



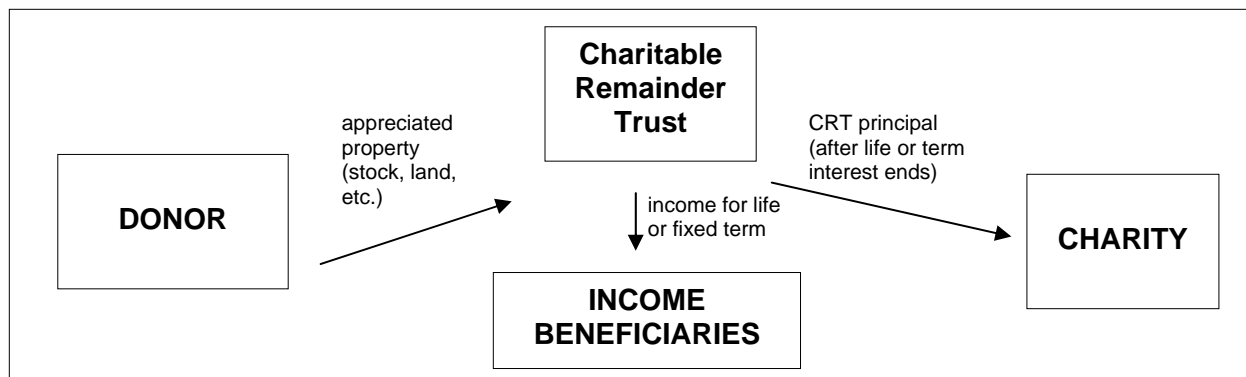
CHARITABLE REMAINDER TRUSTS

Charitable remainder trusts, a form of life-income gift, can have substantial benefits for the donor as well as the Vermont Land Trust. Like charitable gift annuities and pooled income funds, charitable remainder trusts, often referred to simply as remainder trusts or CRTs, can provide an immediate income tax deduction and increased annual income. Depending on how a donor funds the remainder trust, an individual may reduce capital gains and even estate taxes. A remainder trust provides great flexibility to establish specific objectives and meet personal financial circumstances. Because remainder trusts are more complex than gift annuities, we recommend that donors use them when the gift has a value of at least \$100,000 and the income beneficiaries are not yet 75 years or older.

WHAT IS A CHARITABLE REMAINDER TRUST?

A charitable remainder trust is an independent trust that holds assets. A donor transfers cash or appreciated property (stock, bonds, land, or other marketable property) into the trust, reserving an income interest for one or more beneficiaries. Depending upon the assets used to fund the trust, a trustee manages the cash or real property (generally selling the property and reinvesting the proceeds) to generate income for the beneficiaries. The trustee can be one or more individuals and/or a trust department, and, in some cases, the donor. The charity benefiting from a trust can serve as trustee. The Vermont Land Trust (VLT) will serve as trustee for remainder trusts with a minimum principle of \$150,000 in which VLT is the only remainder beneficiary and VLT's designation as such is irrevocable. Trusts in which VLT serves as trustee must be funded with cash or publicly traded securities. If funded with real estate, then VLT has discretionary consent regarding the acceptance of the property.

Usually, the trustee makes quarterly payments to the income beneficiaries that may continue either for the lives of the beneficiaries or for a fixed term of up to 20 years. After the income interest ends, either at the beneficiary's death or the conclusion of the term, the trust terminates. The trustee then pays the remaining assets in the trust to the charity or charities named in the trust for whatever use the donor originally stipulated. The following diagram explains the relationship among the donor, trustee, income beneficiaries, and charity in a charitable remainder trust:



ARE THERE AGE LIMITATIONS IN ESTABLISHING A CHARITABLE REMAINDER TRUST?

To qualify for beneficial income tax treatment, including a charitable income tax deduction for the donor, a charitable remainder trust must be established such that at least 10 percent of the amount contributed to the trust will ultimately pass to the charity when the donor dies. The IRS has actuarial tables to determine whether, based on the donor's age at the time the trust is funded as well as other factors, this requirement will be met. Accordingly, a trust with younger beneficiaries could have a problem satisfying this requirement. VLT can determine whether this will be an issue in the case of a particular donor and trust arrangement.

WHAT BENEFITS DO I GAIN FROM A CHARITABLE REMAINDER TRUST?

A charitable remainder trust is most useful when a donor has substantial resources and owns highly appreciated assets that earn a low rate of return (like stock) or cost the donor money to maintain (such as land). When the assets are transferred to the trust and then sold, no capital gains tax is due on the sale. This preserves the maximum amount of principal for reinvestment. The donor is thus able to convert a low-earning asset into a high-earning one without a significant loss of capital. If the donor sells the asset outright, rather than through the trust, state and federal taxes may devour as much as 18 percent of its value.

The donor also benefits by gaining a charitable income tax deduction in the year the trust acquires the asset. The amount of the deduction depends upon the value of the donated property, the number and ages of the income beneficiaries, and the annual payout rate selected. If the donor cannot use the deduction in the year the trust is established, he/she can carry the unused deduction forward for up to five years and apply it against subsequent income. Since a remainder trust is not a part of the donor's estate, it may also lower estate taxes in larger estates. The assets in a charitable remainder trust pass without the expense and delay of probate.

Finally, for charities like the Vermont Land Trust, remainder trusts provide significant long-term financial support, including the establishment of permanent endowment funds.

WHAT ARE THE DISADVANTAGES?

The major disadvantage is that the donor and heirs do not have access to the trust principal during their remaining lifetimes. The donor and family cannot make any personal use of the trust's property other than to receive income payments. Therefore, before establishing a charitable remainder trust, donors should consider carefully whether they have other capital resources that will be sufficient to meet their future needs.

