LUKINOVICH LAGNIAPPE

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LUKINOVICH
A PROFESSIONAL LAW CORPORATION

Lukinovich, APLC has law offices in Metairie and Baton Rouge, Louisiana. Our areas of practice include estate planning, wills and trusts, business planning, wealth preservation, probate administration and charitable gift planning.

Our mission is to devote our best skills, efforts and resources to advise our clients enthusiastically and creatively to accomplish their business, tax, family and estate planning goals and objectives, and we offer superior personalized attention with the utmost regard for privacy and confidentiality.

Learn more about our areas of practice online:
www.lukinovichlaw.com

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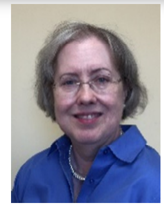
<u>Suggested Reading</u>:

Dale Carnegie's Classic:
How to Win Friends & Influence People
(Over 75 Years in Print)

This book has enhanced relationship building like no other book.

Utilizing Charitable Trusts for Wealth Conservation



Bonnie Wyllie

Recently during a conversation with a client, we were discussing government spending and he mentioned that he wished it were possible to direct where his tax dollars would be spent. He seemed surprised when I said there is a way to do that. A charitable contribution provides you an itemized deduction on your personal tax return, which reduces your taxes. However, you are specifically directing where those tax dollars are spent. You name the charitable organization that will receive those dollars.

When an individual creates an estate plan that provides for a charitable bequest, this reduces the amount of federal estate taxes owed by his estate/succession. In essence, he has diverted tax dollars from the government and directed where they will be spent. This enables him to provide a gift to one or more of his selected charitable organizations that can sustain and improve the community where he has lived. So instead of his money disappearing into government coffers to be used in a distant state, his money can be spent where and how he directs. There are a number of different charitable giving strategies that can be utilized.

<u>Charitable Trusts</u>

There are two types of charitable gifts that permit a donor to give a partial interest to charity and still retain an interest in the donated assets. To implement these charitable gifts, the donor (settlor) creates a trust—a charitable remainder trust or charitable lead trust. The difference between the two trusts depends upon whether the revenue stream of the trust is distributed to the donor/settlor or to charity during the term of the trust and whether the assets remaining at termination are returned to the settlor or given to charity.

A **<u>charitable remainder trust (“CRT”)</u>** enables the settlor to receive a revenue stream at least annually from the trust. This trust can remain in existence for a specified period of time or for the duration of the settlor’s life. The remaining assets are distributed to the charitable beneficiary at the termination of the trust. Hence the name charitable remainder trust.

A **<u>charitable lead trust (“CLT”)</u>** enables the settlor to give a charitable organization a revenue stream from the trust for a specific period of time or for the duration of his life. The assets held in the trust then revert back to the settlor at the termination of the trust or they are distributed to the beneficiaries that he named in the trust. This type of trust is typically utilized by an individual that already has an adequate income stream and can afford to donate a revenue stream to charity. If the trust has a named beneficiary other than the settlor, such as the settlor’s child, then at the termination of the trust the asset can be transferred with a significant tax savings.

These charitable trusts can be created and funded during the settlor’s life (inter vivos charitable trusts) or they can be created in the settlor’s will (testamentary charitable trusts) and funded after his death.

Structure of the Payout

When a charitable remainder trust or a charitable lead trust is created, the settlor selects how the payout is structured.

- If he selects an **<u>annuity</u>** structure, the payout is based on a flat percentage of the assets that funded the trust at creation. The annuity payment is calculated in the initial year and remains constant for all subsequent years. In this way, he knows exactly how much will be distributed annually.

- If he selects a **<u>unitrust</u>** structure, the payout is computed on a flat percentage of the fair market value of the assets in the trust on a particular date each year. In this way, he gets to take advantage of any appreciation of assets in the trust.

If the income of the trust is not sufficient to pay the required distribution, then it is paid from the corpus of the trust.

Advantages of Creating Charitable Trusts

If a settlor creates a <u>Charitable Remainder Trust</u>, there are several advantages:

- When a settlor contributes appreciated assets to the trust, he never pays capital gains taxes when these assets are sold by the trust.

- The settlor is entitled to take an immediate charitable deduction for income tax and gift tax purposes that equals the present value of the remainder interest passing to charity.

- The charitable remainder trust is not subject to income taxes.

- If the settlor creates a trust during his life and does not retain any controls, the assets that are transferred to charity at the settlor's death are not brought back into his estate and are not subject to estate taxes.

If a settlor creates a Charitable Lead Trust, there are a number of advantages:

- A revenue stream is created for charities the settlor selects. This trust removes income from the settlor's gross income, which reduces his income tax liability.

- Federal gift and estate taxes are either reduced or eliminated for assets transferred to the trust or on the appreciation of assets in the trust.

- At the termination of the trust a substantial amount can be transferred to family members with a minimal gift tax cost. These gift taxes were computed on the gift tax return filed at the creation of the trust.

- Assets in a charitable lead unitrust can be passed to grandchildren and successive generations without generation-skipping transfer taxes, if the settlor allocates enough of his GST exemption amount at the creation of the trust.

