

The Charitable Remainder Unitrust: The Best Financial Planning Tool

November 19, 2013 Webinar for Donors

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What Will We Learn?

Point #1: Income tax rates are high & will go higher:

- a) The American Taxpayers Relief Act of 2012 (enacted January 2, 2013) has changed the landscape; and
- b) The President has proposed another tax of 3%-5%.

Point #2: Asset values are up.

Point #3: In a similar environment in the 1990s, CRUTs were the solution for individuals wanting to sell an asset, or save for retirement.

Side Note

- ▶ What exactly is a CRUT?
- ▶ A CRUT is a **C**haritable **R**emainder **U**ni**T**rust
- ▶ Typically, a CRUT pays income to husband and wife, with remainder to charity on the death of the survivor
- ▶ Because the remainder goes to charity, the law allows the CRUT to be tax-exempt
- ▶ More to come on this definition in later slides

Point #1: Income Tax Rates Are High

Taxes in the New World of 2013

Ordinary Income Tax - Fed Only

	<u>2012</u>	<u>2013</u>	<u>% Change</u>
Basic Rate	35.0%	39.6%	
ObamaCare	0%	3.8%	
PEP & Pease	<u>0%</u>	<u>1.2%</u>	
Total Fed	35.0%	44.6%	27%

Capital Gains Tax - Fed Only

	<u>2012</u>	<u>2013</u>	<u>% Change</u>
Basic Rate	15.0%	20.0%	
ObamaCare	0%	3.8%	
PEP & Pease	<u>0%</u>	<u>1.2%</u>	
Total Fed	15.0%	25.0%	67%

Point #1: Income Tax Rates Are High

Taxes in the New World of 2013

Ordinary Income Tax - Fed & CA

	<u>2012</u>	<u>2013</u>	<u>% Change</u>
Basic Rate	35.0%	39.6%	
ObamaCare	0%	3.8%	
PEP & Pease	0%	1.2%	
CA (13.3%)	<u>8.65%</u>	<u>7.37%</u>	
Total Blended	43.6%	52.0%	19%

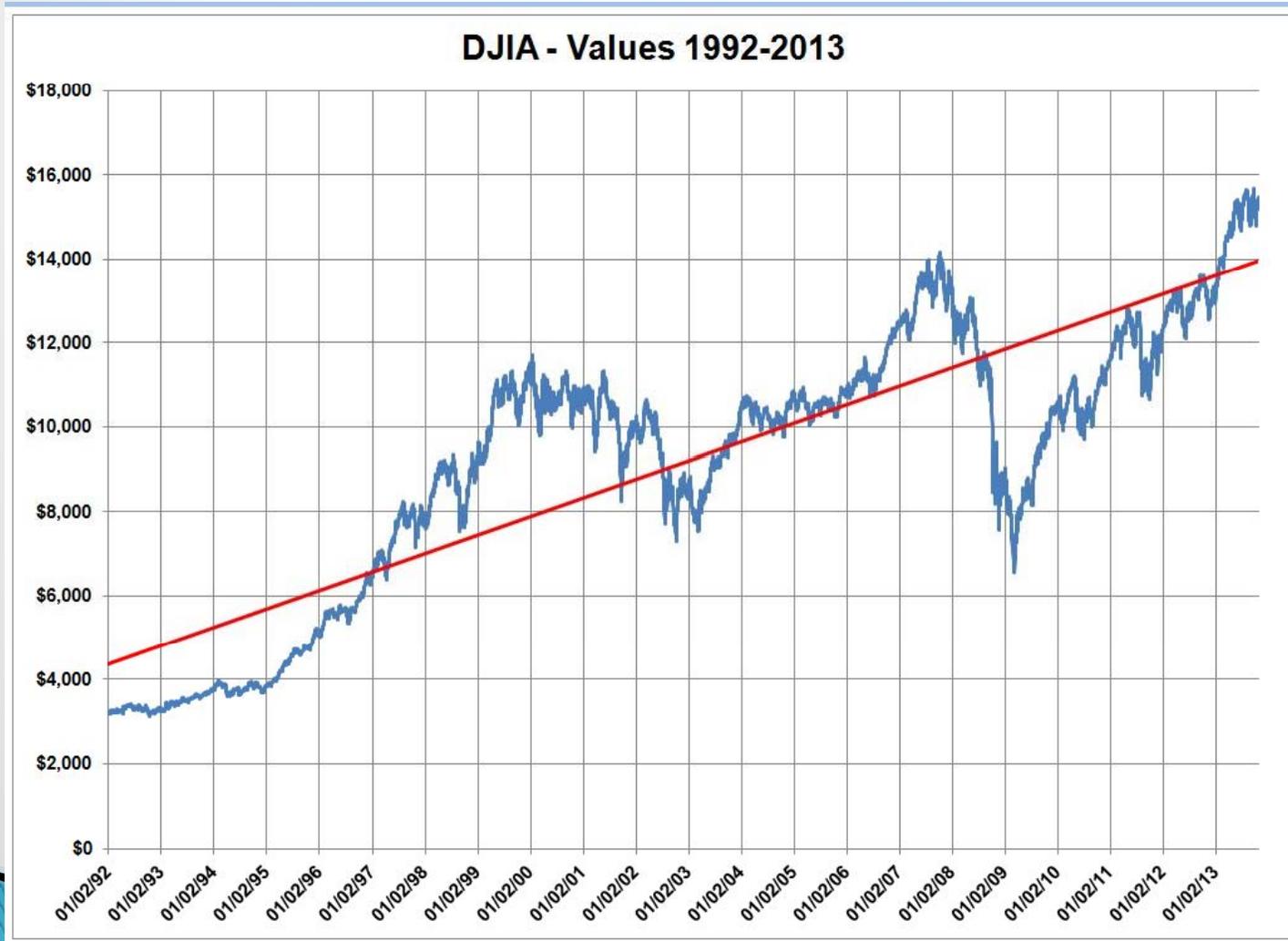
Capital Gains Tax - Fed & CA

	<u>2012</u>	<u>2013</u>	<u>% Change</u>
Basic Rate	15.0%	20.0%	
ObamaCare	0%	3.8%	
PEP & Pease	0%	1.2%	
CA (13.3%)	<u>11.31%</u>	<u>7.37%</u>	
Total Blended	26.3%	32.4%	23%

