

## Flexible Trusts for Changing Political Times

*With the Democrats in power in Congress, income taxes for affluent clients could rise and a repeal of the estate tax seems less likely. With that in mind, this may be a good time to recommend a charitable remainder trust or other flexible trusts to your clients.*

After winning majorities in both houses of Congress in the November elections, Democrats are preparing their agenda for the new legislative session. As such, the estate tax repeal is now unlikely to be made permanent, and income tax rates for the affluent could rise. Both possibilities should increase the incentive for wealthy clients to donate and create new opportunities for community foundations to encourage more giving.

“Quite simply, our goal is to grow philanthropy in size and service,” says Steve Gunderson, president and chief executive of the Council on Foundations. “As the nation continues the transfer of wealth and resources defined by our changing demographics, we must find ways to ensure that these resources fuel philanthropic engines. In so doing, we can engage in the collaborative process that empowers our community to increase its service to enhance the common good.”

Taking this shifting landscape into consideration, advisors may want to encourage clients to consider a charitable remainder trust (CRT) or other flexible trusts. Not only do trusts reduce the value of an estate, they also offer income tax deductions, provide an income stream and help donors meet charitable goals. Community foundations are outstanding resources for charitable remainder trusts, whether the foundation serves as a trustee or recipient of the trust’s proceeds.

### **Tax Benefits**

Donations to a CRT are tax-free and grow on a tax-deferred basis. The trust pays out taxable distributions—usually to the donor and spouse—for a fixed term or for life. A donor can also receive tax deductions depending on how the trust is set up. After the beneficiaries pass away, the remaining trust assets go to charity.

Donors generally set up a CRT with highly appreciated assets, like stock or real estate, in part because their sale would trigger a hefty capital gains tax, according to Charles Foster, financial advisor and a founding partner of Solana Beach, Calif.’s Blankinship & Foster. The trust also provides an income tax deduction that is equal to the current value of the assets ultimately expected to reach the charity’s coffers.

### **Income Streams**

CRTs also reduce the total assets in an estate, says Alan Rothschild, an estate lawyer and partner at Hatcher, Stubbs, Land, Hollis & Rothschild, of Columbus, Ga. The trust’s distribution is derived from a number of factors, such as the recipient’s age, the value of the trust, current IRS discount rates, and how much will be left to charity. A minimum of

5 percent of the trust must be distributed each year, although many choose to receive a greater percentage. Ultimately, current calculations must indicate that at least 10 percent of the original principal will pass on to a charity, Rothschild says.

Some clients may choose to receive the payments in a flat annual rate, in which case advisors should establish a charitable remainder annuity trust, or CRAT. Others may opt to receive payments based on a fixed percentage of a trust's annual value, which calls for a charitable remainder unitrust, or CRUT. Here are some of the distinctions between them:

- **CRAT:** Rothschild recommends annuity trusts to older or conservative clients—people who have more money in bonds than stocks. “If that’s their investment personality, they will be more comfortable with annuity trusts,” he says.
- **CRUT:** These funds are designed to offset inflation, Rothschild says. Hopefully, over time the trust will grow, which will result in higher payouts, offsetting the rising cost of living. Conversely, if the trust decreases in value, so will the payments.

## Choosing Assets

While all appreciated assets can be considered for CRTs, some assets fit more seamlessly than others. “Stocks are a natural,” Foster says, because assets within a CRT can be sold without realizing a capital gains tax. This makes for higher distribution rates and, ultimately, more money for the charity.

Placing stocks in a CRT can also create a greater payout than the shares’ dividends. For example, former company executives who have large blocks of appreciated stock paying 1 percent in yearly dividends could sell the stock, pay the capital gains tax and reinvest the remainder. But if they decide to invest it in a CRT, they could potentially fix an annual payout at 5 percent or 6 percent while also taking a tax deduction.

Assets like real estate, paintings and collectibles also fit the bill, Foster says. However, he warns, be careful with collectibles. “The government is more suspicious because people have misused charitable devices with collectibles,” he explains.

## Setting Up a CRT

When setting up a CRT, advisors should make sure their clients surround themselves with a qualified CPA, attorney, investment manager and trustee, according to Foster. “There are control and fiduciary issues people have when setting up these trusts,” he says. “You have to pick good people and good institutions to do it for you to keep you out of trouble.”

## Involving Community Foundations

Community foundations are an ideal resource when it comes to CRTs. Their expertise in local giving makes them a valuable partner in choosing charities that serve community needs. Some community foundations act as trustees, says Amy Cheney, vice president for giving strategies at the Greater Cincinnati Foundation. But many—including her own—act as the ultimate beneficiaries of CRTs, ideally suited for serving donors' philanthropic intent. "We carry out their charitable wishes after they're gone," she says.

Clients who wish to leave their CRT assets to community foundations can choose one of the following types of funds, depending on their giving goals:

1. Those wanting to benefit a region without choosing a specific charity can open an **unrestricted fund**.
2. Donors who want to support charities in one sector, like culture or health care, can establish a **field of interest fund**.
3. People who would like their money to benefit one or more specific organizations may opt for a **designated fund**.
4. Those who would prefer their heirs help carry out their charitable wishes may opt for a **donor advised fund**.

Cheney prefers to meet and work with clients who intend for their CRTs to benefit the Greater Cincinnati Foundation. "The more we can understand the clients' interests, the better we can carry them out," she says.

*Amy Braunschweiger is a freelance writer based in Brooklyn, N.Y. Copyright 2007, Council on Foundations and Community Foundations of America. Used with permission.*