Understanding CRTs

A Summary of
Charitable Remainder Trusts (CRTs)

PACIFIC LIFE

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GET READY FOR RETIREMENT

If your retirement planning objectives include lifetime income planning, estate tax reduction,[1] and leaving a financial legacy for both heirs and charitable organizations, using a charitable remainder trust (CRT) may be an effective strategy to help you balance these goals.

TABLE OF CONTENTS

[1]According to the American Taxpayer Relief Act of 2012, the federal estate, gift, and generation-skipping transfer (GST) tax exemption amounts are all $5,000,000 (indexed for inflation effective for tax years after 2011); the maximum estate, gift, and GST tax rates are 40%.

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WHAT IS A CRT?

A CRT is a tax-exempt, irrevocable trust with two types of beneficiaries: income beneficiaries and remainder beneficiaries.

CRTs are usually used as part of an overall estate plan that has the objectives of providing current income, reducing estate tax, and leaving a financial legacy to a charity.

WHO'S WHO IN A CRT?

Donor: The individual (or individuals) who establishes and gifts assets to fund the CRT.

Trustee: The individual (or individuals) or entity (such as an independent trustee) that is responsible for managing and investing the CRT (including its assets) in a manner that will best meet the CRT objectives.

Income Beneficiary: An individual (or individuals) that receives income from the trust. Income beneficiaries receive distributions that are paid out over a lifetime or a fixed period of time (such as 20 years). An income beneficiary is usually the individual (or individuals) who establishes and gifts assets to fund the CRT (donor and/or spouse), but can also be non-donors (such as children).

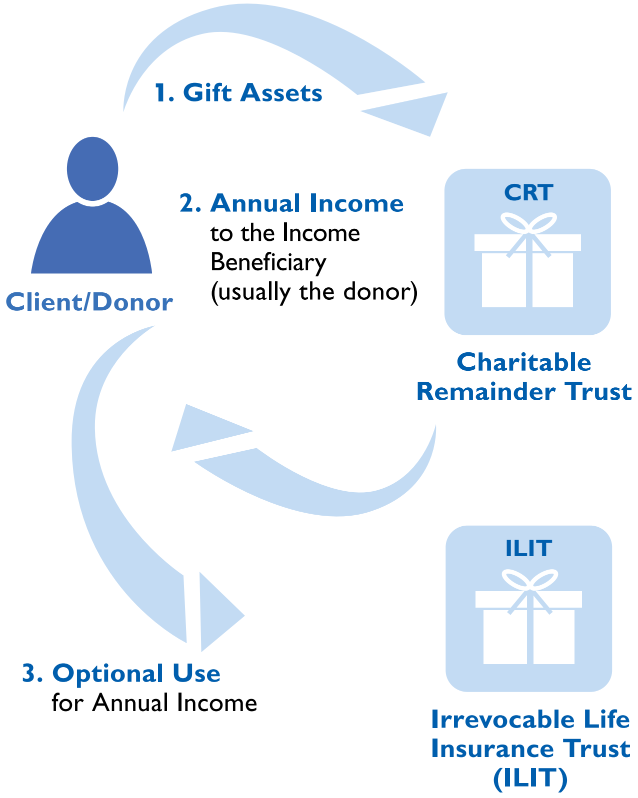
Remainder Beneficiary: At the termination of the trust, the remainder beneficiary, which must be a qualifying charitable organization as described in Internal Revenue Code (IRC) Section 170(c), receives the assets that remain in the trust.

It is advisable that the trustee appointed not be the financial professional. A financial professional who is paid a commission on the sale of an annuity contract represents both his or her personal interest and the interests of the trust, creating a conflict of interest.

HOW A CRT WORKS

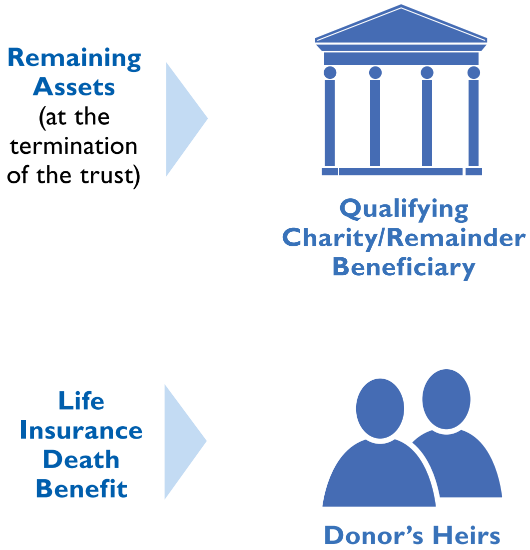
The donor gifts an asset, usually a highly appreciated capital asset such as stock or real estate, to the CRT. The CRT sells the asset, and because the CRT is tax-exempt, no income or capital gains tax is paid; the gross proceeds from the sale are reinvested.