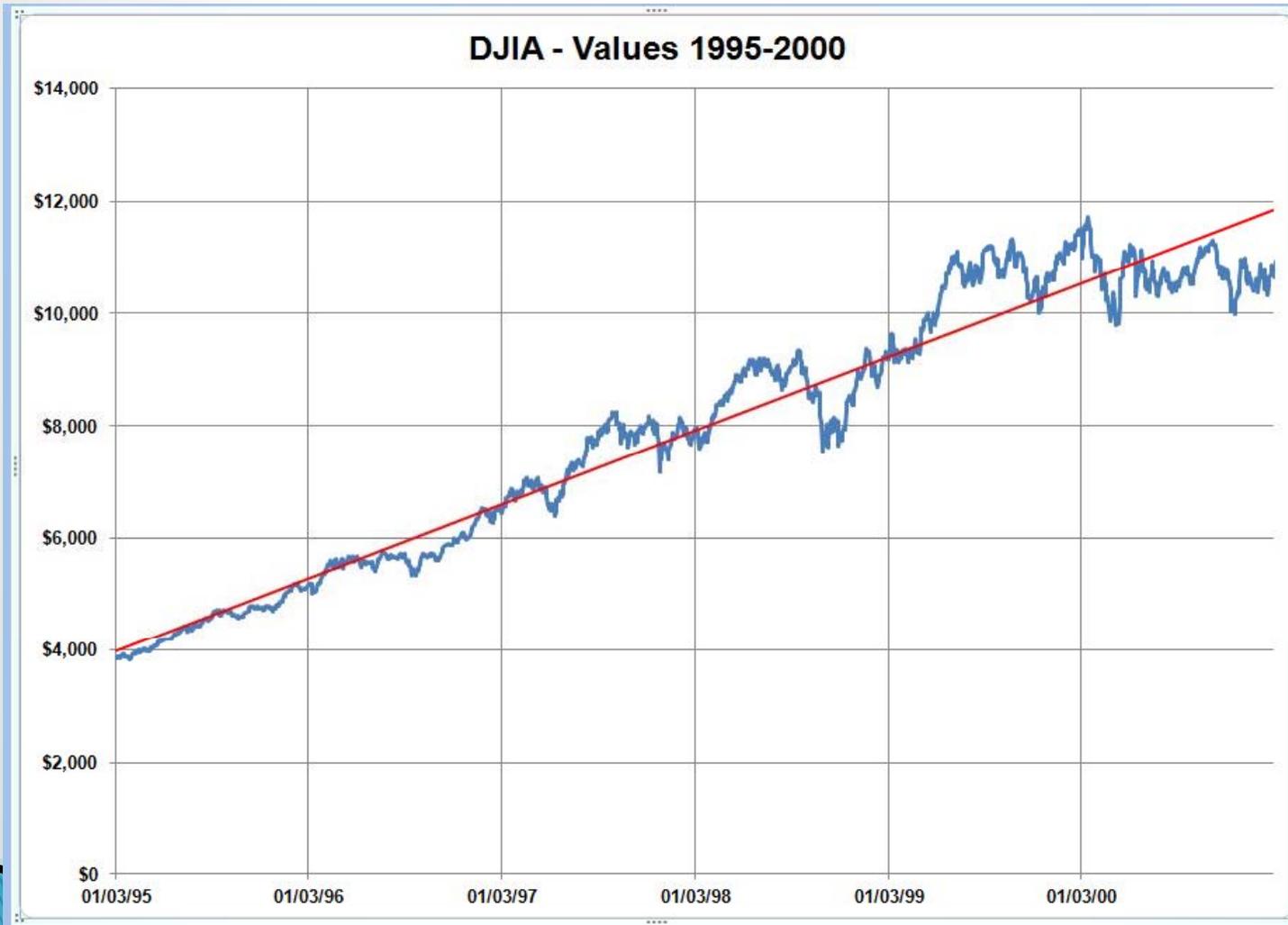
Point #1: Income Tax Rates Are High & Will Go Higher

- ▶ The President and Senate have proposed higher income taxes on the wealthy.
- ▶ Rationale: The highest marginal taxpayers only pay 22-23% of their income in taxes.
- ▶ Most “wealthy” individuals are only “wealthy” for a one year period, and then fall out of the “wealthy” category.
- ▶ This is due to “Life Events” (more to come on this).

