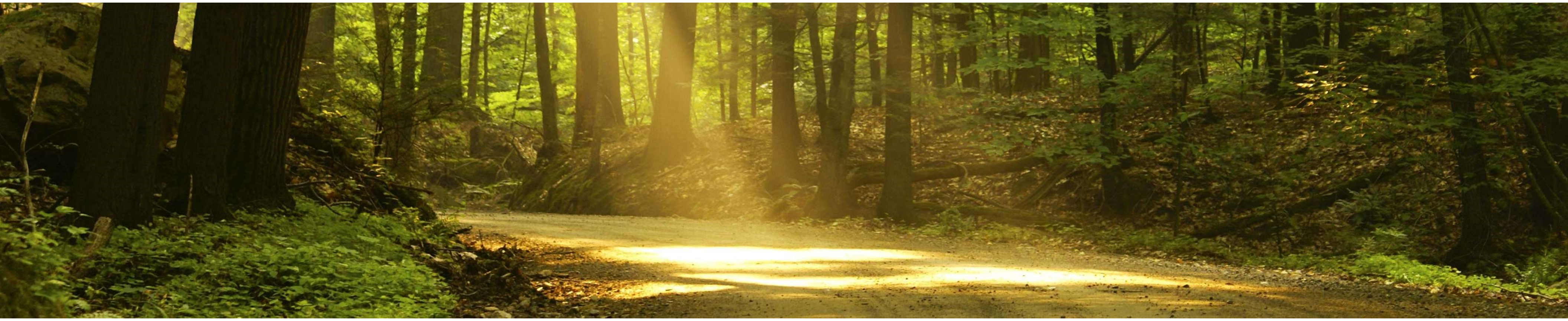

Secondary Planning for Clients with Charitable Remainder Trusts (CRTs)

Presenter:
Evan Unzelman, *President*
Sterling Foundation Management

Sterling Foundation Management

- Private Foundation Management
- Charitable Advisory
- Secondary planning for CRTs
  - *Sales of CRT income interests*
  - *CRT rollovers*
  - *Reviewed 7,000+ CRTs*
- Support legal, tax and financial advisors

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House Analogy

- When a client buys a house, they probably don’t expect to keep it forever
  - *Kids grow up and move out*
  - *Health changes and a different house serves better*
  - *Cold winters grow old and a warmer state beckons*
  - *Etc.*
- But that doesn’t mean it was a mistake to buy the house in the first place

House Analogy

- Same logic applies to clients' CRTs
- Circumstances change over time
  - *The CRT was a great solution and worked well for years*
  - *But is it the best possible use of those assets today?*
- Advisors are making their clients aware of their options with respect to their CRTs

Charitable Remainder Trusts – the Pros

- Powerful tax-planning vehicles
  - *Defer capital gains tax on appreciated asset*
  - *Generate an income stream*
  - *Up-front income tax deduction*
  - *Benefit charity*
- The economics of a CRT
  - *Tax benefits + income stream > sell and pay tax*
  - *Whether this turns out to be the case depends on what happens after the CRT is set up*
    - Investment returns, **tax rates**, longevity

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Charitable Remainder Trusts – the Cons

1. Irrevocable
2. Last for a long time, usually decades
   - *Combination can lead to a misalignment between beneficiary's situation and the CRT*
   - *Often, a CRT will simply "run its course"*
     - Akin to a house
     - This drives most of the transactions we've arranged

- Tax Deferral
  - ***Costly when tax rates rise***

Why a CRT is a bet that tax rates won't rise

- A CRT defers a client's income into the future
  - *Works well if tax rates are flat or falling*
  - *But if rates rise, the deferral works against the client by forcing them to take income at higher rates and pay more tax*
- As tax rates rise, the value of a CRT interest falls
  - *Loss in value can leave client in a position where they would have been better off not creating the CRT*
  - ***This tax trap is completely avoidable***

