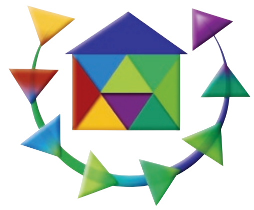
Charitable Remainder Annuity Trust

Udell Associates

From Estate Planning to Wealth Enjoyment

Charitable Remainder Annuity Trust



Key Benefits

Fixed income stream payable to the donor and spouse for as long as either is alive.

Income tax deduction available for the computed value of the charitable gift.

Investments are managed inside an income tax exempt trust, making investment decisions easier.

The trust can be used to sell a highly appreciated asset and avoid capital gains tax.

Trust assets pass estate and income tax free to designated charity after donor's and spouse's deaths.

Designated charity can be donor's favorite charity (including donor's private foundation).

Please see page 7 of this booklet for important information concerning the planning technique illustrated herein.

Charitable Remainder Annuity Trust

Scenario

Bill and Mary (both age 65) presently own 20,000 shares of stock in Widget Industries, Inc. This stock, bought several years ago for $100,000, has been an extraordinary investment, and it is presently trading on the New York Stock Exchange at $50 per share (making the shares worth $1,000,000). Their investment advisor has recommended for some time that they sell the Widget stock and diversify their holdings. Bill and Mary agree that this is good advice, but they hesitate, knowing that they will lose $135,000 in capital gains taxes, as well as all the future earnings on the amount lost to taxes.

Over the years, Bill and Mary have enjoyed contributing to various charities, and they have expressed an interest in someday making a sizable gift to their favorites. They wouldn't be comfortable making such a gift during their lifetimes, because they want to be sure that their own financial needs are met. However, they think that a large gift to their favorite charities after their deaths would be a good idea.

After careful consideration, Bill and Mary decide to use a planning technique known as a Charitable Remainder Unitrust. The technique will allow Bill and Mary to avoid capital gains taxes upon the sale of the stock, provide them a lifetime income, generate an income tax deduction, save estate taxes, and provide a large gift to their favorite charities after their deaths.

Charitable Remainder Annuity Trust

Construction

1 Bill creates an irrevocable trust, known as a Charitable Remainder Annuity Trust, or "CRAT", from which Bill and Mary will receive a stream of income for as long as either is alive. Trust assets remaining after the survivor's death will be transferred to the qualifying charities they have designated.