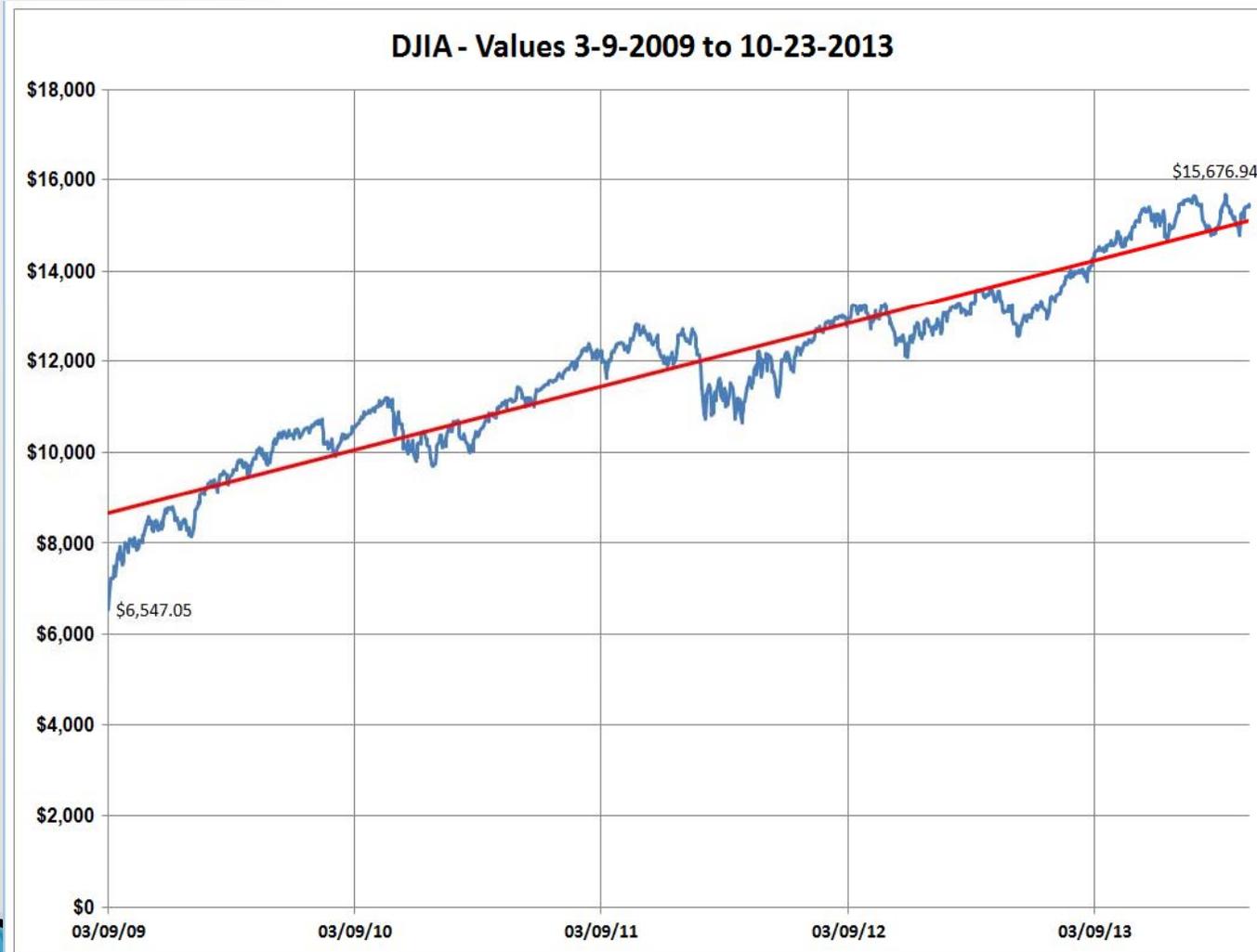
Point #2: Asset Values Are Up



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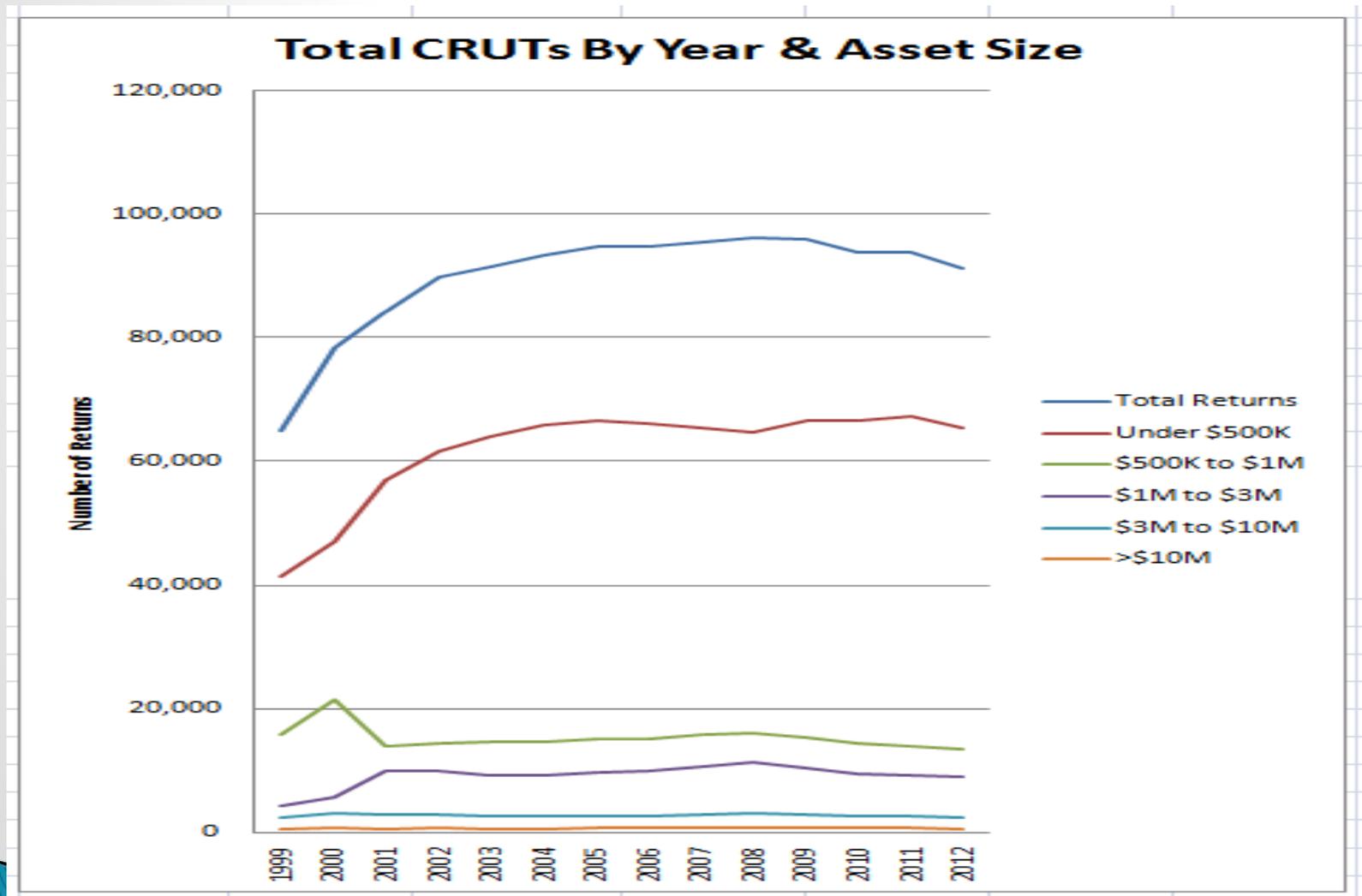
Point #3: In a Similar Environment...

- ▶ The last time we had a similar environment, with high taxes and significant appreciation in values, donors flocked to life income vehicles, especially CRUTs.
- ▶ If things repeat, we should have significant push by donors and their advisers to use CRUTs as a prime planning tool.

Point #3: In a Similar Environment...

- ▶ Let's look at the facts:

Point #3: In a Similar Environment...

