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Commentary

BY CHAD CARLSON

CRUT or CRAT?

FOR MANY PEOPLE, RETIREment means living on a smaller income, but it doesn't necessarily follow that once you're retired you're no longer able to help your favorite charity. Quite the contrary. Not only is there a way to achieve that worthy goal, but you can also increase your retirement income and save taxes, all at the same time.

How? By setting up a catch-all legal device known as a charitable remainder trust. In addition to having a desire for charitable giving, the typical candidate for such a trust owns highly appreciated assets, wants a steady stream of income and wants to minimize capital gains and estate taxes.

Done right, a charitable remainder trust can also help preserve the value of your estate for the benefit of your heirs. And there's another plus: Charitable contributions no longer trigger the alternative minimum tax. The only negative, in fact, is that a charitable remainder trust is irrevocable. In other words, once you set it up, the Internal Revenue Service won't let you change your mind.

Basically, a charitable remainder trust is an arrangement whereby you transfer cash, securities, property or some combination to a trustee. If you make the transfer during your lifetime, it is called an inter vivos trust. If it is done at death through a provision in your will, it is a testamentary trust.

There are several variations of the trust to meet individual goals and needs, but the two most popular are a charitable remainder unitrust, commonly referred to as a CRUT, and a charitable remainder annuity trust, known as a CRAT.

The two types of trust are very similar. Under the terms of a CRUT, you, your spouse or other beneficiaries receive income payments based on the fair market value of the trust assets as valued each year. A CRAT provides for a guaranteed fixed-income payment based on the value of the assets at the time they are initially transferred. In either case, the trust must pay out at least 5 percent annually for a fixed term of no more than 20 years or for the life or lives of the income beneficiaries. Then the remaining assets go to your designated charity.

That philanthropic gesture gets you an immediate income tax deduction, even though it may be many years before you actually make the gift.

The tax savings don't end there. Highly appreciated assets you put in the trust, such as securities or real estate that may be producing little or no income, are not counted as part of your estate. Presto! Your heirs save on estate taxes. What's more, the trust can sell part or all of the assets without having to pay capital gains taxes. The proceeds can then be reinvested in income-producing assets.

Whether you establish the trust while you're alive or by will is very much a question of individual circumstances; however, the decision does have tax implications. Creating the trust by will deprives you of an immediate income tax deduction for your charitable gift; your estate gets to take the deduction instead.

There's another tax angle to watch for. If you or your spouses are the only beneficiaries of the income from a charitable remainder trust, there is no gift tax. Naming another beneficiary subjects you to a gift tax, though the annual $10,000 exclusion applies.

The choice between a CRAT and a CRUT depends, in part, on whether you want to make additional contributions to the trust in later years. A CRUT allows you to do that; a CRAT doesn't. What's more, income from a CRUT fluctuates as the worth of the trust assets rises or falls. That helps to cushion the effects of inflation, although the income declines if the assets decline. The income from a CRAT, by contrast, is fixed and predictable.

So far, so good. But by now you may be wondering about your heirs. Won't their inheritance be reduced by your charitable gift? Not necessarily. Your heirs can be made whole by using part of the income the trust generates to pay for premiums on life insurance on your life. By putting the policy in another trust, the death benefit can go to your heirs free of estate taxes.

A charitable remainder trust is admittedly complex, and you'll want some expert advice from your financial consultant before you make any decisions. Given its unique combination of benefits, though, it's a financial planning tool well worth considering. ■

Chad Carlson is a financial adviser with Delta Trust Investments Inc. in Little Rock. For more information, call (877) 467-9610. Delta Trust does not provide legal or tax advice. Be sure to consult with your own tax and legal advisers before taking any action that would have tax consequences.