San Antonio Estate Planning Council

Charitable Remainder Trust with an Option of Using Income Tax Savings to Convert to a Roth IRA

Presented by
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How a Charitable Remainder Annuity Trust Works

The donor transfers an asset to the trustee of the charitable remainder annuity trust (CRAT) and receives a fixed dollar amount for each year thereafter. A current income tax deduction is also available.

When the donor or other named beneficiary dies, the remaining trust assets pass to the designated charity.

DONOR
- Transfers asset to CRAT.
- Receives fixed dollar amount each year.[1]
- Receives income tax deduction.[2]

Asset →
← Annual Annuity Payout
← Income Tax Deduction

CRAT
- Trustee sells asset and reinvests for greater return.
- Pays no capital gain tax on the appreciation at the time of sale.
- Trustee pays fixed dollar amount yearly.

After the beneficiary is deceased, remaining trust assets pass to the charity.[3]

CHARITABLE ORGANIZATION
- Receives any assets remaining in the trust when the beneficiary is deceased.

[1] The annual annuity payout is taxed under a four-tier system. Generally speaking, ordinary income is paid first, followed by capital gain, other income, and trust principal.
[2] The income tax deduction is based on a government determined applicable federal rate and may have to be spread over more than one year, if it exceeds certain percentage of income limitations.
[3] If a surviving spouse "elects" to claim a part of a deceased spouse's estate, the income and estate tax benefits of a CRAT may be lost.

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Charitable Remainder Annuity Trust

A Charitable Remainder Annuity Trust (CRAT) is an irrevocable trust which pays a fixed dollar amount each year to a beneficiary, such as the donor of the trust assets, his or her spouse, child, etc. This fixed dollar amount is determined by applying the trust's stated percentage payout, e.g., 5%, 6%, etc., to the value[1] of the assets initially transferred by the donor.

After the death of the income beneficiaries or at the end of a set number of years,[2] whatever assets remain in the trust are distributed to the charities named in the trust. If additional contributions are desired in later years, new trusts must be established.

Income Tax Considerations

The charitable income tax deduction is based on the current value of the charity's right to receive the trust assets at some time in the future (a remainder interest). There are several factors in determining this value:

- The first factor is the estimated length of time which the charity must wait; for example, a term of years (like 10, 15, 20, etc.) or for the donor's or other person's lifetime.
- Another factor is the percentage rate payable to the income beneficiaries each year and how frequently it is paid, e.g., annually, monthly, etc. Obviously, the higher the rate of payout, the less there will be for the charity; and, therefore, the smaller the charitable deduction will be.
- The current rate of return on investments as determined by the applicable federal (midterm) rates (AFR) is also an important factor.[3]

All of these factors are applied to government tables to determine the current value of the charitable deduction. If the charitable deduction exceeds a certain percentage of the donor's adjusted gross income for the year of the gift, that portion must be carried over into future years.

[1] In cases of hard to value assets like real estate, a qualified appraisal is required to support the values.
[2] If a set number of years is chosen to determine the term of the trust (instead of the lifetime(s) of one or two beneficiaries), the maximum term is 20 years.
[3] This rate changes monthly.

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Charitable Remainder Annuity Trust

Gift Tax Considerations

If the income from the CRAT is payable to someone other than the donor, it may be subject to federal gift taxation. If certain requirements are met, the income gift can be made to qualify for the annual gift tax exclusion of $14,000[1] per beneficiary. Also, the marital deduction will usually eliminate any gift tax on payments to the donor's spouse.

Estate Tax Considerations

The value of the interest passing to the charity is deductible from the gross estate. If there are income beneficiaries other than the donor and his or her spouse, there may be an estate tax on the value of this income interest.

Some states allow a surviving spouse to "elect" to receive a portion of the deceased spouse's estate. Such laws are designed to prevent the surviving spouse from being completely disinherited. If state law allows assets in a CRAT to be used to satisfy the surviving spouse's election, the CRAT could cease to qualify as a charitable trust under federal law. As a result, previous income tax deductions can be lost and the assets in the trust could be added back to the deceased spouse's estate. The IRS originally provided a "safe harbor" for this situation in Revenue Procedure 2005-24, with a grandfather date of June 28, 2005. In Notice 2006-15, however, the federal government extended the June 28, 2005 date until "further guidance is issued by the Internal Revenue Service."

