Attract Major Gifts with a CRT

CRTs offer key tax, income, and estate planning benefits to donors–and major gifts for nonprofits.

BY TODD S. THOMPSON

Most people don't give to charity solely for their own financial benefit, yet major donors appreciate thoughtful gift structuring that reduces their cost of giving, addresses estate planning concerns, and maximizes the effectiveness of the gift. A nonprofit organization with the skills to facilitate this kind of structuring can offer something of value to its donors while enhancing its own fundraising professionalism.

A charitable remainder trust (CRT) is a popular way to make charitable contributions. It lets donors make major gifts now while keeping income from the assets for use during their lifetime. A charitable remainder trust also lets donors sell highly appreciated securities through the trust, reinvesting proceeds to obtain a desired level of income without incurring capital gains taxes. The remainder interest is the asset remaining which passes to the charity on completion of the income interest according to the terms of the trust.

Donors can make major gifts now while keeping income for use during their lifetime.

Which Donors to Target?

CRTs work best for donors who own highly appreciated stock–that is, equity in a company with such a low cost that selling would create a tax problem, thus discouraging donors from selling and reinvesting in a 7% income oriented investment. A dividend yield of about 2% is typical for larger, mature companies. The CRT provides a way to make the conversion while avoiding the capital gains tax.

How a charitable remainder trust works

When donors give assets to a charity through a remainder trust, they transfer ownership of the assets to the trust, which then pays income to them during their life, the life of their designated beneficiary, or for a specified term of years. The amount of income the donor will receive is based on a percentage of the fair market value of the donated asset, generally not less than 5%. At the death of the donor or beneficiary, or at the completion of the trust's term, the trustee will distribute the balance of the trust assets to the chosen charity.

Figure 1 compares donating versus selling and reinvesting stock. As it illustrates, if the donor had sold the asset and reinvested the net proceeds directly rather than using the charitable remainder trust vehicle, the amount reinvested and resulting income would be less.

The donor's current income tax deduction

The donor is entitled to a current income tax deduction when the charitable remainder trust is established. The amount deductible is a percentage of the value of the property placed in the trust. The actual deduction is calculated using IRS tables. The deduction amount depends on the annual payout, the age of the donor or beneficiary (or the trust's specified term of years), and the published IRS interest rate for the month. The donor's tax advisor will determine the amount of the deduction.

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Donating Versus Selling and Reinvesting

Suppose you own $100,000 of stock with a cost basis of $10,000. You could sell the stock and reinvest the proceeds at 7%. Or you could transfer the stock to a charitable remainder trust that specified a 7% payout. Let's compare these two strategies:

	Sell and Reinvest the Proceeds	Transfer To Charitable Remainder Trust
Proceeds/Fair Market Value (Cost Basis + $10,000 Capital Gains + $90,000)	$ 100,000	$ 100,000
Capital Gains Tax ($90,000 x 20%)	(18,000)	0
Amount Reinvested	$ 82,000	$ 100,000
	x 7%	x 7%
Annual Income at 7%	$ 5,740	$ 7,000

As you can see, by using the trust, you would receive $1,260 ($7,000 - $5,740) more income than by selling the stock and reinvesting the proceeds yourself.

FIGURE 1

Estate tax shelter

When the charitable remainder trust is set up for the life of the donor and the donor's spouse, all the assets in the trust avoid estate taxes, which can result in a substantial tax savings. If a beneficiary other than the donor's spouse is designated, a portion of the trust assets may not escape estate or gift taxation. For example, if the donor's will sets up a charitable remainder trust for the life of the donor's child, the value of the child's income interest may be taxable in the donor's estate. See the example in Figure 2.

There are two types of charitable remainder trusts

An ***annuity trust*** pays the donor a fixed amount each year for life or for a specified number of years, much like an annuity from an insurance company. The payout is a percentage of the original amount contributed to the trust and is fixed for the trust's term. Only one contribution to the trust can be made. Once the annuity trust is established, the donor cannot add to it.

