USING A CHARITABLE REMAINDER TRUST TO OFFSET INCOME FROM STOCK OPTIONS, RETIREMENT DISTRIBUTION OR ROTH IRA CONVERSION

CORNETET, MEYER, RUSH & STAPLETON
ATTORNEYS AT LAW

The purpose of a charitable remainder trust, or CRT, is to provide a benefit to the donor (income for life) and charity (distribution at death) while receiving an immediate charitable tax benefit.

You expect a high income year or several years due to stock options, your retirement distribution, or Roth IRA conversions. A high income taxpayer would be defined as someone with taxable income in the 32% income tax bracket or above. Using a CRT would reduce income taxes in the high income year.

You should consider a CRT if you:

- **Have significant <u>charitable intent</u>, AND**

You want to reduce your taxes in a year in which one of the following occurs:

- **Retirement plan distribution**
- **Roth conversion**
- **Stock option exercises**
- **Sale of your business**
- **Diversify stock with large built in capital gains**

Charitable Remainder Trust Types
CRTs are set up to provide income to the donor for life for a specified number of years or for your lifetime, depending on your objectives. The income distributions can be based on a fixed percentage of beginning of year values (charitable remainder unitrust, or CRUT), or a fixed dollar amount (charitable remainder annuity trust, or CRAT). All are irrevocable.

Types of Property to Put in Trust
CRTs can be funded with cash, securities, or other property. When contributing securities or property that will be sold, it is imperative that the contribution occur prior to agreeing upon a sale.

Charitable Beneficiaries
When the income beneficiary passes away, whatever is left in the trust is distributed to charity (remainder beneficiary). The remainder beneficiary can be one or more charitable organizations. The CRT is irrevocable so that the remaining principal must always go to charity. It is possible to change charitable beneficiaries during the donor’s lifetime

Use a CRUT or a CRAT?
Because the investment returns will vary during the Trust, choosing distribution rates and type of trust is key to accomplishing the goals of the donor.

CORNETET, MEYER, RUSH & STAPLETON
ATTORNEYS AT LAW

CRUT Example
You create a CRUT and transfer $100,000 of low basis stock into the Trust that was inherited, the result of stock option exercise or received at retirement under a split or partial rollover (e.g. P&G NUA). The stock is sold by the Trust and diversified without any capital gain tax. Since you may be the Trustee of the Trust, you retain control over the investments (but you do have to consider the Charity's interest with regard to investment decisions). The terms of the Trust indicate a payment of 10% of the value of the Trust to you each year for 10 years. The income from the Trust is distributed to you each year and taxed on your personal income tax return. The fees to set up a CRUT and to prepare the tax return may be paid by and deducted by the Trust. During the ten year period, you are required to file a form 5227 with the IRS.

At the end of the 10 year period, the Trust transfers the remainder to the charity (or charities). The transfer of the stock into the Trust, based on this example, creates a charitable deduction of $35,206 that is deducted in the year of the transfer (even though the charity will not get the remainder for 10 years). You could increase the charitable deduction by keeping 9% rather than 10% or doing it for 8 years rather than 10 year.

Below is a chart of the cash flow to you and the remainder to the charity, assuming a 6% rate of return on the investments. If the return is higher, you and the charity receive more. If the return is less, both receive less. This example has the Trust paying the fees.

Example of 10 Year CRUT, 10% payout, 6% ROR

Year	Distribution (10%)	Return (6%)	Admin Costs	CRUT Balance
Begin				$100,000
1	$10,000	$6,000	$2,200	$93,800
2	$9,380	$5,628	$900	$89,148
3	$8,915	$5,349	$900	$84,682
4	$8,468	$5,081	$900	$80,395
5	$8,039	$4,824	$900	$76,279
6	$7,628	$4,577	$900	$72,328
7	$7,233	$4,340	$900	$68,535
8	$6,853	$4,112	$900	$64,893
9	$6,489	$3,894	$900	$61,398
10	$6,140	$3,684	$900	$58,042
To Grantor	**$79,146**			
To Charity				**$58,042**

The net results of using a CRUT are as follows:

- Immediate charitable deduction to be used during “high income” year
- Capital gain tax is avoided on the sale of the stock contributed.
- You can retain investment control as the Trustee.
- A block of stock gets diversified sooner, thereby, reducing portfolio risk.
- The Trust can deduct the fees.
- More than 79% of the contributed asset is returned to you over 10 years.

Sale of Business Example

Henry an interest in a company that is in the process of negotiating a sale to a large publicly held company. He believes the sale will create $1.5 million of taxable proceeds. His cost basis in the company is negligible. His tax bill will be approximately $375,000, leaving $1,125,000 remaining and available for investment. If Henry contributes one-half of the company to a CRT, he will get a charitable deduction of approximately $267,000, which will reduce his tax bill by about $120,000.

In the end, Henry will have contributed $750,000 to charity, but retained a personal investment portfolio of $495,000 plus an annuity from the Trust. Henry’s annual cash flow may be as if he simply sold all of his stock and he has satisfied his charitable intent to his favorite charity after his lifetime.

Do not make decisions before consulting a tax advisor. This article does not constitute legal or tax advice, or an attorney client relationship.

Matthew A. Montgomery, Esq.
123 Boggs Lane
Cincinnati, Ohio 45246
www.cmrs-law.com
Phone (513) 771-2444
mmontgomery@cmrs-law.com