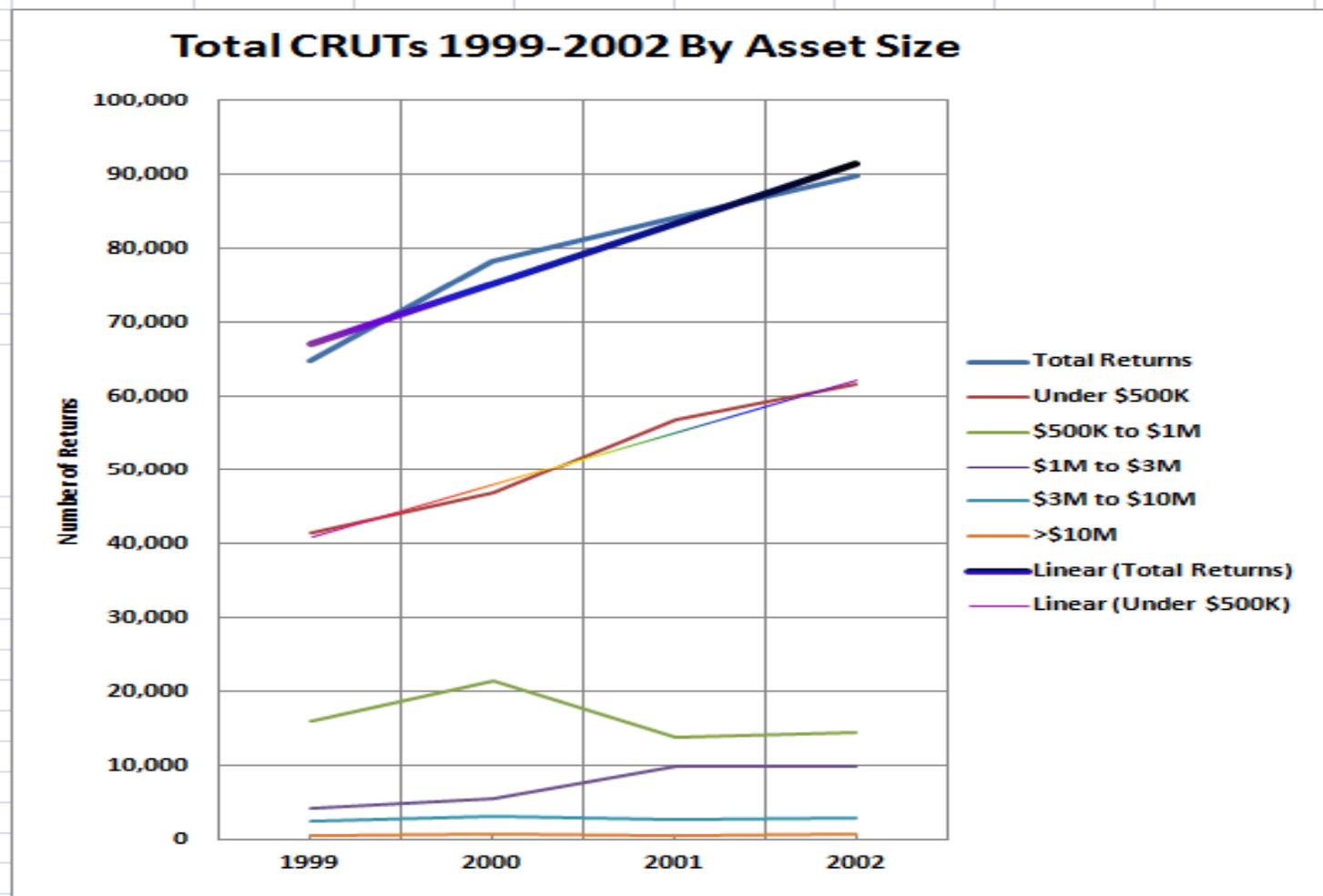


Point #3: In a Similar Environment...

Number of Returns by Year							
Year		Under \$500,000	\$500,000 to 1,000,000	\$1,000,000 to \$3,000,000	\$3,000,000 to \$10,000,000	\$10,000,000 or more	% Increase/Decrease Total Returns
1999	64,923	41,425	15,930	4,381	2,555	632	-----
2000	78,239	47,003	21,467	5,682	3,270	816	20.5%
2001	84,201	56,888	13,906	9,922	2,808	676	7.6%
2002	89,874	61,732	14,463	10,011	2,895	773	6.7%
2003	91,371	63,880	14,782	9,311	2,737	661	1.7%
2004	93,329	65,869	14,763	9,361	2,647	689	2.1%
2005	94,779	66,517	15,070	9,781	2,698	713	1.6%
2006	94,767	66,187	15,116	9,974	2,743	746	0.0%
2007	95,567	65,371	15,806	10,631	2,956	802	0.8%
2008	96,248	64,776	16,100	11,317	3,191	864	0.7%
2009	95,928	66,548	15,294	10,378	2,916	792	-0.3%
2010	93,831	66,555	14,431	9,458	2,672	715	-2.2%
2011	93,828	67,211	13,897	9,366	2,642	713	0.0%
2012	91,250	65,444	13,587	9,012	2,532	675	-2.7%

Statistics drawn from <http://www.irs.gov/uac/SOI-Tax-Stats-Split-Interest-Trust-Statistics>.

Point #3: In a Similar Environment...



Point #3: In a Similar Environment...

- ▶ Clients/donors would rather give to charity, than to the government.
- ▶ Given a choice of paying taxes to the government, or benefiting a charity they support, donors historically pick the latter.

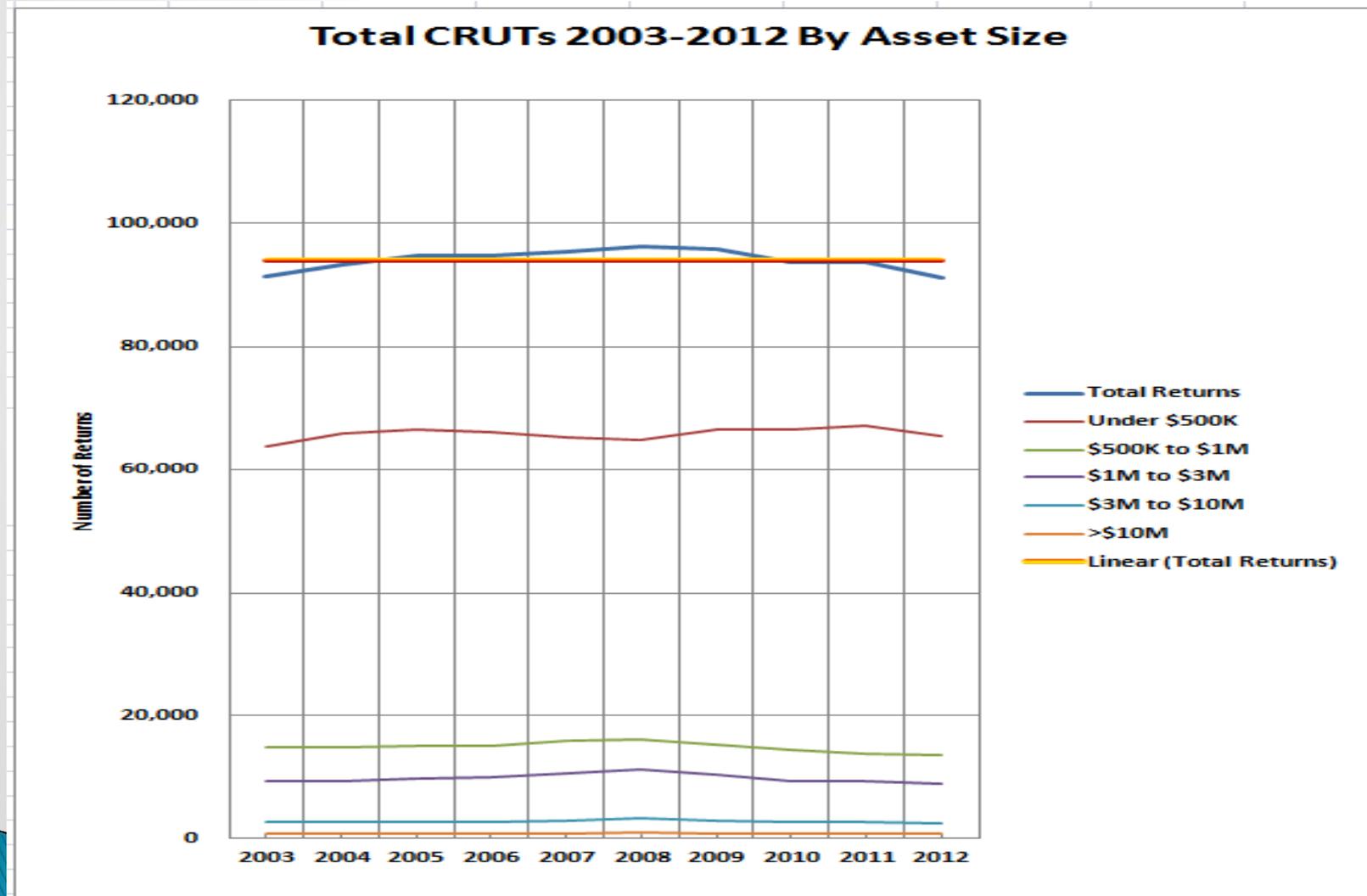
Point #3: In a Similar Environment...

