



rebirth of the charitable remainder trust

MSK Client Alert

April 2013

Throughout the Nineties, and continuing through 2007, the charitable remainder trust was an extremely popular planned giving vehicle used to balance the philanthropic and financial planning objectives of clients and donors. The primary financial planning objective in most CRT planning is to sell appreciated assets in the tax-exempt environment of the CRT, allowing the reinvestment of the full before-tax proceeds to produce income and the deferral of tax resulting from the transaction. A secondary financial planning objective is the tax savings derived from the charitable deduction, which, depending on the terms of the trust, can be substantial. The philanthropic objective may be to commit currently to a charitable gift that the donor intends to make at death anyway or, in many instances, to allow the donor to make a larger philanthropic commitment than he or she thought possible.

The popularity of charitable remainder trusts began to recede in a long process beginning with the reduction of the federal tax rate on long-term capital gains in 2001. In evaluating the pros and cons of a charitable remainder trust, most planners consider the primary "con" to be giving up access to the principal that would be held in the CRT: after the trust is funded, the income beneficiary must look only to the formula distributions from the trust, under the annuity or unitrust payouts, and does not have access to the trust principal even in case of emergency. The primary "pro" is the ability to defer capital gains tax, but the importance of that factor was reduced as the general capital gains rate was cut from 20% to 15%. However, through the early Aughts, CRTs managed to retain some of their vitality for planners, especially for trusts funded with real estate, since the rate remained as high as 25% for some gain from the sale of real estate.

Even this limited residual popularity of CRTs was severely tested by the Great Recession, since the primary financial planning objective requires both appreciated assets and a planned transaction involving those assets. A plummeting stock market and falling real estate prices meant that even wealthy individuals had fewer appreciated assets in their portfolios. Moreover, since

attorneys

David Wheeler Newman

practice areas

nonprofit organizations



rebirth of the charitable remainder trust

many transactions, including sale of a business and especially real estate, require financing, the freezing of credit markets during the recession meant that fewer and fewer transactions were taking place.

The confluence of these facts led to a noticeable reduction in the number of new charitable remainder trusts, beginning in 2008 and continuing through the beginning of last year. There has been a recent reversal of this trend, which appears likely to accelerate.

The first quarter of 2013 has seen stock markets recover, achieving all-time highs for some indices. Slowly but surely, real estate values have improved, at least for some types of real estate and in some parts of the country.

More dramatically, as a result of the American Taxpayer Relief Act, the federal tax rate on long-term capital gains recognized in 2013 is more than 50% higher than the maximum tax rate in 2012. This tax legislation, intended to avoid the fiscal cliff, not only increased the maximum rate to 20%, but also subjected long-term capital gains to the new Medicare tax of 3.8% on investment income, resulting in a maximum federal tax rate on long-term capital gain of 23.8% (and 28.8% for some types of gain from real estate). Moreover, the charitable income tax deduction has become more valuable: as the maximum federal rate on ordinary income has increased to 39.6%, a dollar of charitable contribution now receives a federal tax incentive of 39.6 cents, rather than 35 cents just a few months ago.

Many organizations are reporting increased CRT activity beginning in the last quarter of 2012, no doubt as a result of these trends, and there is no reason to believe that interest in this charitable gift planning warhorse will not increase further as the economy and asset values continue to improve. This forecast should cause planners to refresh their technical knowledge of charitable remainder trusts and sharpen analytical tools that may have fallen into disuse in recent years. It is important that charitable gift planners learn (or relearn) how to talk to clients and donors about the benefits of charitable remainder trusts and how to assist those clients and donors in balancing their philanthropic and financial planning objectives with this flexible vehicle.