Trust Topics

WINTER 2005

Fiduciary Trust International

*This **Trust Topics** discusses charitable remainder trusts as philanthropic vehicles, the potential tax consequences of using charitable remainder trust structures and how and when they may make sense for you.*

Charitable Remainder Trusts

How They Can Work For You

Investors who own appreciated properties often find themselves reluctant to sell them, preferring not to incur the capital gains taxes such transactions would generate. To address this problem, some property owners have considered giving these assets away to a charitable remainder trust. The trustee of that trust may sell those assets with no capital gains tax, yet the investor may continue to retain benefits from the gifted property.

Trusts generally create two separate legal interests: the current beneficiary, who is entitled to enjoy the stream of payments from the trust during its existence, and the remainderman, who is entitled to receive the property upon the trust's termination. You or any individual you select can be the current beneficiary and one or more charitable organizations must be the remaindermen. The current beneficiary receives an annual amount that may be:

- an annuity, often based on a fixed percentage of the trust property's initial fair market value;
- a unitrust amount, defined as a fixed percentage of the trust's fair market value each year; or
- the lesser of net income or a unitrust.

The lower the annuity or unitrust percentage, the greater the tax advantages. However, the minimum percentage or annuity amount is 5% (with a maximum unitrust percentage of 50%).

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How Capital Gains Tax Applies

Let's assume for a moment that you have transferred your appreciated property to a charitable remainder trust, and that the trustee has sold the property and then invested the proceeds in a diversified portfolio. Since the remainderman is a charity, no capital gains tax is due on the gain realized by that sale.

Each payment to you or your beneficiary will be subject to income tax to the extent of the taxable income generated by the trust in a given year. If the payment exceeds the trust's taxable income, that excess may be taxed to you or your beneficiary as capital gains. Because capital gains are taxed at a lower rate than ordinary income, a strategy emphasizing total return, rather than mere production of income, maximizes a beneficiary's after-tax income.

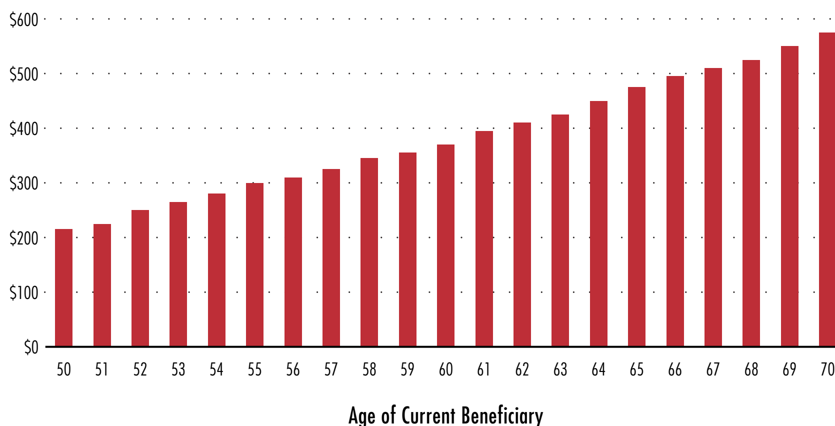
Income Tax

Creating a charitable remainder trust also entitles you to a charitable deduction on your income tax for the year in which the property is given to the trust. This deduction may be based on the property's appreciated value and is equal to the value of the charity's remainder interest in that property, according to the U.S. Treasury's mortality and annuity or unitrust tables. The older the current beneficiary, the more valuable your income tax deduction may be. Your deduction will also be subject to the usual charitable deduction percentage limitations. (Sample unitrust income tax deductions are represented in the chart at left.)

Charitable Remainder Unitrust

Funded with $1,500,000 paying 8% annually

Sample Unitrust Income Tax Deductions (In thousands of U.S. dollars)



The older your current beneficiary, the higher your charitable deduction may be.

Gift Tax

Because your proposed gift to the charitable remainder trust would be a completed gift, you may be subject to gift tax, depending on who the current beneficiary is. If it is you or your spouse, for example, there should be no gift tax. However, if the current beneficiary is someone other than you or your spouse, there may be some gift tax consequences. In any event, the amount of the charity's remainder interest will qualify for a gift tax charitable deduction equal to the income tax deduction.

Estate Tax

Charitable remainder trusts are generally not subject to estate tax. However, there are limited situations in which an estate tax may apply.

Conclusion

A charitable remainder trust is irrevocable and its property ultimately passes to charity instead of to family members. Therefore, it is logically a tactic best suited to charitably inclined individuals. Some families use life insurance trusts to replenish the property that would otherwise have passed to their heirs.

Your lawyer or other professional advisor is, of course, in the best position to determine whether such a strategy is appropriate for you and should be consulted to design a structure to achieve maximum overall tax savings.

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Fiduciary Trust's investment management services were extended to foundations and endowments during the 1930s and then to other institutions. Fiduciary Trust began investing internationally in the early 1960s, making it one of the first American firms to develop global investment capabilities. Fiduciary Trust, an affiliate of Franklin Templeton Investments, offers the following services to clients throughout the world:

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About the Author

Gail E. Cohen, Esq., executive vice president and general trust counsel at Fiduciary Trust Company International, has more than 25 years of experience in the area of trusts and estates. She is responsible for estate planning and administration at Fiduciary Trust's New York headquarters and oversees trusts and estates matters at its subsidiaries in Florida, California, Delaware and Grand Cayman. Ms. Cohen is a member of The Rockefeller University Committee on Trust and Estate Gift Plans, the Planned Giving Committee of the Anti-Defamation League, and the Trusts and Estates Steering Committee of the UJA-Federation of New York and the New York City Ballet's Professional Advisors Committee.

This article and other information on wealth management can be found on Fiduciary Trust International's web site at www.ftci.com.

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