- ▶ When tax rates are low, and appreciation in value is not significant, donors are willing to pay a small amount of taxes (e.g., 15%)
- ▶ When taxes are high, forget it!

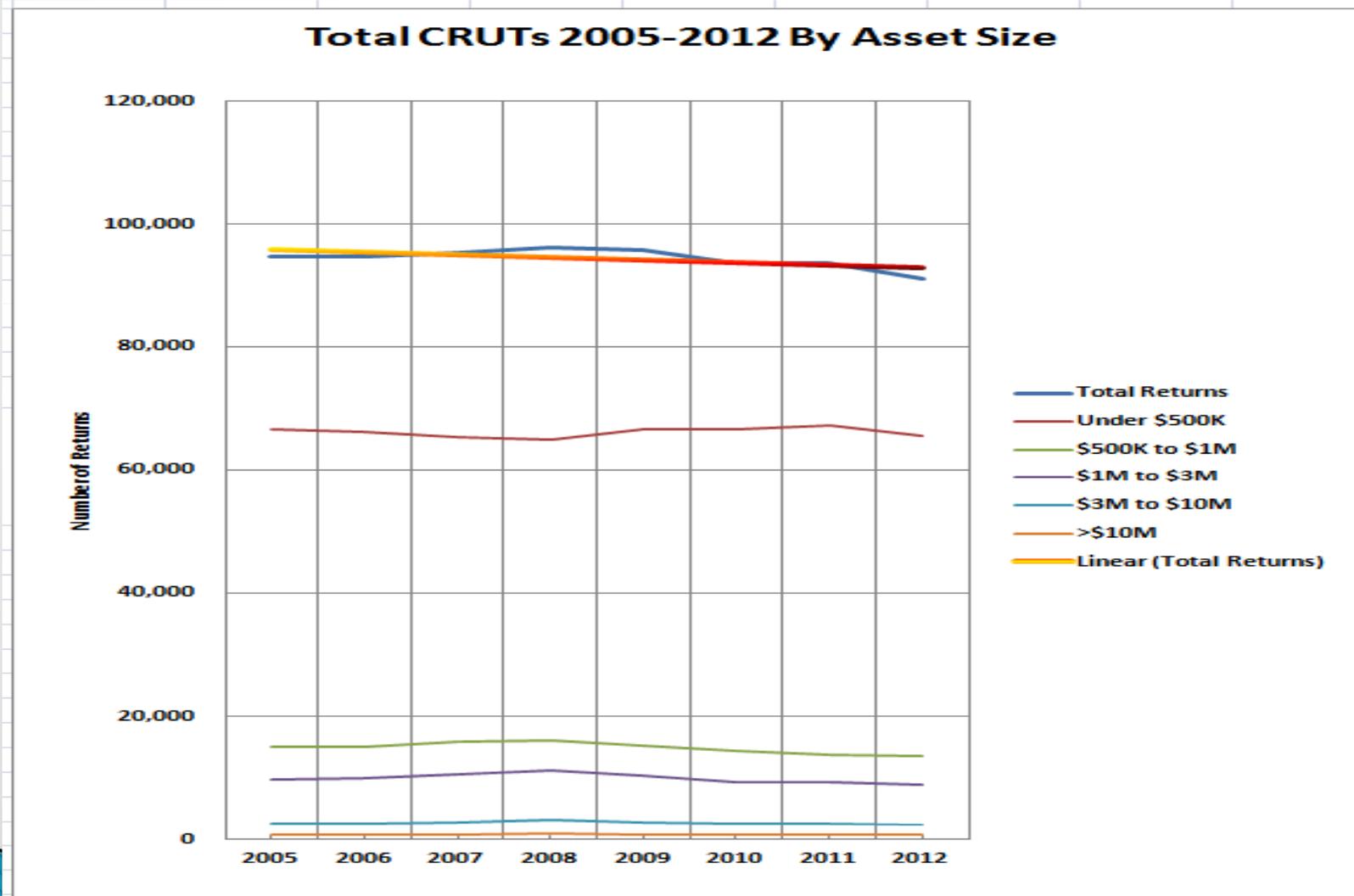
Point #3: In a Similar Environment...

What happened when tax rates drastically dropped
in years 2002 to 2012?

Point #3: In a Similar Environment...



Point #3: In a Similar Environment...



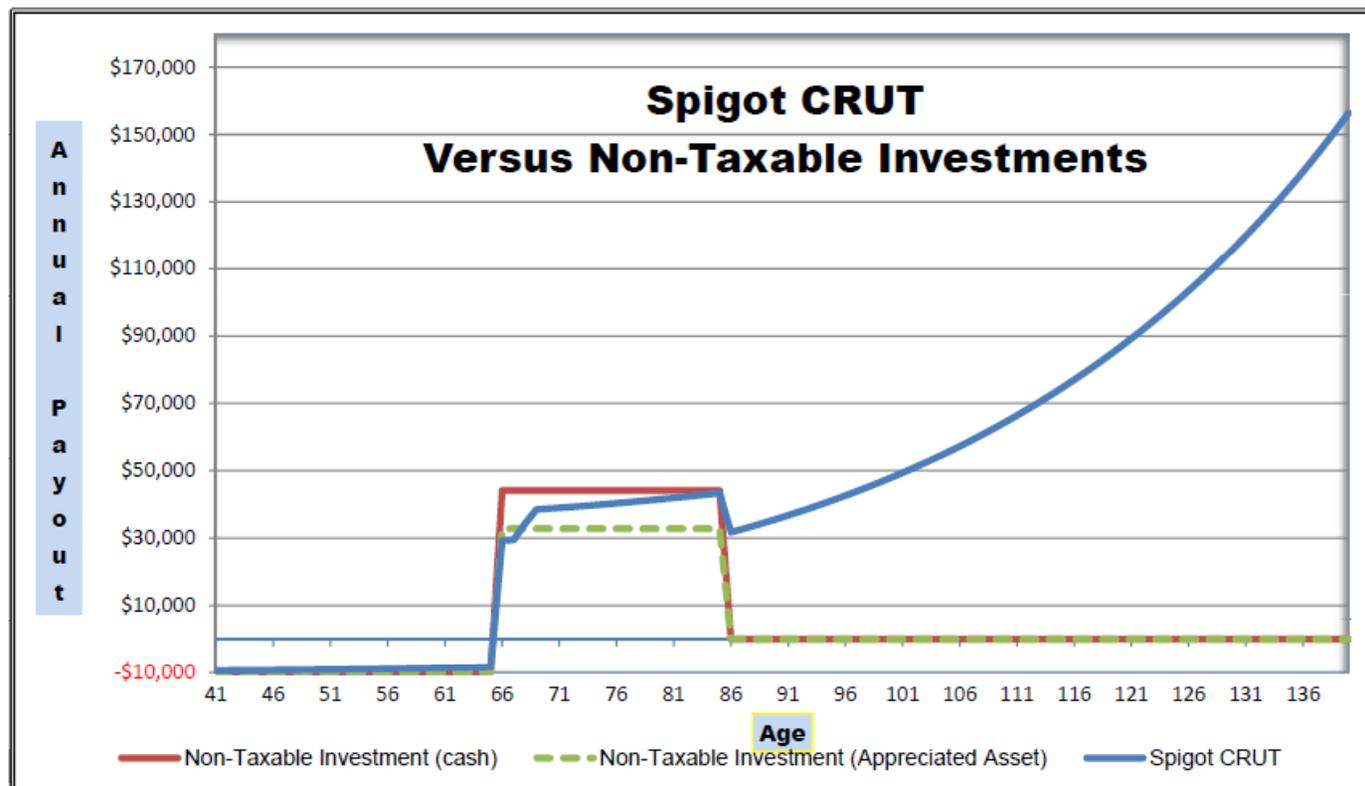
Does Gift Planning Make Sense Today?