The interest of the income beneficiary may conflict with that of the charitable remainder beneficiary. When creating a trust, it may be advisable to name a special independent trustee—who invests and distributes assets in the best interest of both beneficiaries—to help resolve conflicts.



Income beneficiaries receive distributions from the CRT. Following the income beneficiary's death or expiration of a fixed period of time, any remaining CRT assets are given to the remainder beneficiary.

As an option, the donor may make gifts to an Irrevocable Life Insurance Trust (ILIT) to pay the premium for a life insurance policy. For heirs, the life insurance death benefit can replace all or a portion of the value of the gift to the CRT.



TYPES OF CRTs

CRTs are often categorized by the way the amount distributed to the income beneficiary is determined.

	Payout to Income Beneficiary
SCRAT (Standard Charitable Remainder Annuity Trust)	A fixed amount each year determined when the CRT is established.
SCRUT (Standard Charitable Remainder Unitrust)	A fixed percent of CRT assets determined each year.
NICRUT (Net Income Charitable Remainder Unitrust)	The lesser of a fixed percent of CRT assets or the income the CRT assets generate.
NIMCRUT (Net Income with Makeup Charitable Remainder Unitrust)	The lesser of a fixed percent of CRT assets or the income the CRT assets generate. Additionally, when income is less than the fixed percent, the shortage can be distributed in later years when income exceeds the fixed percent.
FLIPCRUT (Flip Charitable Remainder Unitrust)	Initially follows payouts of NICRUT or NIMCRUT. Flips to payout of SCRUT on January 1 of the year following the year containing a "triggering event" stated in the trust: (1) on a specific date, or (2) a single event that occurs that is not at the discretion or control of the trustee(s) or any person(s).

TAXATION OF DISTRIBUTIONS

Amounts distributed to the income beneficiary can be subject to taxation. Income is categorized into one of four tiers: ordinary income, capital gains, other income (such as tax-exempt income), and cost basis. Income is distributed in this order, one tier at a time, and taxed accordingly. An additional 3.8% tax may apply to net investment income generated and distributed.

Order of Distribution and Taxation

First	»	Ordinary Income
Second	»	Capital Gains
Third	»	Other Income (Tax-Exempt Income)
Last	»	Cost Basis

Tax Treatment

If particular conditions are met, the CRT and the donor can receive favorable tax treatment. The CRT will be tax-exempt, the assets are not included in the donor’s taxable estate, and the donor may be able to receive a charitable income-tax deduction equal to the present value of the assets that are expected to go to the remainder beneficiary. This deduction may be limited in any one year, but can be available for up to five full years following establishment of the CRT.

FREQUENTLY ASKED QUESTIONS

Q. Who is most likely to establish a CRT?

A. Generally, if you are charitably inclined, have highly appreciated assets, and are looking for a tax-efficient strategy to generate income and reduce estate tax, a CRT could be appropriate. But, CRTs can work in other scenarios. Contact your tax and financial professionals to discuss whether or not a CRT makes sense for you.

Q. What can be done if you like the CRT strategy, but do not want to diminish the inheritance of your heirs?

A. Consider establishing both a CRT and an Irrevocable Life Insurance Trust (ILIT). Life insurance purchased within the ILIT can be used to replace all or a portion of the inheritance value of the asset gifted to the CRT.

Q. What conditions must be met for the CRT and its grantor to receive favorable tax treatment?

A. Primarily, the stated payout amount to the income beneficiary may not be less than 5% or exceed 50% of the value of the assets. Additionally, the present value of the assets that are expected to be paid to the charitable remainder beneficiary may not be less than 10% of the value of the asset gifted to fund the CRT. When establishing a CRT, it is important to work closely with tax and financial professionals who are well versed in charitable planning.

Q. Can a deferred annuity be used to generate income from a CRT?

A. While income can be derived from many different types of investments, a deferred annuity may also offer additional benefits within a CRT. For example, a contract death benefit guarantee will help protect the remainder beneficiary's interest. However, keep in mind that your investment choice should be appropriate for your income needs and goals, as well as the goals of the charity.

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[1]Recipient of multiple DALBAR Service Awards since 1997. Refer to www.DALBAR.com for more information regarding awards, certification, and rankings.

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