Almost Everyone Benefits

A taxpayer can contribute an asset (usually highly appreciated and low income producing) to a CRAT and receive a current income tax deduction.

The trustee can sell the appreciated asset without paying any capital gain tax and can then reinvest the entire proceeds at a higher rate of return.

The trust will often pay out a higher return than the donor previously received. This, coupled with the income tax deduction, can create a substantial increase in cash flow.

Thus far, the only ones to lose are the donor's heirs. To solve this problem, many taxpayers use a portion of the increased cash flow to purchase a life insurance policy (outside of the estate) to replace all or part of the value of the asset placed in the trust. This arrangement lets almost everyone benefit.

[1] 2015 value. This amount is subject to adjustment for inflation in future years.

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Charitable Remainder Annuity Trust

Party	Benefit
Donor (and spouse)	Increased cash flow during retirement years
Children/heirs	Same size or larger inheritance (with insurance)
Favorite charity	Receives remaining assets after donor's death
Internal Revenue Service	Receives less income and estate tax

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Mechanics of a CRT

Annuity Trust

- Fixed Payment
- Future Contributions

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Mechanics

Unitrust

- Percentage of payment
- Future contributions

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Mechanics

- Termination of Trust

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Advantages

- Charitable Gift
- Tax Deduction
- Estate Consequences

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Tax Consequences

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Income Tax at Formation

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Taxation on income distributions

- Ordinary income
- Capital gains
- Tax-exempt income
- Corpus

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Gift tax

- Income interest in non-charitable beneficiary.
- Annual exclusion and marital deduction.
- Charitable deduction for present value of remainder interest.

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Estate Tax

- Inclusion
- Deduction

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Common Features

- Irrevocable
  - B) Distributions Frequency
  - C) Sprinkle provisions
  - D) Expiration of Trust
  - E) Lives and years
    - Living individuals
- Duration

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Payouts

- Minimum
- Maximum

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Remainder Interest Rules

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Wealth Replacement Ideas

- Life Insurance
  - Individual Life Insurance
  - Joint and Last to Die Life Insurance

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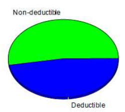
Charitable Remainder Annuity Trust

Trust Type:	Life
Transfer Date:	9/2018
§7520 Rate:	3.40%
FMV of Trust:	$1,000,000
Growth of Trust:	6.00%
Percentage Payout:	5.000%
Payment Period:	Annual
Payment Timing:	End
Lives:	1
Ages:	70
Exhaustion Method:	IRS

Rev. Rul. 77-374 Prob. Test: 0.19%, 35 yrs.; Char Ded. is ALLOWABLE

Amount of Annuity:	$50,000.00
One Life Annuity Factor	10.5519
Payout Frequency Factor:	1.0000
Present Value of Annuity = Annuity Payout times Factors:	$527,595.00
Charitable Remainder = FMV of Trust less PV of Annuity:	$472,405.00
Charitable Deduction for Remainder Interest:	$472,405.00
Donor's Deduction as Percentage of Amount Transferred:	47.240%

Deduction as Percentage of Amount Transferred



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Charitable Remainder Annuity Trust

Section 7520 Treasury Regulations Exhaustion Test

Final Partial Payment Amount:	$4,028.37
Value of $45,971.63 for 34.00 Years:	$485,009.89
Value of $4,028.37 for 35.00 Years:	$42,503.33
Value of Annuity Interest:	$527,513.22
Charitable Deduction for Remainder Interest:	$472,486.78
§7520 Regs Increase in Char. Deduction:	$81.78