- ▶ There are no other viable options
 - Tax shelters are gone
 - No other way to obtain a large income tax deductions
 - No other way to prevent income from being taxed
- ▶ Example #1: Annual cash gifts to a NIMCRUT
- ▶ Example #2: One-time gift of an appreciated asset to a
NIMCRUT

NIMCRUT – Annual Contributions

COMPARISON - SPIGOT UNITRUST ("UT") V. NONTAXABLE INVESTMENT ("NTI")							
Donors (Ages 1 & 2)		41	41	Fed. Ord. Income Tax Rate			39.50%
Annual Contribution (cash)		\$10,000		Fed. Cap. Gains Tax Rate			20.00%
Total Contributions		\$250,000		Health Care - Medicare			3.00%
UT Stated Amount		5%		PEP & Pease Limitations			1.20%
UT Invest. Return (B/T)		8%		State Tax Rate			8.00%
NTI Invest. Return (A/T)		5.40%		State Tax Rate (after Fed. Deduc)			3.56%
Retirement Age		65		Blended Ordinary Income Rate			48.06%
Years of Payout		20		Blended Cap. Gain Rate			28.56%
Age at Death		85		UT IRR (B/T)			8.12%
FMV of Gift		\$10,000		UT IRR (A/T)			6.69%
Adj. Basis of Gift		\$1,000		NTI IRR (A/T - cash)			5.64%
Investment Return				NTI IRR (A/T - property)			4.30%
Ordinary Income		20%		Remainder to Charity			\$972,950
Capital Gains		80%		Date			10/30/2013

NIMCRUT– Annual Contributions



Noncash Assets

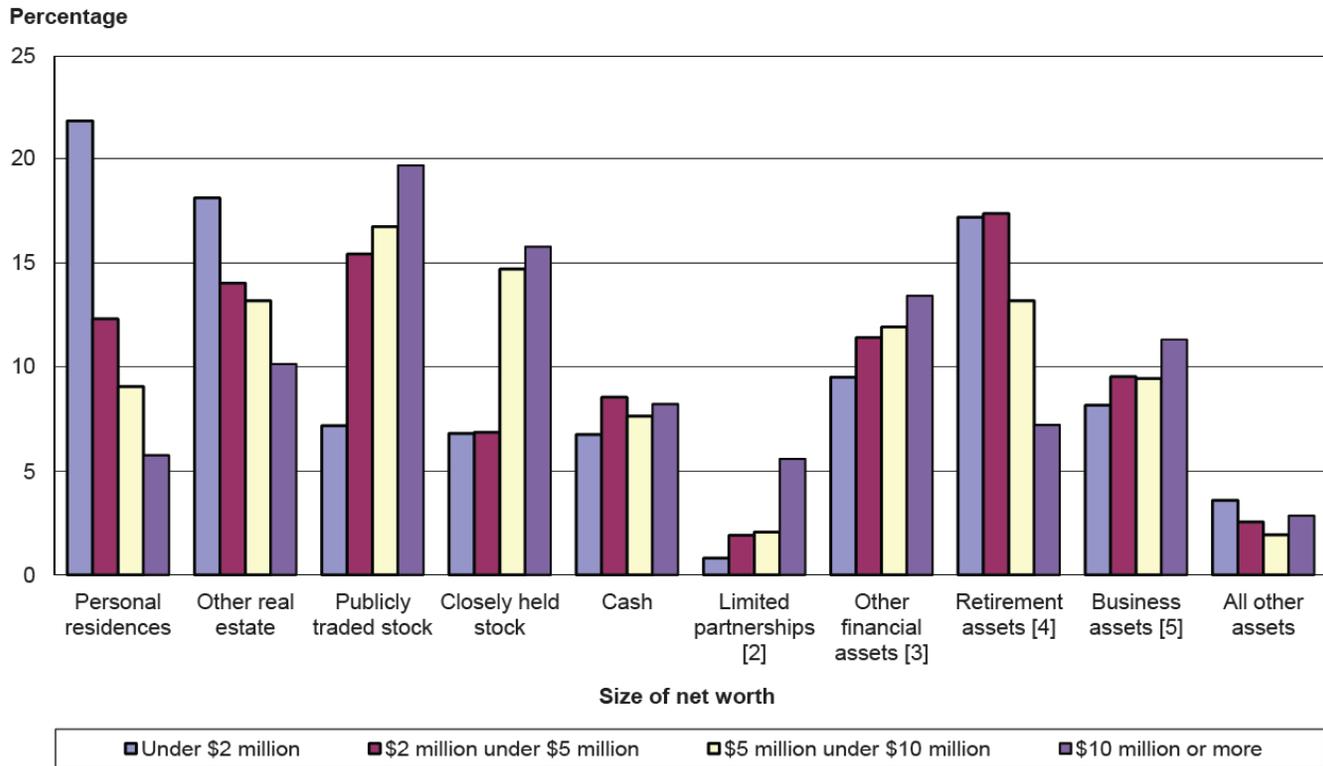
- ▶ Everyone wants donors/clients' cash:
 - Grocery store
 - Spouse
 - Children
 - Government
 - Almost all charities
- ▶ What percentage is cash in the average millionaire's portfolio?

