Using Charitable Trusts In Your Retirement Planning

Brought to you by Andrew Seaborg in conjunction with Lincoln Financial Advisors

Land “rich” and cash “poor.” That describes Jim and Angela in a nutshell. While they actually live quite comfortably on their professional incomes, they are getting closer to retirement age and are looking for ways to supplement the income they expect from their employers’ retirement plans.

By far the largest asset they own is a tract of unimproved real estate that Angela received from her parents. Part of her family’s former farm, the property is located in a prime new development area, which has made its value increase over the past few years. But the land provides no current income.

What Can They Do?

Angela could sell the land to a developer now or at retirement and invest the proceeds in income-producing investments. Either way, she and Jim would lose a substantial portion of the property’s appreciation to capital gains tax.

A better strategy might be to establish a charitable remainder trust (CRT). To implement this strategy, Angela would transfer the land to an irrevocable trust created to provide lifetime payments to her and Jim. At the death of the surviving spouse, the trust property would be transferred to a charitable organization Angela has named in her trust agreement.

With a CRT, generally the trustee can sell the trust property and reinvest the proceeds without having to pay any immediate tax on the gain. Thus, Jim and Angela would have more money invested toward retirement than if they had sold the land and invested the proceeds themselves. Jim and Angela could invest their tax savings outside of the trust to produce additional income.

Income Options

A CRT can be structured either as an annuity trust or as a unitrust. The type of CRT chosen determines how payments from the trust are calculated. If Angela chooses a charitable remainder annuity trust (CRAT), she and Jim will receive annual payments of a set percentage of the trust’s initial fair market value. The percentage must be at least 5% and cannot exceed 50%.

A charitable remainder unitrust (CRUT) would pay Jim and Angela an annual income based on the fair market value of the trust property, revalued each year. Again, the percentage must be at least 5% and cannot exceed 50%. If the trust investments perform well, the income will increase. Some people prefer to use a CRUT because it can provide a hedge against inflation. CRUTs also can accept additional gifts; CRATs cannot.

Two other CRUT features that might appeal to Jim and Angela are the option to limit the annual payments to the trust’s income in any year when the trust’s income is less than the fixed percentage amount (a net-income CRUT or NICRUT) and the ability to include a “makeup” provision (a net-income makeup CRUT or NIMCRUT). The makeup provision would require the trustee to make higher payments in years in which the trust income exceeds the fixed percentage amount, to the extent that payments in prior years were less than the fixed percentage.

How would these features help Jim and Angela? When they establish the CRUT, Angela could transfer the land and Jim could transfer a small amount of income-producing investments or cash to be invested. The trust could hold the land until Jim and Angela are ready to retire, paying them the income from the investments in the meantime. Then, the trustee could sell the appreciated land and invest in securities that would produce a current income for their retirement.

Even if the investment income exceeds the fixed percentage set for their CRUT, the makeup provision would require the trustee to pay the excess to Jim and Angela to compensate for the earlier years of low income.

Protection, Too

A CRT also may offer some protection from creditors. Depending on the laws of their state, inserting spendthrift clauses in their trust agreement could protect the trust property from creditors. (In some states, spendthrift protection is applied automatically by statute.) Jim and Angela should be aware, though, that certain states extend spendthrift protection only to trust beneficiaries *other than the trust grantor(s)*.

A charitable remainder trust can be used to help accomplish numerous financial planning objectives. However, complex legal requirements must be met to secure many of the benefits a CRT offers. You'll want to consult with your professional advisor before deciding to use a CRT in your financial planning. And, if you decide to establish a CRT, seriously consider using an experienced professional trustee, such as a bank or the charity itself, to administer your trust.

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