Why It's Avoidable

- CRT income interest is a capital asset
  - *Rev. Rul. 72-243, 1972-1 C.B. 233*
  - *PLRs (e.g., PLR 2007390041)*
- This creates flexibility for the income beneficiary
  - *Like other capital assets, CRT income interests can be:*
    1. *Sold*
    2. *Given to charity*
    3. *Contributed to a new CRT*

Each of these three options enables a client to fully avoid the impact of higher tax rates on their CRT income

How It's Avoidable

- Sell income interest
  - *Avoid risk of higher tax rates in future by taking advantage of current tax rate on long-term capital gains*
  - *Maximum value to* ***client***
- Gift income interest
  - *Contribute income interest to remainderman*
  - *Maximum value to* ***charity***
- CRT Rollover
  - *Contribute income interest to new CRT*
  - *Maximum value to* ***heirs***

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Sell Income Interest

- Sellers
  - *Convert future CRT income into a cash payment today*
  - *Lock in capital gain tax treatment at the current rate*
  - *Remove CRT tax exposure*
    - A CRT is a bet that tax rates won't rise
    - Client can make the opposite bet by selling the income interest
- Buyers
  - *Who can buy?*
  - *Who can't buy?*
  - *Typical buyer profile*

Sale Does Not Terminate CRT

- Termination
  - *Treas. Regs. Section 1.664-4 for valuing CRT interests*
    - IRS interest rate (7520 rate) and IRS life expectancy
  - *Be mindful of self-dealing rules (IRC Section 4941)*
- Sale of Income Interest
  - *Does not terminate CRT*
  - *Value of income interest is determined by market*
- *Sale value > Termination value*
  - If goal is maximum value, client is best off selling

Sale Process

- Review CRT
- Process once decision is made to proceed (2-4 weeks)
  - *CRT documentation reviewed to confirm salability*
  - *Sale documents prepared by Sterling's counsel*
  - *Buyer and seller review/sign sale documents*
  - *Sale completed under supervision of escrow agent*
  - *Seller receives cash*

Additional Sale Benefits/Drivers

- Ability to sell interest at financial premium
- Flexibility
  - *Client prefers cash to waiting for future distributions*
- Simplification
  - *Client grows tired of administrative costs/hassles*
  - *Client looking to simplify financial affairs*
- Family
- Removal of mortality risk

Gift Income Interest

- Client does not need/want CRT income and is <u>not</u> interested in transferring additional assets to heirs
- Client contributes income interest to remainderman
  - *Terminates CRT; all assets go to remainderman*
  - *Client receives charitable deduction*
    - Need to file a Form 8283 for the non-cash contribution and obtain an appraisal (even if the CRT is fully cash)

CRT Rollover

- Client does not need/want CRT income and is interested in transferring additional assets to heirs
- Client contributes income interest to new CRT
  - *Most often, heirs are named as beneficiaries*
  - *Client receives charitable deduction*
    - Value of remainder interest in new CRT
- New CRT monetizes income interest
  - *Taxable event to new CRT, not to client*
    - Akin to creating a CRT with real estate or closely-held stock

Recap

- Sale = Maximum Value to Client
  - *Client gets cash at current capital gain rate*
- Gift = Maximum Value to Charity
  - *Client gets charitable deduction*
- Rollover = Maximum Value to Heirs
  - *Client's heirs get new income stream*
  - *Client gets charitable deduction*

CRT Review

Evan Unzelman, *President*

(703) 677-8747

EUnzelman@SterlingFoundations.com

- All reviews are:
  - *Free of charge*
  - *Confidential*
    - We only need ages, payout rate and trust value

Resources Available

- CRT Secondary Planning Resource Handbook (*Sterling Foundation Management*)
- Alternatives to CRT Terminations *(Trusts & Estates)*

Disclaimer

Sterling Foundation Management does not provide tax, legal, investment or insurance advice, and nothing in the preceding presentation should be construed as such. Any information or analysis provided is believed to be accurate but is not guaranteed or warranted.

Sterling Foundation Management
12030 Sunrise Valley Drive, Suite 450
Reston, VA 20191
Phone: (703) 437-9720
Email: contact@SterlingFoundations.com