Personal Wealth, 2007

Statistics of Income Bulletin | Winter 2012

Figure F

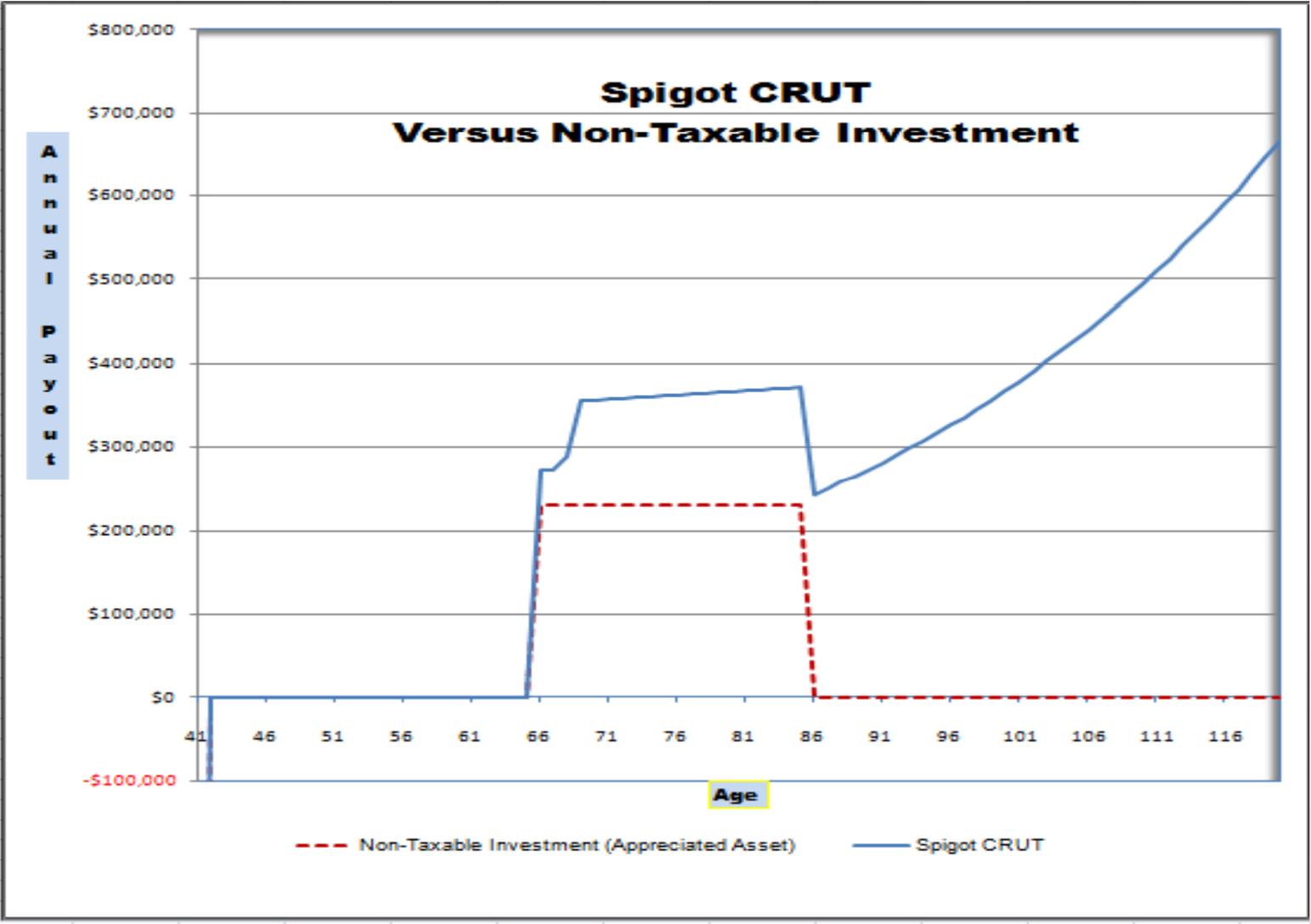
Male Top Wealth Holders [1], Selected Assets as a Percentage of Total Assets, by Size of Net Worth, 2007



NIMCRUT– One-Time Contribution

COMPARISON - SPIGOT UNITRUST ("UT") V. NONTAXABLE INVESTMENT ("NTI")					
Donors (Ages 1 & 2)		41	41	Fed. Ord. Income Tax Rate	39.50%
Annual Contribution (cash)		\$1,000,000		Fed. Cap. Gains Tax Rate	20.00%
Number of Contributions		1		Health Care - Medicare	3.80%
Total Contributions		\$1,000,000		PEP & Pease Limitations	1.20%
UT Stated Amount		5%		State Tax Rate	8.00%
UT Invest. Return (B/T)		8%		State Tax Rate (after Fed. Deduc	3.56%
NTI Invest. Return (A/T)		5.40%		Blended Ordinary Income Rate	48.06%
Retirement Age		65		Blended Cap. Gain Rate	28.56%
Years of Payout		20		CRUT IRR (B/T)	8.05%
Age at Death		85	85	CRUT IRR (A/T)	6.88%
FMV of Gift		\$1,000,000		NTI IRR (A/T - property)	4.62%
Adj. Basis of Gift		\$100,000		Remainder to Charity	\$7,458,148
Investment Return					
Ordinary Income		20%		Date	10/30/2013
Capital Gains		80%			

NIMCRUT- One-Time Contribution



Benefits to the Donor, Heirs, & Charity

- ▶ Let's take a look at the benefits of the NIMCRUT, this time not from an “internal rate of return” perspective, but from standpoint of:

- 1. Benefits to the Donor**
- 2. Benefits to the Heirs**
- 3. Benefits to Charity**

Hold v. Sell v. Gift to CRUT

HOLD v. SALE v. GIFT TO CHARITABLE REMAINDER TRUST

<u>ASSUMPTIONS:</u>					
Estate Tax Rate	16.00%	Older Donor/Benefic. Age			60
Investment Return	8.00%	Younger Donor/Benefic. Age			60
CRT Return	8.00%	Blended Cap. Gain Rate			28.56%
Investment A/T Return	5.40%	Blended Ord. Inc. Rate			48.06%
Current Investment Return	2.00%	FMV of Gift (total):			\$1,000,000
Life Expectancy (yrs)	27	Donor's Basis in Gift:			\$100,000

Hold v. Sell v. Gift to CRUT

I. HOLD PROPERTY UNTIL DEATH			
A. Fair Market Value			\$1,000,000
B. Annual Income		\$20,000	
C. Net Income A/T		\$10,388	
D. Future Value of Net A/T Income @ death	----->		<u>\$603,486</u>
E. Taxable Estate	----->		\$1,603,486
F. Estate Tax	----->		<u>(\$256,558)</u>
NET TO HEIRS	----->		<u>\$1,346,928</u>

Hold v. Sell v. Gift to CRUT

II. SALE OF PROPERTY:				
A. Sale Price	\$1,000,000			
B. Adjusted Basis	<u>(\$100,000)</u>			
C. Taxable Gain	\$900,000			
D. Income Tax	<u>\$257,040</u>			
E. Net Proceeds ----->			\$742,960	
F. Annual Income	\$59,437			
G. Net Income A/T	\$40,120			
H. Future Value of Net A/T Income @ death ----->			<u>\$2,330,743</u>	
I. Taxable Estate ----->				\$3,073,703
J. Estate Tax ----->				<u>(\$491,793)</u>
NET TO HEIRS ----->				<u>\$2,581,911</u>