NOTE: THE IRS HAS NOT RULED ON THIS INTERPRETATION

Year	Beginning Principal	6.00% Growth	Payment	Remainder
1	$1,000,000.00	$60,000.00	$50,000.00	$1,010,000.00
2	$1,010,000.00	$60,600.00	$50,000.00	$1,020,600.00
3	$1,020,600.00	$61,236.00	$50,000.00	$1,031,836.00
4	$1,031,836.00	$61,910.16	$50,000.00	$1,043,746.16
5	$1,043,746.16	$62,624.77	$50,000.00	$1,056,370.93
6	$1,056,370.93	$63,382.26	$50,000.00	$1,069,753.19
7	$1,069,753.19	$64,185.19	$50,000.00	$1,083,938.38
8	$1,083,938.38	$65,036.30	$50,000.00	$1,098,974.68
9	$1,098,974.68	$65,938.48	$50,000.00	$1,114,913.16
10	$1,114,913.16	$66,894.79	$50,000.00	$1,131,807.95
11	$1,131,807.95	$67,908.48	$50,000.00	$1,149,716.43
12	$1,149,716.43	$68,982.99	$50,000.00	$1,168,699.42
13	$1,168,699.42	$70,121.97	$50,000.00	$1,188,821.39
14	$1,188,821.39	$71,329.28	$50,000.00	$1,210,150.67
Summary:	$1,000,000.00	$910,150.67	$700,000.00	$1,210,150.67

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CRAT Tax Breakdown

- Figures used in calculation:
  - 5% fixed payout ($50,000/year)
  - 15% tax on dividends
  - 20.37% tax on interest of bonds
  - 15% tax on capital appreciation
- Total taxes are approximately $7,715-$8,090 per year for the life of the annuitant

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Charitable Remainder Annuity Trust (CRAT)

This calculation determines the value of the noncharitable beneficiary's annuity (nondeductible) and the value of the charitable remainder interest (deductible) for a gift made through a charitable remainder annuity trust.

When a charitable remainder annuity trust is established, a gift of cash or property is made to an irrevocable trust. The donor (and/or another noncharitable beneficiary) retains an annuity (fixed payments of principal and interest) from the trust for a specified number of years or for the life or lives of the noncharitable beneficiaries. At the end of the term, the qualified charity specified in the trust document receives the property in the trust and any appreciation.

Most gifts made to a charitable remainder annuity trust qualify for income and gift tax charitable deductions (or in some cases an estate tax charitable deduction). A charitable deduction is permitted for the remainder interest gift only if the trust meets certain criteria.

A trust qualifies as a charitable remainder annuity trust if the following conditions are met:

- The trust pays a specified annuity to at least one non-charitable beneficiary who is living when the trust is created. Annuities can be paid annually, semiannually, quarterly, monthly, or weekly.
- The amount paid, as an annuity, must be at least 5%, but less than 50% of the initial net fair market value of the property placed in the trust. The charity's interest at inception also must be worth at least 10 percent of the value transferred to the trust.
- The annuity is payable each year for a specified number of years (no more than 20) or for the life or lives of the noncharitable beneficiaries.
- No annuity is paid to anyone other than the specified noncharitable beneficiary and a qualified charitable organization.
- When the specified term ends, the remainder interest is transferred to a qualified charity or is retained by the trust for the use of the qualified charity.
- The Internal Revenue Service has also ruled that a trust is not a charitable remainder annuity trust if there is a greater than 5% chance that the trust fund will be exhausted before the trust ends.

annuity paid must be a specified amount expressed in terms of a dollar amount (e.g., each non-charitable beneficiary receives $500 a month) a fraction, or a percentage of the initial fair market value of the property contributed to the trust (e.g., beneficiary receives 5% each year for the rest of his life).

The grantor will receive an income tax deduction for the present value of the remainder interest that will ultimately pass to the qualified charity. Government regulations determine this amount, which is essentially calculated by subtracting the present value of the annuity from the fair market value of the property and/or cash placed in the trust. The balance is the amount that the grantor can deduct when the grantor contributes the property to the trust.

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Options for Using a Charitable Remainder Trust

- Use the income tax deduction to reduce your current taxes
- Convert your 401(k)/403(b)/IRA to a Roth
- Buy some life insurance to replace the gift to the Charity

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How a CRT used to convert a qualified plan to a Roth can be helpful to you

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Medicare Part B Premiums

If your yearly income in 2017 (for what you pay in 2019) was			You pay each month (in 2018)
File individual tax return	File joint tax return	File married & separate tax return	
$85,000 or less	$170,000 or less	$85,000 or less	$135.50
above $85,000 up to $107,000	above $170,000 up to $214,000	Not applicable	$189.60
above $107,000 up to $133,500	above $214,000 up to $267,000	Not applicable	$270.90
above $133,500 up to $160,000	above $267,000 up to $320,000	Not applicable	$352.20
above $160,000 and less than $500,000	above $320,000 and less than $750,000	above $85,000 and less than $415,000	$433.40
$500,000 or above	$750,000 and above	$415,000 and above	$460.50