With a ***unitrust***, the payout is also a fixed percentage of the value of the trust, but the value is recalculated annually and based on the fair market value of the trust assets. As a result, the annual payments in a unitrust will vary as the fixed percentage is applied to a fluctuating principal amount. This feature makes the unitrust a valuable hedge against inflation. The donor may make additional contributions to a unitrust over the trust's term.

Example of a Charitable Remainder Trust

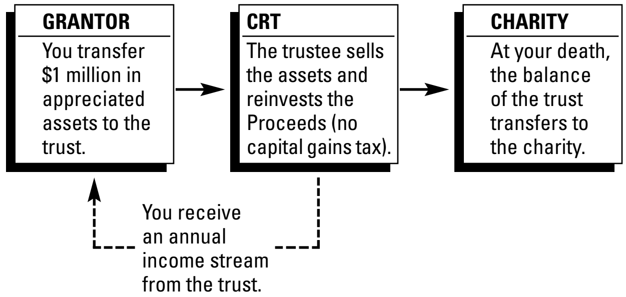

FIGURE 2

Wealth replacement for the donor's beneficiaries

One disadvantage of a charitable remainder trust for the donor is that the gifted assets used to create the trust won't be available for the donor's heirs. Assets donated to a charity through a charitable remainder trust are irrevocable gifts. This problem can be alleviated by using the tax savings or the additional income generated by the trust to create a separate wealth replacement trust—that is, an irrevocable life insurance trust designed to replace the wealth donated to the charity. As long as the irrevocable life insurance trust or the heirs own the life insurance poli-

Benefits to Donor	Without a Charitable Trust	With Charitable Remainder and Wealth Replacement Trusts
Original Assets	$ 1,000,000	$ 1,000,000
	x 2%	x 7%
Annual Income	$ 20,000	$ 70,000
Income Tax at 36%	(7,200)	(25,200)
Total	$ 12,800	$ 44,800
Insurance Premium	$ 0	$ 18,400
Net Annual Income	$ 12,800	$ 26,400
Income Tax Deduction	$ 0	$ 251,461
Tax Savings at 36%	x 0%	x 36%
Tax Benefit	$ 0	$ 90,526
Benefits to Heirs		
Original Assets	$ 1,000,000	$ 1,000,000
Capital Gains Tax	0	0
	$ 1,000,000	$ 1,000,000
Life Insurance Proceeds	$ 0	$ 1,000,000
Charitable Donation	0	(1,000,000)
Estate Tax at 55%	(550,000)	0
Balance to Heirs	$ 450,000	$ 1,000,000

FIGURE 3

cy, the insurance proceeds will not be included in the donor's estate. The net assets the heirs receive will generally be greater than they would be by simply leaving the original wealth to the heirs at death, because the proceeds will now avoid the estate tax.

How an irrevocable life insurance trust works

Suppose the donors transfer $1 million of stock now paying a 2% dividend to a charitable remainder annuity trust. The trustee sells the stock and begins paying the donors $70,000 per year in accordance with the terms of the trust.

Assume that both donors are 60 years old and can purchase a $1 million life insurance policy for $18,400 per year. The donors set up an irrevocable life insurance trust for the benefit of their two children, paying $18,400 each year to the trustee of the life insurance trust who uses that money to purchase the life insurance and pay the annual premiums. By transferring the donors' stock to the charitable remainder annuity trust, the donors' investment income would increase from $20,000 (the 2% dividend) to $70,000 per year. Subtracting the insurance premium of $18,400 and income taxes of $25,200 at 36%, the net investment income to the donors would be $26,400 compared with only $12,800 after tax without the trust.