Control of the Trust

The settlor selects the trustee that will control the trust. Often the settlor selects corporate fiduciaries, such as banks and trust companies, or charitable organizations that have the expertise and experience to handle the management of the trust. The settlor may act as trustee, but there are a number of reasons this is not always advisable.

The regulations require that there be no provision or powers to invade, alter, or revoke for the beneficial use of a person other than a charitable organization. This limits the settlor's ability to control the trust.

Contribution of Assets to a Charitable Trust

We recommend contributing assets to a charitable trust that have appreciated in value and are relatively easy to value, such as publicly traded securities, corporate stocks, corporate bonds, government bonds, and mutual funds.

However, it is not advisable to contribute property that has debt, any investment that generates unrelated business income, stock options, U.S. Savings Bonds, annuities, installment obligations, real estate with environmental issues, or assets that are part of a pre-arranged sale. Any unrelated business taxable income earned by the trust will be taxed at 100%.

Conclusion

The charitable lead trusts and charitable remainder trusts provide planning opportunities to reduce taxes and enable the settlor to direct dollars to his favorite charitable organizations. These trusts can be an important wealth conservation strategy. A summary of the pertinent issues and steps necessary to create Charitable Remainder Trusts (CRTs) and Charitable Lead Trusts (CLTs) is outlined on the attached charts to help answer any questions you may have regarding these strategies to benefit charities and save taxes.

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Charitable Remainder Trusts (CRTs)

	Intervivos CRT	Testamentary CRT
Creation of trust	The trust is created by an Act of Donation during settlor's life	The trust is created by the settlor's last will and testamant and is funded after his death.
Term of trust	The trust lasts for a specified period of time not to exceed 20 years or for the duration of the life of the settlor	The trust lasts for a specified period of time not to exceed 20 years.
Income Beneficiary	The income is paid annually to the settlor or his designated beneficiary	The income is paid annually to the settlor' designated beneficiary
Remainder Beneficiary	At the termination of the trust the assets are distributed to the designated charity	At the termination of the trust the assets are distributed to the designated charity
Payout selected:	The income of the trust is paid out in the form of an annuity or unitrust at the time designated in the trust document.	The income of the trust is paid out in the form of an annuity or unitrust at the time designated in the will.
Annuity (CRAT)	The payout is based on a flat percentage of the assets placed in the trust on the date of creation. This annuity amount cannot be less than 5% or more than 50% of the initial fair market value of the property placed in the trust. The amount of the annual distribution is constant. The settlor or beneficiary will know at the beginning of the trust how much they will receive annually.	The payout is based on a flat percentage of the assets placed in the trust on the date of creation. This annuity amount cannot be less than 5% or more than 50% of the initial fair market value of the property placed in the trust. The amount of the annual distribution is constant. The settlor or beneficiary will know at the beginning of the trust how much they will receive annually.
Unitrust (CRUT)	The payout is computed annually based on a flat percentage of the fair market value of the assets in the trust. The recipient gets to take advantage of any appreciation in value of the assets in the trust. The unitrust amount paid annually cannot be less than 5% or more than 50% of the fair market value of the trust assets valued annually.	The payout is computed annually based on a flat percentage of the fair market value of the assets in the trust. The recipient gets to take advantage of any appreciation in value of the assets in the trust. The unitrust amount paid annually cannot be less than 5% or more than 50% of the fair market value of the trust assets valued annually.
Remainder requirement	The present value of the charitable remainder interest must be at least 10% of the fair market value of the property contributed	The present value of the charitable remainder interest must be at least 10% of the fair market value of the property contributed

Income Tax consequences for the trust:	The trust will file Form 5227 to report the trust's income and distributions. It does not pay any tax on the income.	The trust will file Form 5227 to report the trust's income and distributions. It does not pay any tax on the income.
Income Tax consequences for the settlor:	The settlor will be entitled to an immediate income tax charitable contribution deduction on his Form 1040 equal to the present fair market value of the remainder interest to charity. Since the deduction is taken in the initial year, there are no additional charitable deductions in subsequent years. The contribution is subject to the limitations on income tax charitable deductions.	
Income Tax consequences for the beneficiary:	The trust will annually issue a K-1 to the beneficiaries to provide them the necessary information to prepare their personal income tax returns.	The trust will annually issue a K-1 to the beneficiaries to provide them the necessary information to prepare their personal income tax returns.
Gift tax consequences for the settlor:		
If the settlor retains the right to the income stream	there are no gift tax consequences.	None
If the settlor designates a beneficiary to receive the income stream	the settlor has a gift tax liability for the present value of the income stream given to the beneficiary. The settlor receives a gift tax charitable deduction for the gift to the charity.	None
Estate tax consequences for settlor:	If the settlor retains the annuity or unitrust interest, then the assets may be brought back into his estate. If the settlor does not retain the annuity or unitrust interest, then the assets will not be brought back into his estate at his death.	There is an estate tax charitable deduction for the present value of the remainder interest at the date of death.
Generation-skipping transfer tax consequences for beneficiary:	If the designated beneficiary is a skip person (for example, a grandchild), distributions may trigger a generation-skipping transfer tax if there has not been enough generation-skipping transfer tax exemption allocated to the trust. This tax will be paid by the recipient of the distribution.	If the designated beneficiary is a skip person (for example, a grandchild), distributions may trigger a generation-skipping transfer tax if there has not been enough generation-skipping transfer tax exemption allocated to the trust. This tax will be paid by the recipient of the distribution.
Operational issues	Some of the prohibitions for private foundations are applied to CRTs. There are rules against self-dealing, taxable expenditures, excess business holdings, and jeopardizing investments.	Some of the prohibitions for private foundations are applied to CRTs. There are rules against self-dealing, taxable expenditures, excess business holdings, and jeopardizing investments.

