

# How The Tax Advantage Works

John Smith and his wife Mary own a piece of property worth \$600,000. They paid \$100,000 for the property a number of years ago. John is 62 years old; Mary is 60. They are preparing to retire and have found that their income sources will not provide the funds necessary to meet their projected living expenses.

Additional capital is needed to provide more retirement income.

In order to generate the additional income needed to retire, John and Mary decided to create a Charitable Remainder Trust that will pay them seven percent of its value each year. When the trust was established the property was “donated” to the trust and sold under the trust name. John and Mary named themselves trustees of the trust and beneficiaries of the income that will be generated from the sale proceeds.

By taking this course of action, John & Mary were able to sell the appreciated property without paying any capital gains taxes. This strategy saved them approximately \$135,000 in capital gains taxes.

In addition to the capital gains tax savings, John and Mary receive a charitable tax deduction totaling \$375,000. At their current tax bracket, John and Mary would realize a total tax-savings of \$131,250. This tax-saving benefit is a result of the fact that the amount inside the Charitable Remainder Trust will go to charity upon the death of John and Mary.

In addition to saving the amount that would have gone to capital gains taxes and receiving a significant tax deduction to boot, the CRT also has a profound impact on their estate planning.

At John and Mary’s death the proceeds inside the CRT pass to the charity named in the trust. At the same time the CRT was established John and Mary also funded a “Wealth Replacement Trust.” This trust holds a life insurance policy on John and Mary in the amount of \$600,000. Upon their death their heirs will receive the value of the property that will go to charity, outside of the estate. This greatly reduces the exposure they have to costly estate taxes.

Most importantly to John and Mary is the fact that they now have the full amount from the sale of the house invested at seven percent interest providing the retirement income needed to make ends meet..

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John Smith, age 59, owns non-dividend paying stock which he received from a trust at the death of his mother. The stock is worth \$100,000, but has a tax cost basis of \$10,000. John and Mary, his wife, also age 59, wish to diversify their portfolio, increase their income, and create tax deductions. They are in the 36 percent federal tax bracket.

John donates the stock to a charitable remainder unit trust with a 5 percent payout for their joint lives. Based on their ages and the payout rate, John and

Mary would receive a charitable income tax deduction of \$29,615, which would reduce their taxes by \$10,661 in the year they create the trust. Further, assume the trust sells the stock and invests in a high quality growth and income fund earning a total return of 10 percent.\* John and Mary will receive a growing stream of income, compounding at better than 5 percent, which should outpace inflation.

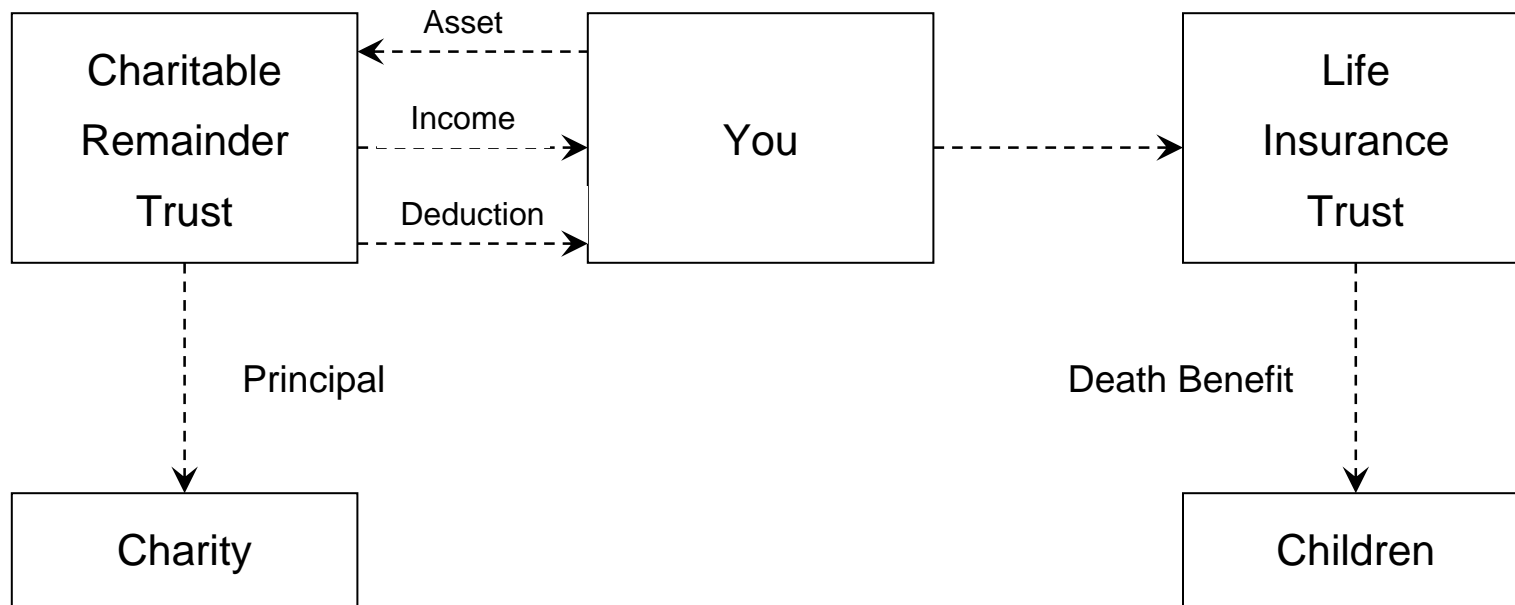
Alternatively, if John and Mary donate the stock to a charitable remainder unit trust with a 5

percent payout for his life, they would receive a tax deduction of \$40,857, which would reduce their taxes by \$14,709 in the year they create the trust. The income flows and appreciation of trust principal would be the same. John could use a portion of the income to purchase life insurance for Mary's benefit should he predecease her.

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# How The Charitable Remainder Trust Works



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