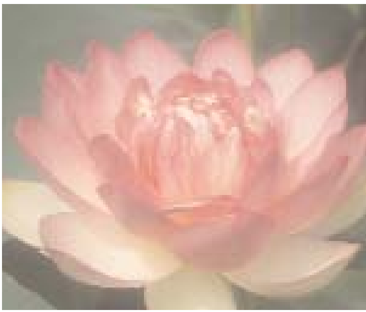

Hope for a Better World

A Creative Estate Planning Newsletter for friends of Ananda

Taking a Step Beyond

The Creative Side of Estate Planning

There is a saying, *"Any fool can dream, but it takes a planner to fulfill one."*

I would like to believe that every one of our readers would include a planned charitable gift in their estate plan if they truly believed that, number one they could afford it and that, number two they and their heirs would benefit by making such a gift. Hence our reason for writing and making available a newsletter such as this: to inform and motivate our donors to remember the Janaka Foundation in their estate plans.

As promised in earlier newsletters, this issue is dedicated to one particular form of charitable estate planning: ***Charitable Remainder Trusts***. Admittedly, such trusts are complicated and tightly regulated , but they are able to do so many good things for donors/grantors and the charities that represent their lifetime values. So it is worth the time and effort it takes to consider what they can do.

The Unitrust and the Annuity Trust

There are two types of charitable remainder trusts, a Charitable Remainder Unitrust (CRU) and the Charitable Remainder Annuity Trust (CRAT). In these trusts there are two identifiable interests, the present or *income interest* and the future or *remainder interest*. The value of each interest is calculated by using government tables at the inception of the trust and is measured by the number of beneficiaries, their ages and the amount of the annual payments.

Like the CRAT, the CRU must pay out a fixed percentage, not less than 5% and not more than 50%, of the net fair market value of the funding assets. The *income beneficiaries* must be living at the time the trust is created and can include one or more living persons. *A qualified charitable organization is the beneficiary of the remainder interest*.

Like the CRAT, the CRU distributes its income on a four-tier system: first, as ordinary income; second, as long-term capital gains; third, as tax-exempt income; fourth, as tax-free distribution of principal. This distribution system may well determine which trust to use, what type of assets should be used to fund the trust, and when and how the income should be received.

In both trusts the charitable remainder, calculated at the trusts' inception, cannot be less than 10% of the contributed assets' value. In both trusts the charitable deduction is inversely proportionate to the chosen rate of return and the number and ages of the beneficiaries. *In other words, the higher the rate of return and the number of people receiving the income and their ages, the lower will be the charitable deduction.*

In both trusts the duration of the trust is measured by the lives of the beneficiaries or a term of years not to exceed 20 years, or a combination of the two. For example, the husband and wife receive income from the trust during their lifetimes and, after the death of the survivor, the children as a class receive income for 12 years.

The more flexible of the two is the CRU because it can be adapted to correspond to the financial objectives of the donors and beneficiaries, to say nothing of the charities' interests.

Differences between the Two

Whereas the CRU is very flexible in the types of assets that can be used to fund it, the grantor/donor must be careful in his choice of assets to be used to fund the CRAT. Why? Because of the strict requirements of the payout.

For example, it would not be wise to use vacant land to fund a CRAT. This is because of what would happen to the required 5% payout at the end of the year if the land were not sold. (Anyone for a load of dirt?) The trustee would have to deed back parcels of land to the beneficiaries.

Or what would happen if the land eventually sold for less than the estimated fair market value of the land? The trustee might be hard pressed to fulfill the 5% required payment and the donor's charitable deduction and estate tax deduction might be in serious jeopardy.

By contrast, the CRU can be structured in the controlling document to pay out its income in one of three ways.

Straight: income plus return of principal at the stated percentage of the trust's value is paid out;

Income only: only earned income is paid out up to the maximum of the payment originally required;

Income only with make-up provision: the CRU is allowed to pay more than the contractual rate when the trust income exceeds the stated percentage that year but only to the extent that the amounts paid in prior years would be less than the stated percentage, e.g., it can make up the income it did not pay out in previous years.

Another advantage the CRU has is its requirement that it evaluates its assets annually and bases its payout upon this new evaluation. This means that, if the value of the trust's assets grew by 10%, that year's payout would also increase by 10%, thus providing a hedge against inflation.

The practicality of these advantages allows the trustee to strategize his investment of assets to meet the needs of the beneficiaries.

For example, Mr. and Mrs. Smith fund their CRU with appreciated securities worth $100,000 with a payout of 7%. They are both in their late 50's and plan to retire at age 67. Since they are both still working, they do not need current income. Therefore, the trustee invests in growth stocks with no dividends.

Results: In nine years (with a growth rate of 8%), the trusts' value will be $199,900 and it will have accumulated IOU's of over $89,400. Now the trustee can begin to sell off some of that stock, make the required 7% payout and supplement it by paying down the accumulated IOU's, all with capital gains type income.

Another important difference is that the CRU can receive additional contributions in subsequent years, whereas the CRAT can be funded only once. Another trust would have to be created to receive additional assets.

"Different Strokes...

...for Different Folks." There are aspects of each of the two trusts that appeal to different people who have different goals. If the donor has other sources of income, wants to make a larger gift to charity and would really benefit from the larger charitable deduction in the year of the gift, he/she would be well served by choosing a lower yielding Charitable Remainder Annuity Trust and let the appreciation of the assets accrue to the benefit of the named charity(ies)

On the other hand, if the donor/grantor wanted more flexibility and options, the CRU would have more appeal. Either way his/her charitable and personal goals can be reached using these planning tools. **This is the challenge these gift-planning instruments present to our generous donors: *Choosing where you want your lifetime financial blessings to go and where can they do the most good.***

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The Janaka Foundation - Building Ananda's Legacy of Light.

This newsletter has been written by qualified specialists in financial planning and offers explanations of current techniques in easy-to-understand language. Through charitable gift planning, you can help us to prepare for our future of helping others. The information provided is general in nature. Each reader should consult his or her own counselors in applying the principles provided here.