



# Planning Options for Clients with Charitable Remainder Trusts

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# House Analogy

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- When a client buys a house, they probably don't expect to keep it forever
  - *Kids grow up and move out*
  - *Health changes and a different house serves better*
  - *Cold winters grow old and a warmer state beckons*
  - *A lower-tax state beckons*
  - *Etc.*
- Selling the house years later doesn't mean it didn't work well for the client while they lived in it (i.e., it wasn't a mistake to buy the house in the first place)

# House Analogy

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- Same logic applies to clients' CRTs
- Circumstances change over time
  - *The CRT was a great solution and worked well for years*
  - *But is it the best possible use of those assets today?*
- Advisors are making their clients with CRTs aware of their secondary planning options

# Charitable Remainder Trusts – the Pros

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- CRTs are charitable vehicles but charity is rarely the primary driver
- Powerful tax-planning vehicles
  - *Defers capital gain*
  - *Generates an up-front income tax deduction*
- Note that the tax benefits are achieved early in the life of the CRT, usually in the first year
  - *Moving forward, the client's benefit is limited solely to the CRT's income stream (their "income interest" in the trust)*

# Charitable Remainder Trusts – the Cons

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- Irrevocable
- Usually span decades of clients' lives
- This combination can lead to a misalignment between client's situation and the CRT
  - *When the CRT is created, it's a perfect fit with the client's situation, and most CRTs remain good fits early in the overall lifecycle (the first decade or two). But, as a client's situation changes – they retire, move, have grandchildren, change tax brackets, etc. – their fit with the CRT often wanes because the trust's terms cannot adjust to their changing life.*

# The Importance of CRT Reviews

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- CRT income interests are capital assets
  - *Rev. Rul. 72-243, 1972-1 C.B. 233*
  - *PLRs (e.g., PLR 2007390041)*
- Yet they are rarely reviewed like other capital assets
  - *Clients left in the dark (“my CRT is a lifetime lockup”)*
  - *Don’t assume clients know*

# Options Available

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- Gift income interest
  - *Gives the entire trust to charity today*
  - *Client receives a charitable deduction*
- Sell income interest
  - *Income stream sold through a secondary market*
  - *Does not terminate CRT*
- Terminate CRT
  - *Value of income interest determined using IRS formula*
  - *Uncommon because of sale option*
    - *Sale value of income interest usually significantly higher*



# Gift Income Interest

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- Client doesn't need/want their CRT income
- Client doesn't wish to receive any value for their income interest
- Client situations to look for
  - *Client complaining about paying tax on CRT income*
  - *Client not interested in gifting additional assets to heirs*
  - *"Nuisance" CRTs*
    - Very wealthy client; small CRT

# Gift Income Interest

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- The Process
  - *Client irrevocably contributes their income interest (a private capital asset) to the charitable remainderman*
  - *Client receives charitable deduction equal to 7520 value of their income interest*
    - Client will need to file a Form 8323 and obtain an appraisal (even if the CRT owns only cash and/or marketable securities) from a qualified appraiser

# Sell Income Interest

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- Key benefits (not usually drivers)
  - *Ability to sell income interest at a financial premium*
  - *Taxation*
  - *Reduction of mortality risk*
- Main drivers
  - *Flexibility*
  - *Simplification*
  - *Family*
- The Process

# Sell Income Interest

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- Common situations to look for
  - *Major life events*
    - Divorce
    - Death of a spouse
    - Change in health status
  - *Unforeseen need for liquidity*
  - *Desire to transfer additional assets to heirs*
  - *Frustration with administrative costs/hassles*
  - *NIMCRUTs*

# When Taxation *is* a Driver

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- CRTs distributing all/mostly ordinary income
  - *Often NIMCRUTs invested in variable annuities*
  - *In effect, sale converts ordinary income into capital gain*
- When the capital gains rate is expected to rise
  - *2012*
    - On 1/1/13, capital gains rate increased from 15% to 20% and 3.8% NII Tax further increased it to 23.8%
  - *2020-2021?*
    - Biden tax proposal: capital gains taxed at the top 39.6% rate on ordinary income for individuals with income of more than \$1 million

# Case Study: Sell Income Interest

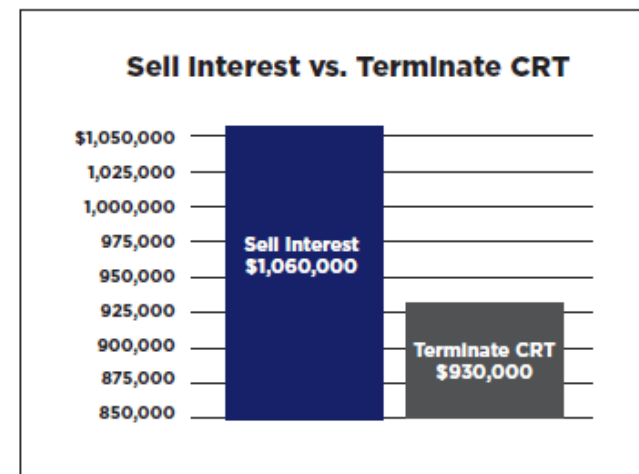
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- Situation

