Charitable Remainder Trust

The ups and downs of the stock and real estate markets have prompted your clients to revisit their financial plans. They may have experienced significant fluctuation in their holdings. The summer house in Maine that they never visit has tripled in value, but their stock portfolio has not fared as well. They also want to make a large contribution to their local charity. Your clients are not ready to part with stock, are short on liquid assets, and need some tax deductions. One solution is to create a Charitable Reminder Trust (CRT).[1]

WHAT IS A CHARITABLE REMAINDER TRUST?

A CRT is an irrevocable trust created for the benefit of one or more charities as well as one or more noncharitable beneficiaries. It is a tax-exempt trust and can last for a life, lives, or a term not to exceed 20 years.

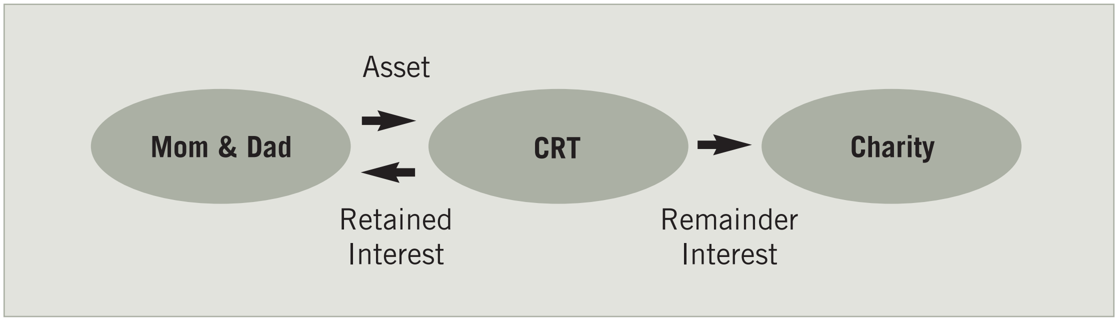
HOW DOES A CRT WORK?

A CRT is comprised of three components: assets, retained interest, and remainder interest.

- **Assets:** Low basis, highly appreciated assets, such as real estate or stock, are irrevocably transferred to the CRT.
- **Retained Interest:** After the asset is transferred to the trust, the donor retains an income interest in the CRT. The CRT is required to provide the donor with a stream of income over the donor's life or the joint lives of the donor and his/her spouse (other beneficiaries may be chosen as well).
- **Remainder Interest:** Once the CRT term has ended, any assets remaining in the trust will be distributed to the charitable beneficiary.

CRTS AND LIFE INSURANCE

Another function of a CRT is to use it as a way to fund an Irrevocable Life Insurance Trust (ILIT). This will allow the donor to provide his/her heirs with a sum of money equal to the amount of the assets given to charity. If the asset remained in the estate until death, the heirs may have to pay estate taxes before they receive anything. These taxes not only erode the value of the assets, but may ultimately cause a loss to the beneficiaries. Wealth replacement through an ILIT is an excellent alternative. Not only does the charity benefit from the CRT, but the donor's heirs will benefit from the ILIT. To understand how this works, let's look at an example.



EXAMPLE

Caroline Moore (55) and her husband, Kyle Nelson (53), are active in a local charity, Preservation of the Great Forest. They have three children. Caroline has a lot of assets in her name, some of which she needs to use now. However, she does not want to cash them in and be hit with capital gains taxes. Kyle recommends that she create a CRT with the Preservation of the Great Forest as the remainder beneficiary. Caroline likes that idea, but is concerned that she will be giving away the inheritance of her children. Kyle told her that part of her annual distributions from the CRT can be used to fund a life insurance policy inside of an ILIT.

Here is how it will work:

1) Caroline will give assets totaling $500,000 to a CRT for the benefit of the Preservation of the Great Forest.
2) Caroline will receive an income stream from the CRT during her life. Part of the distributions will be used to fund an ILIT, which will purchase a life insurance policy and Caroline will use the rest.
3) Upon Caroline's death, the life insurance death benefit proceeds will go to the ILIT, of which the three children are benefi1ciaries.
4) The Preservation of the Great Forest will receive the remainder interest in the CRT after Caroline's death.

BENEFITS OF A CRT

The donor receives a number of tax and non-tax benefits from the creation of a CRT.

- ***Capital Gains Tax Avoidance:*** A CRT is a tax-exempt entity. Once the asset is given to the CRT, it can be sold without having to pay capital gains taxes. Thus, the trust receives the full value of the asset.
- ***Charitable Income Deduction:*** The donor receives an immediate income tax deduction based upon the estimated value of the remainder interest.[2]
- ***Taxable Estate Reduced:*** By transferring the assets to the CRT, the assets are removed from the estate. This results in a smaller taxable estate, and a lower estate tax bracket.
- ***Benefits to Charity:*** The charity may receive a large charitable donation.
- ***Wealth Replacement:*** The income from the CRT can be used to fund an ILIT, which can be used to replace the value of the assets given to the charity for the donor's heirs.

SUMMARY

For individuals who are wealthy on paper and charitably inclined, a CRT combined with an ILIT can be an excellent planning tool. Not only are the donors able to fund a life insurance policy inside of an ILIT, but they can also receive income distributions and make a donation to their favorite charity.

For more information on CRTs, please contact your local John Hancock Representative or call the Advanced Markets Group at (888) 266-7498, option 3.

1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. This is only intended to provide an overview of the benefits of CRTS. For more details on charitable income deductions and charitable remainder trusts, please consult your financial and legal advisor.

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