https://www.medicare.gov/your-medicare-costs/medicare-costs-at-a-glanc

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2019 Tax Rates

2019 Individual Income Tax Rates ▼	Single-Taxable Income	Married Filing Jointly - Taxable Income	Head of Household - Taxable Income
10 percent	0 to $9,700	0 to $19,400	0 to $13,850
12 percent	$9,701 to $39,475	$19,401 to $78,950	$13,851 to $52,850
22 percent	$39,476 to $84,200	$78,951 to $168,400	$52,851 to $84,200
24 percent	$84,201 to $160,725	$168,401 to $321,450	$84,201 to $160,700
32 percent	$160,726 to $204,100	$321,451 to $408,200	$160,701 to $204,100
35 percent	$204,101 to $510,300	$408,201 to $612,350	$204,101 to $510,300
37 percent	$510,301 and up	$612,351 and up	$510,301 and up

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2019 Tax Rates- Married Filing Jointly

If taxable income is between:	Tax Rate is:
$0-$19,400	10% of taxable income
$19,401-$78,950	10% for $19,400 and 12% for over $19,400
$78,951-$168,400	11.50% for $78,950 and 22% for over $78,950
$168,401-$321,450	17.08% for $168,400 and 24% for over $168,400
$321,451-$408,200	20.37% for $321,450 and 32% for over $321,450
$408,201-$612,350	22.84% for $408,200 and 35% for over $408,200
$612,351 +	26.90% for $612,351 and 37% for over $612,351

https://www.forbes.com/sites/kellyphillipserb/2018/11/15/irs-announces-2019-tax-rates-standard-deduction-amounts-and-more/#175f11772081

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Dividend Tax Rates for 2019

- The dividend tax rate that you pay on ordinary dividends is the same as your regular income tax rate.
- Qualified dividends, on the other hand, are taxed at the capital gains rates, which are lower. If you have between $78,951 and $408,200 of ordinary income and are married filing jointly, then you will pay a tax rate of 15% on qualified dividends. The rate for $408,201 or more is 20%.
  - A qualified dividend is a type of dividend that is taxed at the capital gains tax rate. Generally speaking, most regular dividends from U.S. companies with normal company structures (corporations) are qualified.

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Capital Gains Tax Rates for 2019-Married Filing Jointly

Income	Tax Bracket	Short-Term Capital Gains Rate	Long-Term Capital Gains Rate
$0-$19,400	10%	10%	0%
$19,401-$78,950	12%	12%	0%
$78,951-$168,400	22%	22%	15%
$168,401-$321,450	24%	24%	15%
$321,451-$408,200	32%	32%	15%
$408,201-$488,850	35%	35%	15%
$488,851-$612,350	35%	35%	20%
$612,351 +	37%	37%	20%

https://www.forbes.com/sites/kellyphillipserb/2018/09/14/projected-2019-tax-rates-brackets-standard-deduction-amounts-and-more/#5ad3df4612d9

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IRA Planning

- At death strategy –
  - Devise IRA to charity
  - No income tax paid by charity
- Win-win strategy –
  - The charity gets IRA and pays no income tax
  - Heirs can get life insurance as legacy replacement
    - Life insurance passes tax-free

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IRA Planning

- During life strategy –
  - Qualified Charitable Distribution (QCD)
    - Distribution from IRA to charity
    - Limit $100,000/year ($200,000/year for couple)
    - Benefits –
      - Charity pays no income tax
      - Not added to donor's gross income
        - Lowers donor's income tax, Medicare Part B premiums, tax on social security benefits
      - Satisfies donor's RMD requirement
    - Requirements –
      - Age 70 ½ or older
      - Funds must go directly from IRA to charity

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Legacy IRA Act

- Would allow individuals age 65 or older to transfer money from an IRA to a charitable remainder trust or charitable gift annuity
- Meant for person who –
  - Is charitably inclined
  - Needs a retirement income stream (called "life income plans")
  - Does not have enough deductions to itemize
- Income beneficiaries are limited to the donor and spouse
- Transfer from IRA to CRT or CGA is not a taxable distribution
  - Equivalent to a tax deduction
- Income payment to donor is taxable
- At donor's death, assets in the plan go to the charity
- Annual transfer limit is $400,000
- Can be used on top of a QCD if donor is older than 70 1/2

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Thank you!

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