In addition to the substantial increase in annual income the trust provides, the donors would also receive a $90,526 tax benefit based on an income tax deduction of $251,461 and a 36% tax bracket. The heirs will receive $1 million from the proceeds of the life insurance, while the nonprofit named in the charitable trust receives its $1 million endowment. Without the two trusts, there would be no charitable donation, and the benefit to the donors' heirs would be cut in half by estate taxes. See Figure 3 for an illustration of this example.

Benefits of a charitable remainder trust with an irrevocable life insurance trust

Figure 4 shows how a charitable remainder trust can be combined with an irrevocable life insurance trust. Benefits of such a combination include the following:

- Low income is converted to high income producing assets.
- Highly concentrated equity position is diversified.
- The donor realizes income tax savings generated by the charitable tax deduction.
- The nonprofit receives funding to carry on its work.
- The donors' beneficiaries receive an asset free from estate and income taxes.

Example of a Charitable Remainder Trust Combined with an Irrevocable Life Insurance Trust

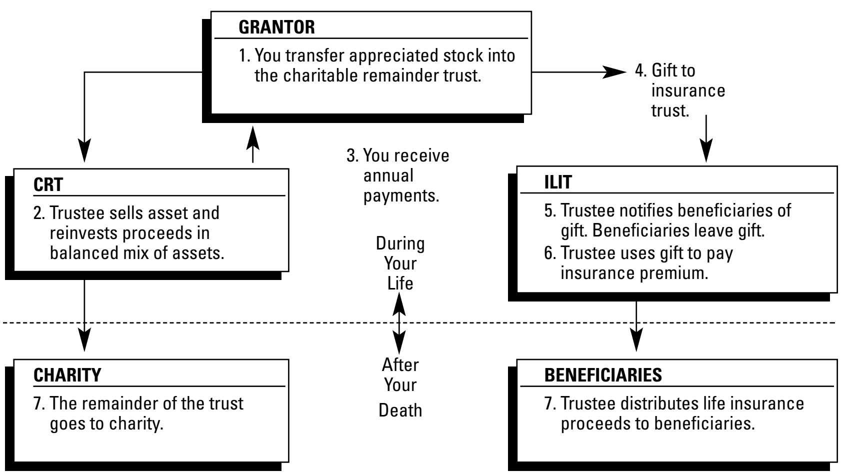

FIGURE 4

CREATIVE FUNDRAISING IDEAS

Make It Easy to Reply Quickly

For offers with an emotional flavor, you may actually *damage* response if you emphasize replying by mail. Instead, highlight ways that people can respond instantly—for example, a 24-hour toll-free number. Eliminate any barriers that may get in the way of immediate response to your message.

Motivate People to Respond

Which phrase will make more people respond to your mailing:

"2 percent per month" or "24 percent per year"? The answer: It depends. If you're telling people what they will *pay*, two percent per month is better, because it sounds like nothing. If you're telling people what they will *receive*, 24 percent per year is better, because it sounds like a lot. This strategy, called information optimizing, doesn't change the facts, just people's perception.

Watch Those Asterisks

When should you use an asterisk in direct-mail copy? The answer: Never. Asterisks call attention to exceptions and blunt the power of your message, according to master marketer Herschell Gordon Lewis in his new video, "Creative Tips for the Year 2001." To order the 45-minute cassette ($59.95), contact Teach 'Em, 160 East Illinois, Suite 300, Chicago, Illinois 60611, 312-467-0424.

- The donors' assets are invested at full value without deduction for the payment of capital gains taxes.

Who will benefit from charitable remainder trusts?

Those who should consider charitable remainder trusts include:

- donors who own highly appreciated assets and want higher income
- those who are charitably inclined
- those who can use a current income tax deduction
- those who want to reduce their estate tax
- those who want to diversify a concentrated equity position.

Implementing a charitable remainder trust plan takes a lot of teamwork with donors and their tax, legal, and investment professionals. But the benefits for the nonprofit and the donor can be substantial. ■

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These publications are available through the Society for Nonprofit Organizations, 608-274-9777.

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