The cash flow is gifted to an irrevocable trust that uses the money to purchase insurance on your life.

When all the variables are right, a charitable remainder trust will create more after-tax, spendable income than an outright sale (assuming the same yield on investments), simply because there is more money at work all the time and some of the income is tax sheltered by the charitable gift.

As you can see, the establishment of a charitable remainder trust can dramatically enhance your financial situation. Your ranch can generate more money to you and for your family through a charitable remainder trust than through an outright sale.

The Charitable trust and real estate (*Illustrations for example*)

Income tax consequences	**Trust**	**Sale/Reinvest**
Net fair market value	$5,000,000	$5,000,000
Less capital gains tax @15%	$0	$675,000
Net proceeds	$5,000,000	$4,325,000
Charitable deduction	$1,549,350	$0
Tax savings (using the deduction)	$526,779	$0
Projected cash flow		
Before-tax benefit	$8,504,079	$7,356,029
After-tax benefit	$6,461,600	$4,704,831
Insurance trust premiums	$(1,200,000)	$0
Increase in lifetime income	$1,083,548	
(Insurance trust premiums paid from tax savings first, then income)		
Family and Charity		
Amount subject to estate tax	$0	$6,426,722
Less estate tax @ 55%	$0	$3,534,697
Insurance trust	$5,000,000	$0
Net estate to family	$5,000,000	$2,892,025
Increase to family	$2,107,975	
Amount to your favorite charities	$7,429,737	$0
Total benefit	**$18,891,337**	**$7,596,856**

This chart illustrates the comparison between a charitable remainder trust and a sale and reinvestment of the proceeds. The real estate owners are both 70. Their property is valued at $5 million with a cost basis of $500,000. Proceeds from each option are invested at 9%, with 7% paid out in income. The owners are in the 37% income tax bracket.