

## Averting a Family Crisis

By

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Jim and Carol looked tanned and healthy. I felt a twinge of envy as I glanced out the window at yet another snowy day.

They were home from Florida for the weekend to celebrate the christening of their latest grandchild. I was pleased to report that their portfolio looked as healthy as they did.

“That’s always good news!” Jim laughed, “But, we have actually come to discuss something else. As you know, we have a condo that has been rented out for many years. The tenants are moving out and we have decided to sell the property. We would like to gift the proceeds to our favorite children’s charity but there are a couple of problems. The property has appreciated in value so much since we bought it that we are going to be whacked with capital gains taxes. Secondly, my oldest son does not approve.”

“Now, Jim,” Carol interrupted looking anxious, “He didn’t exactly say that. He does think that it’s not completely fair to be giving the whole amount to charity. Also, he is only thinking about us. What if for one reason or another we needed that money to live on?”

Jim looked ready to argue.

“There is a way you could give the money to your favorite charity,” I quickly interrupted, “While at the same time providing yourself with income, tax advantages and providing for your heirs.”

The solution was a Charitable Remainder Trust (CRT) combined with a Wealth Replacement Trust.

A CRT enables a donor to set-up an irrevocable trust, usually funded by appreciated assets, such as the proceeds from the sale of a property or stocks. Charitable Remainder Trusts do not pay capital gains tax as the assets are intended for a charity. Therefore, Carol and Jim would not be liable for any capital gains tax on the sale of their condo, which we estimated in their case to be a savings of 15% of the increase in value. The proceeds are reinvested in a diversified income-producing portfolio. The CRT has two sets of beneficiaries: the donor and spouse and the charity or charities of their choice.

Throughout the lifetime of the donor or a predetermined period (not exceeding 20 years), the trust generates income for a designated individual (or individuals), in either a fixed amount or as a percentage of the trust (which by law must be at least 5% and no more than 50%). Usually, the beneficiary is the donor followed by the spouse. After the interests of the beneficiaries expire the remainder of the trust passes to the designated charity.

It is important to remember that CRTs are irrevocable. Once established, they cannot be terminated, but the donor can change the charities. In some circumstances, the donor may serve as a trustee and therefore retain control over the choice of the assets in the trust.

### ***Types of Charitable Remainder Trusts***

The most common types of Charitable Remainder Trusts are a Charitable Remainder Annuity Trust (CRAT) and a Charitable Remainder Unitrust (CRUT)

A CRAT provides a fixed amount of annual income. The danger when withdrawing a fixed amount of income the funds may be completely depleted leaving no income for the donor or the remainder for the charity. Plus it makes no provision for inflation.

A CRUT provides annual payments, which are a predetermined fixed percentage. The payments may vary from year-to-year depending upon the market value of the trust's assets. An important factor when setting the percentage is not only that funds may become depleted, but the higher the percentage the lower your charitable income tax deduction.

To ensure that no ill-will was generated between Carol and Jim and their children, they established a Wealth Replacement Trust. The Trust was funded by life insurance with an Irrevocable Life Insurance Trust (ILIT). The policy premiums were paid for by income tax savings from the Charitable Remainder Trust. The donor(s) normally purchase a policy equal in face amount to the charitable donation. The life insurance policy is owned by the ILIT and is therefore, not considered part of the donor's estate.

It is not often that we can please everyone, but in this case Carol and Jim were very happy, their son was placated and a worthy charity was delighted.

Please remember that a CRT should always be drafted by an experienced attorney, in consultation with your CPA and financial planning advisor.

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