CAN I USE REAL ESTATE TO FUND A CHARITABLE REMAINDER TRUST?

Land can be an excellent asset to fund a remainder trust. Because land that has been owned for a long time is often greatly appreciated, a sale by the individual owner would trigger a large capital gains tax. When land funds the remainder trust, no capital gains tax is due upon the sale of the land by the trust. Charitable Remainder Trusts often include a clause stating that the trustee will not begin making payments to the income beneficiaries until after the land sells and the proceeds are invested in the trust.

If the land has agricultural, wildlife, or open space value, then the donor should place a conservation easement on the land before placing it in the remainder trust. Otherwise, the trustee may be required by law to sell the property for its full development value. Depending on the nature of the restrictions, the easement will probably reduce the selling price. However, the loss in value will usually qualify as an additional income tax deduction.

HOW DO YOU DETERMINE THE PAYMENT I RECEIVE?

Remainder trusts take two forms. A “unitrust” provides income to a beneficiary as a fixed percentage of the trust’s assets, which the trustee recalculates annually. This payment must be at least 5 percent of the assets. The actual dollars paid will fluctuate annually as the value of the trust’s assets changes. The second form, called an “annuity trust,” provides income to a beneficiary as a fixed payment that equals or exceeds 5 percent of the original value of the assets contributed. The annuity trust payment remains constant, regardless of changes in the trust value. Most donors use the unitrust model because if the principal in the trust grows, so will the annual income payments. On the other hand, if the principal in a unitrust decreases in value, the annual payment to the donor would also decrease.

Example: A donor establishes a unitrust paying 6% annually, and funds the trust with \$100,000 in stock. During the first year, the income beneficiaries will receive \$6,000. If the principal in the remainder trust grows to \$105,000 after one year, the income payment in the second year would be \$6,300. On the other hand, if the investments perform poorly and the principal diminishes to \$90,000, the second year's payments would be only \$5,400. Obviously, selecting a trustee and an investment advisor can make a critical difference to the ultimate success of the remainder trust for both the income beneficiaries and the Vermont Land Trust.

HOW IS MY TAX DEDUCTION DETERMINED?

The income tax deduction for a remainder trust is a function of several factors:

- the value of the donated asset.
- the type of remainder trust (either an annuity trust or unitrust).
- the annual income rate selected.
- the number and ages of the income beneficiaries (except where a fixed term is used, in which case the number of years in the term).
- the federal discount rate, which changes monthly.

The Vermont Land Trust makes the calculations using a computer program to factor in all these variables. For example, if a husband and wife, ages 75 and 70, establish a \$100,000 remainder trust (unitrust) paying 6% of the principal value annually, their deduction would be approximately \$39,300. If they elect a 5% income rate, the deduction increases to approximately \$45,600, although their annual income will be substantially lower (\$5,000 vs. \$6,000 in the first year).

On the other hand, a single person, age 75, establishing a \$100,000 unitrust with a 6% income rate, would receive approximately \$55,600 in charitable deductions. If the person is 55 years old, the deduction would be only \$28,000. Typically, if there are fewer and older beneficiaries, a donor will receive a greater charitable income tax deduction. The general tax rules that apply to charitable deductions apply to remainder trusts as well. When donors give appreciated property, they may claim a charitable deduction up to 30 percent of their adjusted gross income (AGI). A

donor who gives cash can deduct up to 50 percent of AGI. In either case, the donor may carry over any unused deduction for up to five years.

HOW DOES A CHARITABLE REMAINDER TRUST COMPARE TO A CHARITABLE GIFT ANNUITY?

Charitable remainder trusts are often advisable for donors who wish to make a planned gift with a value of \$100,000 or more; but want to retain lifetime control over investment of the assets so they can invest for growth and/or income, as they desire, and make additional contributions to the trust over time as their assets and personal objectives permit. Charitable remainder trusts also work particularly well in situations where the beneficiaries are relatively young, so that the principal and annuity payments may appreciate over their remaining lifetimes. Conversely, charitable gift annuities work well for gifts between \$5,000 and \$100,000, or when the donor wants to be assured of regular, fixed income payments for his or her lifetime.

HOW DO I GET STARTED?

As with the preparation of a will, your attorney will be the principal advisor in the preparation of a charitable remainder trust. In addition, you may wish to discuss inclusion of such a trust in your estate and financial plan with your accountant and how it will impact your current income tax liability.

Your attorney will typically prepare the charitable remainder trust document after discussing with you the specific manner in which you would like to structure the trust. To assist your attorney and you in the process, VLT has the computer software necessary to run the charitable remainder trust calculations and determine the annual income you will receive from the trust (depending upon the percentage payout amount you choose) and the charitable income tax deduction you will receive in the year the trust is created.

We will need from you: (1) the age(s) of the donor(s) who are creating the trust; (2) the estimated fair market value of the asset you intend to use to fund the charitable remainder trust; and (3) your "cost" or tax basis in that asset. We can then run the preliminary calculations.

If you are funding the charitable remainder trust with land, you must obtain a qualified appraisal of the land's fair market value before the transaction is finalized. Once the appraisal is complete, you have a 60-day window after the date of the appraisal to complete the transfer of land to the charitable remainder trust, or you will need an appraisal update (usually in the form of a letter). Again, if the land has conservation value that you want to protect, you must place a conservation easement on the land before it is transferred to the charitable remainder trust. Otherwise, the trustee will be legally required to sell the land for its highest value. If your gift is in the form of securities listed on the stock exchange, we will run the final calculations after the transfer, to determine the exact value of the securities on the day of transfer.

For more information, please contact Darby Bradley at darby@vlt.org or at the phone number below.

Vermont Land Trust
8 Bailey Avenue
Montpelier, VT 05602
Phone: (802) 262-1202
Fax: (802) 223-4223
www.vlt.org