2 Bill transfers Widget stock worth $1,000,000 to the trustee.

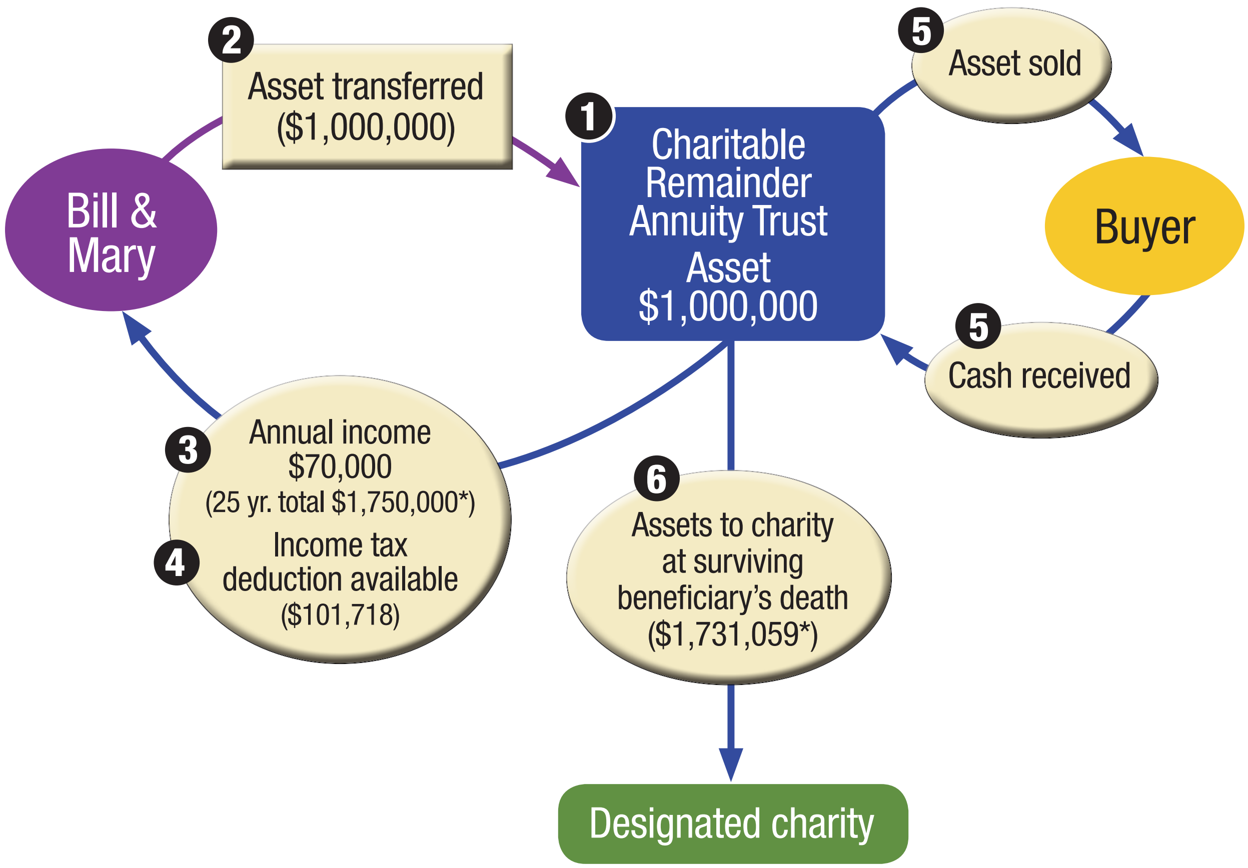
3 Bill and Mary receive a distribution from the trust, annually, equal to $70,000. The amount of this payment is determined at the time the trust is created by multiplying the value of the trust's assets by a percentage specified by Bill in the trust agreement (7% in this scenario), and remains fixed for the duration of Bill's and Mary's beneficial interest in the trust. Note that payments could be made more frequently, e.g., quarterly or monthly.

4 Bill and Mary also can benefit from an income tax deduction, which is based on the actuarial value of the charity's remainder interest (using tables provided by the IRS).

5 The trustee sells the stock in return for cash. Because the trust is tax exempt, no capital gains tax is owed upon the sale of the stock. The trustee invests and manages the proceeds to provide the annual distributions to Bill and Mary.

6 Upon the death of the survivor of Bill and Mary, remaining trust assets are distributed to the designated charities and the trust ends. The value of the trust assets pass to the designated charities estate tax free.

Charitable Remainder Annuity Trust



* Assuming that the surviving income beneficiary's death occurs at end of year 25 and the gross annual return on invested assets is 8%.

Charitable Remainder Annuity Trust

Technical Notes

A Charitable Remainder Annuity Trust (or, "CRAT") is a special type of irrevocable "split interest" trust in which a fixed income stream, the amount of which is determined by multiplying the value of the trust assets by a specified percentage, is payable to a noncharitable beneficiary for life or for a specified period of time not to exceed 20 years, with remaining trust assets being distributed to a qualifying charity (the remainder beneficiary) at the end of the noncharitable beneficiary's interest. Such trusts can be created during the settlor's (i.e., the trust creator's) lifetime or at the time of death (e.g., under the decedent's will).

Typically, the settlor designates himself / herself as the noncharitable income beneficiary of the CRAT for the duration of his or her lifetime, with one of more favorite charities designated to receive the trust's assets at death. The settlor can also include his/her spouse as an income beneficiary of the CRAT so that income can be received as long as either the settlor or the spouse is alive. Someone other than the spouse could be named as an additional income beneficiary, although this is usually not done due to gift and estate tax issues. The designated charity can be changed after the creation of the trust, if the settlor reserves in the trust instrument the right to do so.