Charitable Lead Trusts (CLTs)

	Intervivos CLT	Testamentary CLT
Creation of trust	Trust is created by an Act of Donation during settlor's life	The trust is created by the last will and testament and is funded at death.
Term of trust	The trust can last for a specified period of time or for the lifetime of the settlor	The trust can last for a specified period of time
Income Beneficiary	Payments are made annually to the designated charity during the term of the trust	Payments are made annually to the designated charity during the term of the trust.
Remainder Beneficiary	When the trust terminates the remaining assets paid to settlor or designated beneficiary	When the trust terminates the remaining assets paid to designated beneficiary.
Payout selected:	The income of the trust is paid out in the form of an annuity or unitrust at the time designated in the trust document.	The income of the trust is paid out in the form of an annuity or unitrust at the time designated in the will.
Annuity (CLAT)	Payout is based on a flat percentage of the assets place in the trust on the date of creation making the exact amount of the distribution certain.	Payout is based on a flat percentage of the assets place in the trust on the date of creation making the exact amount of the distribution certain.
Unitrust (CLUT)	Payout is computed annually based on a flat percentage of the fair market value of the assets in the trust. The charitable recipient gets to take advantage of any increase in value of the assets in the trust.	Payout is computed annually based on a flat percentage of the fair market value of the assets in the trust. The charitable recipient gets to take advantage of any increase in value of the assets in the trust.
	NON-GRANTOR TRUST	
Income Tax Consequences:		
for the settlor	Settlor is not taxed on the income of the trust and is not entitled to a charitable income tax deduction on his personal income tax return..	Since settlor is deceased, there is no effect on his personal income tax return.

for the trust	The trust is entitled to a charitable income tax deduction for payments made to the charitable beneficiary and is taxed on income in excess of the payment made to charity.	The trust is entitled to a charitable income tax deduction for payments made to the charitable beneficiary and is taxed on income in excess of the payment made to charity.
Gift Tax Consequences:		
If remainder is to be distributed to the settlor	Since the settlor will receive the remainder, there are no gift tax consequences.	Since the trust is created after the settlor's death there is no gift tax effect.
If remainder is distributed to a designated beneficiary	The settlor has a gift tax liability computed on the actuarial value of the remainder interest at the date of the transfer to the trust. There is a gift tax charitable deduction for the present value of the future payments made to charity.	Since the trust is created after the settlor's death there is no gift tax effect.
Estate Tax Consequences:		
	If the settlor retains the remainder interest or retained control of the trust, his estate is taxed on the actuarial value of the remainder interest at the date of the transfer. Any appreciation in the value of the assets is not taxed in the settlor's estate.	The entire value of the corpus is included in the settlor's estate and there is an estate tax charitable contribution deduction equal to the present value of the interest donated to charity.
Generation-Skipping Transfer Tax Consequences:		
	If the charitable lead trust is structured to leave the remainder interest to the settlor's descendants, then there may be a generation-skipping transfer tax unless there was enough generation-skipping transfer tax exemption allocated to the trust when it was created.	If the charitable lead trust is structured to leave the remainder interest to the settlor's descendants, then there may be a generation-skipping transfer tax unless there was enough generation-skipping transfer tax exemption allocated to the trust when it was created.
GRANTOR TRUST		
Income Tax Consequences:		
for the settlor	The settlor is entitled to an immediate charitable income tax deduction for the present value of the future payments to charity. This deduction is taken in the year the trust is created. Each year the settlor pays income taxes on the income earned by the trust. If this income exceeds the required distribution, the settlor is entitled to a charitable deduction for the excess.	

for the trust	The trust is not required to file an income tax return if the settlor reports all of the income.	
Gift Tax Consequences:		
If remainder is to be distributed to the settlor	Since the settlor will receive the remainder, there are no gift tax consequences.	
If remainder is distributed to a designated beneficiary	The settlor is liable for the gift taxes computed on the present value of the remainder interest to be transferred.	
Estate Tax Consequences:		
	If the settlor has retained control over the trust, the remainder interest may be included in the settlor's estate.	
Generation-Skipping Transfer Tax Consequences:		
	If the charitable lead trust is structured to leave the remainder interest to the settlor's descendants, then there may be a generation-skipping transfer tax unless there was enough generation-skipping transfer tax exemption allocated to the trust when it was created.	If the charitable lead trust is structured to leave the remainder interest to the settlor's descendants, then there may be a generation-skipping transfer tax unless there was enough generation-skipping transfer tax exemption allocated to the trust when it was created.