

## Spotting Advanced Planning Issues: The Charitable Remainder Trust

(Part 2 of 2)

In Part 1 of this article we met Bill and Mary whose estate included one primary asset: highly appreciated farmland worth \$15,000,000. We showed that if they sold their property without proper planning, they could face capital gains tax of approximately \$3M and later estate taxes of \$5.4M – leaving their children with only \$6,600,000 of the original \$15,000,000! Now let's consider an alternative.

### *The Charitable Remainder Trust Option*

What if instead of selling, Bill and Mary transferred title to their land to a Charitable Remainder Trust? The transfer will trigger no tax on the appreciated land because the CRT is a tax-exempt entity. This creates an immediate savings of approximately \$3,000,000 in capital gains taxes. The independent trustee of the CRT would then sell the farmland so that the trust contains cash – allowing for a more diversified investment portfolio. Assume the trust is drafted to pay Bill and Mary 5% of the value of the trust each year while one or both of them is living. This will create an annual income stream to Bill and Mary of \$750,000 (\$150,000 more than the previous example) assuming the investments are earning a return of at least 5%.

In addition, Bill and Mary will receive an immediate income tax charitable deduction. The calculation of the charitable deduction is complex, requiring consideration of the type of trust, term, and current IRS interest rates. Assuming a Charitable Remainder Unitrust and current IRS rates, the charitable deduction itself would exceed \$7,000,000! They can only deduct 50% of their adjusted gross income each year, but they can carry the leftover deduction forward for another 5 years. Even then, they won't be able to take full advantage of such a large charitable deduction.

Later, when Bill and Mary have passed away, no estate taxes will be paid on either death. Assuming the trust principal is still \$15,000,000, this will save the family millions more in federal estate taxes.

### *But what about the kids?*

Since, upon their death, the assets in the CRT must pass to a charity or charities of Bill and Mary's choice, and since the assets in the CRT represent the bulk of the estate, you'll also want to consider providing for the children.

The easiest solution is for Bill and Mary to take a portion of their CRT annual payment and purchase a second-to-die life insurance policy. If the policy is held in an Irrevocable Life Insurance Trust, estate taxes on the insurance proceeds can also be avoided. Bill and Mary may want to purchase enough insurance to cover what the kids would have received under the first example (\$6,600,000) or they may want them to have the full \$15,000,000. Even if Bill and Mary have to spend a few hundred thousand in annual premiums to buy that much insurance, they'll still have much more income than they need to live on. The result is a WIN for Bill and Mary, a WIN for the charity, and a WIN for the children!



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