Hold v. Sell v. Gift to CRUT

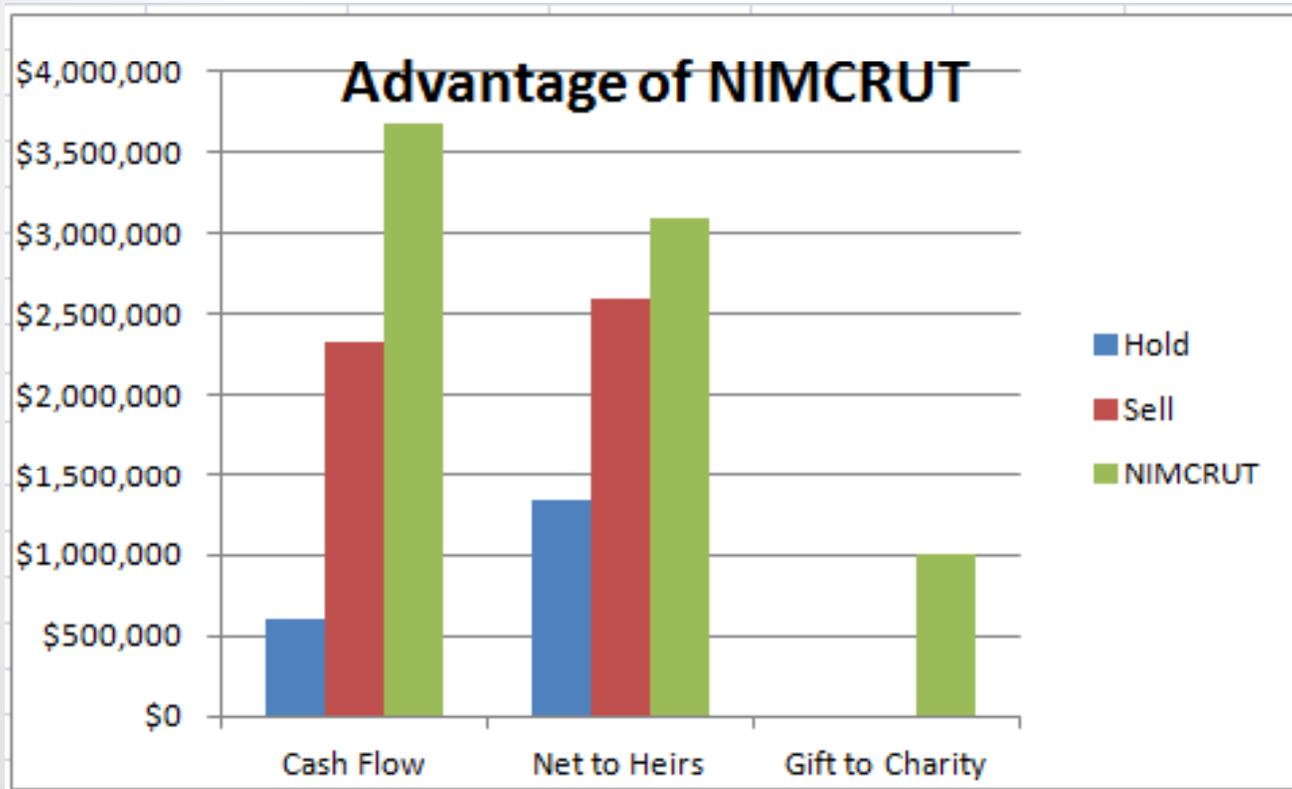
III. GIFT TO CHARITABLE REMAINDER UNITRUST:

A. FMV of Gift to CRT	\$1,000,000			
B. Income from CRT	\$80,000			
C. Net Income A/T	\$54,000			
D. Future Value of D @ Death ----->			\$3,137,105	
E. Char. Deduc.	\$269,690			
F. Tax Savings ----->		\$129,613		
G. Future Value of H @ Death ----->			<u>\$536,223</u>	
H. Taxable Estate ----->				\$3,673,327
I. Estate Tax ----->				<u>(\$587,732)</u>
NET TO HEIRS ----->				<u>\$3,085,595</u>

Hold v. Sell v. Gift to CRUT

ADVANTAGES OF CRT:		versus HOLDING		versus SELLING	
Cash Flow To Donor		\$2,533,619	GREATER	\$1,342,584	GREATER
Net to Heirs		\$1,234,982	GREATER	\$503,684	GREATER
Gift to Charity		\$1,000,000	GREATER	\$1,000,000	GREATER

Hold v. Sell v. Gift to CRUT



“Doing Well By Doing Good”

- ▶ The Philanthropic Initiative, Inc.
- ▶ Study in 2000
- ▶ Donors/Clients do not think their advisors are knowledgeable about charitable giving

“Doing Well By Doing Good”

“Most advisors lack the tools and/or comfort levels to link technical counsel to more personal, values-based philanthropy planning.”

“Doing Well By Doing Good”

“If their advisors are not knowledgeable about philanthropic planning, donors seek referral to others who can.”

What Is a Charitable Remainder Unitrust (“CRUT”)?

A. Generally

- 1) A Fixed Percent or Fraction (@ least 5% & no > 50%)
- 2) Of Net FMV
- 3) Valued Annually (with a CRUT)
- 4) Distributed to a Beneficiary (@ least 1 non-charity)
- 5) For Life or a Term of Years (no >20)
- 6) W/ Irrevocable Remainder to 1 or > Charities

What Is a Charitable Remainder Unitrust?

A. Generally

- 7) “Annual realization of a reasonable amount of income or gain from the sale of assets” = Trustee must not prevent
- 8) CRT must be qualified as such and function as such from its creation



What are the Mathematics Underlying a CRUT?

\$100=FMV

PRESENT VALUE

A. \$10 / yr for 5 yrs @ 8% = \$43

B. \$10 / yr for 10 yrs @ 8% = \$72

C. \$12 / yr for 10 yrs @ 8% = \$87

D. \$12 / yr for 10 yrs @ 6% = \$94

Present Value of Remainder Interest

A	B	C	D
100	100	100	100
<u>-43</u>	<u>-72</u>	<u>-87</u>	<u>-94</u>
57	28	13	6



2. Requirements of a CRUT

B. Types of CRUTs

- 1) SCRUT (Standard CRUT)
- 2) IOCRUT
- 3) NIMCRUT
- 4) FLIP CRUT – IOCRUT or NIMCRUT to SCRUT

SCRUT
IOCRUT
NIMCRUT

CRUT Examples

7% of \$100 (FMV) = \$ 7 = Unitrust Amount

Ex. #1

\$5 Dividend

	<u>Inc.</u>	<u>Prin.</u>	<u>IOU</u>
SCRUT	5	2	0
IOCRUT	5	0	0
NIMCRUT	5	0	2

NIMCRUT Examples

Ex. #2 \$5 appreciation earned
no dividends, interest, etc.

Land

Zero Coupon Bonds

Microsoft

Growth Stock

VA

CTF

ULP

Life Insurance



No
Cash

What Are the Negatives to a CRUT?

- ▶ Loss of control of principal
- ▶ Inability to invade CRUT to pay out principal if it is a NIMCRUT
- ▶ Inability to borrow on monies in CRT

Can The Negatives Be Overcome?

- ▶ CRTs can be terminated, with the donors/income beneficiaries getting back up to 90% of the then fair market value of the CRT.
- ▶ A portion of a CRT can be carved out, and given to charity, and a charitable deduction obtained (be careful!)
- ▶ One CRT can be rolled into another CRT.

What Did We Learn?

- ▶ Taxes are up, and will continue to go up!!
- ▶ Values are up!!
- ▶ CRUTs were used successfully in the past when taxes and values were up, and are the preferred financial planning tool now!!!