- *Husband and wife; both 75; CRT distributing \$100,000/yr.*
- *Clients had simplified their lives as they aged and updated most of their planning accordingly*
- *The CRT was the only planning that couldn't adjust to their changing lifestyle*

- Solution

- *Sold income interest*
  - Some proceeds to heirs
  - Rest to investment advisors



# CRT Rollover

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- Client wants to change something about their CRT
  - *Add income beneficiaries*
  - *Change the type of CRT*
- Rollover uses income interest in existing CRT to form a new CRT reflective of desired changes
- Most common fact pattern
  - *Client not reliant on income their CRT forces them to take*
    - Client often adverse to paying taxes on unneeded income
  - *Client interested in getting additional wealth to heirs*

# Case Study: CRT Rollover

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- Situation
  - *63-year-old widow; surviving beneficiary of 5% CRUT*
  - *Didn't need income; tax-adverse*
  - *Focus is transferring maximum assets to daughters*
- Solution
  - *Roll to NIMCRUT, structured for deferral*
    - Mom defers income during remaining lifetime
    - Trust grows tax-free for 19 years (mom's life expectancy)
    - At mom's death, daughters collect income for their remaining lifetimes



# Case Study: CRT Rollover

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- Outcome
  - *In effect, client converted \$2,075,000 of highly-taxable income into \$5,200,000 of future income for her daughters*
  - *Client avoids paying taxes on the \$2,075,000 of converted income*
  - *Client garnered an immediate income tax deduction of \$135,000*

## No Action

|                    |             |
|--------------------|-------------|
| Tax Deduction      | None        |
| Expected Duration  | 19 Years    |
| Income to Client   | \$2,075,750 |
| Income to Children | \$0         |

| Yr. | Beginning CRT Value | Growth (5%) | Payout (5%) | Ending CRT Value |
|-----|---------------------|-------------|-------------|------------------|
| 1   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 2   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 3   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 4   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 5   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 6   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 7   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 8   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 9   | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 10  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 11  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 12  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 13  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 14  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 15  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 16  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 17  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 18  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |
| 19  | 2,185,000           | 109,250     | 109,250     | 2,185,000        |

## CRT Rollover

|                    |             |
|--------------------|-------------|
| Tax Deduction      | \$135,000   |
| Expected Duration  | 46 Years    |
| Income to Client   | \$0         |
| Income to Children | \$5,202,359 |

Change in Income  
 ← (\$2,075,750)  
 ← \$5,202,359

In effect, rollover converts \$2.1M of client's income into \$5.2M of income for her children

| Yr. | Beginning CRT Value | Growth (5%) | Payout (Variable) | Ending CRT Value |
|-----|---------------------|-------------|-------------------|------------------|
| 1   | 1,525,000           | 76,250      |                   | 1,601,250        |
| 2   | 1,601,250           | 80,063      |                   | 1,681,313        |
| 3   | 1,681,313           | 84,066      |                   | 1,765,378        |
| 4   | 1,765,378           | 88,269      |                   | 1,853,647        |
| 5   | 1,853,647           | 92,682      |                   | 1,946,329        |
| 6   | 1,946,329           | 97,316      |                   | 2,043,646        |
| 7   | 2,043,646           | 102,182     |                   | 2,145,828        |
| 8   | 2,145,828           | 107,291     |                   | 2,253,120        |
| 9   | 2,253,120           | 112,656     |                   | 2,365,776        |
| 10  | 2,365,776           | 118,289     |                   | 2,484,064        |
| 11  | 2,484,064           | 124,203     |                   | 2,608,268        |
| 12  | 2,608,268           | 130,413     |                   | 2,738,681        |
| 13  | 2,738,681           | 136,934     |                   | 2,875,615        |
| 14  | 2,875,615           | 143,781     |                   | 3,019,396        |
| 15  | 3,019,396           | 150,970     |                   | 3,170,365        |
| 16  | 3,170,365           | 158,518     |                   | 3,328,884        |
| 17  | 3,328,884           | 166,444     |                   | 3,495,328        |
| 18  | 3,495,328           | 174,766     |                   | 3,670,094        |
| 19  | 3,670,094           | 183,505     |                   | 3,853,599        |
| 20  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 21  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 22  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 23  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 24  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 25  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |
| 26  | 3,853,599           | 192,680     | 192,680           | 3,853,599        |

Client defers income over remaining lifetime

Client's children receive income for remaining lifetimes

# Additional Resource & Questions

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- CRT Secondary Planning Resource Handbook
  - *Includes articles, case studies, legal and tax analyses, guides for advisors, and more – all on the secondary planning options that are available to clients with CRTs*
  - *For a free copy, e-mail [CRT@SterlingFoundations.com](mailto:CRT@SterlingFoundations.com)*
- Questions
  - *Contact Evan*  
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