To qualify for favorable income, gift and estate tax treatment, the CRAT must satisfy various technical requirements. Examples: the specified percentage used to determine the annual distribution amount from the trust must not be less than 5%, nor more than 50%; the actuarially computed value of the charity's remainder interest must be at least 10%; the trust must satisfy the "5% exhaustion" test; and the designated charity must be a qualifying charity under federal tax law (which could include the settlor's private foundation).

The actuarially computed value of the charity's remainder interest will be available to the settlor as an itemized deduction as a charitable contribution for federal income tax purposes in the taxable year that the asset is transferred to the CRAT. Generally, the amount of the gift that is deductible will be determined by rules governing deductibility of charitable gifts, which include limitations based on the taxpayer's adjusted gross income, the type of asset transferred and the type of charity involved. To the extent that these rules do not allow for deduction of the entire amount in the taxable year that the asset is transferred to the CRAT, the unused amount may be carried over to the following 5 taxable years.

Generally, the trust is exempt from federal income tax, which provides a significant tax advantage in the sale of assets and management of investments in the trust. Generally, the income beneficiary will be subject to income tax on trust distributions, based on the character of the income in the hands of the trustee (e.g., ordinary income, capital gains, nontaxable return of principal), and is determined by applying detailed rules governing the timing and order of distribution.

It is important to understand that while the trust agreement provides for payment of a fixed annuity to the income beneficiary, the annuity can be paid only so long as the trust has sufficient assets to pay it. Consequently, it is important that the invested assets of the trust be managed prudently and in a manner consistent with the need to make annuity payments to the income beneficiary. Generally, the trust should be funded with assets that can produce a substantial and consistent stream of income. However, certain types of assets are not appropriate. For example an operating business produces income that would be treated as unrelated business taxable income, resulting in a federal excise tax equal to 100% of the amount of the unrelated business taxable income received by the trust for the taxable year.

Note that the CRAT permits only a single contribution to the trust. If an additional contribution in the future is desired, it would be necessary to create another CRAT. Alternatively, a similar concept known as the Charitable Remainder Unitrust ("CRUT") might be preferable to the CRAT, as the CRUT permits future contributions.

While the CRAT offers numerous benefits, a disadvantage of the CRAT is that it effectively "disinherits" the settlor's family as to the assets held in the trust. Consequently, settlors often create for their family a so-called "wealth replacement trust", funded with life insurance, to replace the wealth lost to charity.

Unless otherwise stated in this booklet, actuarial calculations are based on the assumptions that the client (and spouse, if applicable) is 65 years old and the Applicable Federal Rate (AFR) is 5.0%.

This booklet is intended solely for the purpose of illustrating conceptually how a particular estate planning technique might work, based on various assumptions. Whether the planning technique is appropriate for you will depend on your goals and your specific situation. This booklet has been prepared to accurately reflect our understanding of existing tax and regulatory laws in effect at the time of printing, and it assumes the continuation of such laws. However, the information in this booklet should not be interpreted as legal or tax advice, and the reader is strongly encouraged to seek guidance from his or her own legal and tax advisors concerning legal and tax consequences of the planning technique. Any amounts shown that relate to life insurance are hypothetical in nature and are not guaranteed. Any assumed investment returns shown are based on hypothetical investments.

The following notice is required by the IRS: Any U. S. federal tax advice contained in this communication is not intended to be written or used, and cannot be used or relied upon, to avoid tax-related penalties under the Internal Revenue Code, or to promote, market or recommend to another any tax-related matter addressed herein.

The Wealth Enjoyment System®
Estate Planning for Life

Udell Associates
From Estate Planning to Wealth Enjoyment

Sarasota, Florida
800-725-6511
941-951-0443

Orlando, Florida
800-749-9499
407-660-0330

Email: **info@WealthEnjoyment.com**
Web site: **WealthEnjoyment.com**