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Is your client's CRT still a good fit?

BY JAMES W. LINTOTT

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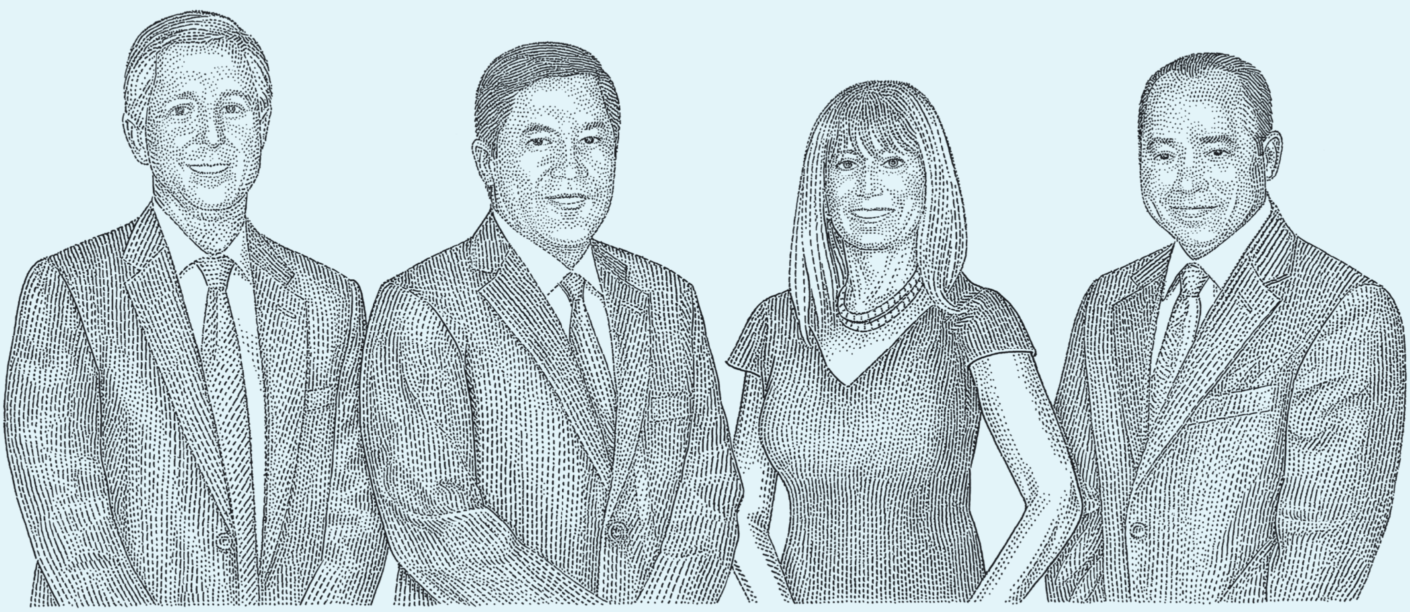

Left to right: *James W. Lintott, Peter F. Najera, Ellen K. Fishbein, Giovanni T. Kotoriy*

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ILLUSTRATION BY KEVIN SPROULS

Charitable remainder trusts (CRTs) offer a number of benefits: an immediate income tax deduction, the ability to convert an appreciated asset into a lifetime income stream, the deferral of capital gains tax, a potential reduction in estate tax and protection from creditors, among others. For many clients—particularly those who are charitably inclined—these benefits carry significant appeal.

WHEN THE SHOE NO LONGER FITS

The downside of CRTs is inflexibility. At its inception, a CRT is usually a perfect fit for a client's situation: It has the appropriate payout rate, trust structure and income beneficiaries. However, because CRTs are irrevocable trusts that can last for decades, they can become misaligned with a client's circumstances over time. Unfortunately, most clients with CRTs don't understand the full range of secondary planning options available to them. At Sterling, we've reviewed countless CRTs, and in our experience, the vast majority of clients with CRTs are under the erroneous impression that their trust is a lifetime lockup. Therefore, it is becoming increasingly important for advisors to inform their clients of the secondary options available, so that they are in a better position to make changes when the need arises.

> "Most clients with CRTs don't understand the full range of available secondary planning options."

SECONDARY PLANNING OPTIONS

Clients can exit a CRT in several ways. They can gift the income interest to charity, which results in an additional tax deduction to the donor, according to an Internal Revenue Service formula, the "7520 rules." They can also terminate their CRT by a complicated division of the assets between the income and remainder beneficiaries (again, based on the 7520 values of those respective interests).

However, if a client is seeking to get the most income possible out of a CRT, his or her best option is nearly always to sell the income interest on the secondary market. Because buyers of CRT-income interests are not bound by the 7520 rules, they are able—and generally *willing*—to pay more than a client would receive by terminating. Moreover, a termination can be a costly, time-consuming process that can take more than six months to complete; a sale, in contrast, can be completed in just two-to-four weeks.

WHY CLIENTS SELL

While the creation of CRTs tends to be driven by tax considerations, most sales occur because something has changed since the CRT was established. Common reasons for selling include: cash needed for an investment opportunity, simplification of financial affairs, divorce, tax considerations, a lack of cash for charitable needs, desire for increased flexibility and value maximization.

AUTHORITY AND TAX TREATMENT

A client's ability to sell an income interest in a trust is rooted in Rev. Rul. 72-243, 1972-1 C.B. 233. This ruling confirms that an income interest in a trust is a capital asset within the meaning of sections 1221 and 1222 of the Internal Revenue Code. In the early 2000s, a series of private letter rulings confirmed the tax treatment and salability of a CRT income interest, referencing the original 1972 Revenue Ruling as their basis.

Until last year, section 1001(e)(1) of the Internal Revenue Code indicated that a seller's basis in a CRT income interest was zero. Last August, however, the IRS issued final regulations, providing new rules for determining a taxable beneficiary's basis in a CRT income interest. These rules enable certain clients with CRTs to take basis, to the extent that that basis consists of a share of adjusted uniform basis.

CRT ROLLOVER

Don't miss our upcoming article on the CRT rollover, an innovative new strategy that enables clients with CRTs to, in effect, make changes to their trusts. Common rollover drivers include adding beneficiaries and deferring highly taxable income from a standard charitable remainder unitrust (CRUT).

ABOUT US

STERLING FOUNDATION MANAGEMENT, LLC IS THE OLDEST NATIONAL FOUNDATION MANAGEMENT FIRM IN THE COUNTRY AND THE NATION'S LEADING FACILITATOR OF SALES OF INCOME INTERESTS IN CHARITABLE REMAINDER TRUSTS. Sterling works with a broad range of clients and high net worth individuals to develop solutions that help them achieve their philanthropic, family and financial goals through the effective use of private foundations and other charitable-planning vehicles and financial services.

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