

# South Seattle Community College

## About Charitable Remainder Trusts

The financial and estate planning flexibility available through trusts has expanded in recent years because of the growing popularity of the charitable remainder trust. Basically, a charitable remainder trust follows the guidelines that have been developed for trusts in general: the grantor transfers property to the trust and specifies how its income and principal are distributed.

As the name implies, the distinguishing characteristic of a charitable remainder trust is that a charity, such as South Seattle Community College, is named as a remainder beneficiary of the trust. Since Congress encourages charitable gifts by allowing various federal income- and estate-tax deductions, charitable remainder trusts offer a variety of attractive planning opportunities.

Charitable remainder trusts are helpful ways to assure a reliable stream of income for life – thereby reducing the risk that you might outlive your retirement assets – while still providing for a generous charitable gift to the College in the future. The remainder trust can also be a way to provide for a surviving spouse, children or even grandchildren while minimizing exposure to estate and other transfer taxes.

### The Unitrust

The charitable remainder “unitrust” is a special trust that pays income to you or a family member for a specified time period (for example, your lifetime; for the your lifetime and a survivor’s lifetime; or a fixed number of years). After all of the income payments have been completed, the remainder is distributed to qualified charities. The payment amount corresponds to a specified percentage chosen by the donor — at least five percent of the total value of the trust assets as they are valued each year. Since the total value may vary from year to year, the payments may vary as well. At the death of the last beneficiary, the trust principal is distributed to the named charitable organization, in this case South Seattle Community College Foundation.

**Illustration:** Martha Washington, age 71, establishes a 5% straight unitrust benefiting the South Seattle Community College Foundation. She funds the trust with \$200,000 in Microsoft stock that she acquired some years ago at a cost of \$40,000. She would receive a variable payment equal to 5% of the total assets of the trust each year. In this case, Martha’s income would be \$10,000 in the first year, and if the trust earned an average of 8%, her annual earnings would increase as well (after 10 years reaching \$12,878). On the date she established the trust Martha would receive an immediate income tax deduction of \$110,166 and would avoid or defer taxes on up to \$160,000 in long-term capital gains. If Martha lived for her expected lifetime of 16 years, the charity would receive \$316,225 at her passing.

**Types of Unitrusts** — There are several basic types of unitrusts from which to choose, each characterized by different payout arrangements:

- A straight unitrust provides a fixed percentage payment (at least five percent) of the annual asset value.
- A net-income unitrust provides for payment of all the income earned by the unitrust up to the limiting percentage specified in the trust agreement.
- An income-only unitrust with a “flip” provision allows a donor to create a trust that starts out as an income-only unitrust but later switches to a straight unitrust. Such a trust can be an excellent vehicle for an individual who wishes to give an appreciated illiquid asset such as real estate and have the trust convert the property to income investments.

**Advantages of Unitrusts** —If you create an irrevocable unitrust during life:

- **Increased income.** Mature business or real estate investments may not be generating any current return, or may be earning only two, three or four percent a year. The unitrust can enable a person to sell an appreciated asset without incurring punitive capital gains taxes and then have the trust reinvest in income-producing assets at a higher rate of return. You or your beneficiary will receive a reliable stream of income for the life of the trust – thereby reducing the risk that you might outlive your retirement assets. Over the years, family members could reinvest the payments, thereby acquiring even more financial security.
- **Bypass capital gains.** You will escape most and perhaps all capital-gains tax otherwise due on appreciated property such as stocks or real estate. The actual savings depends on the trust’s performance. If it earns more than the annual payout, all the gain will be permanently bypassed. But if not, some of the payments will be a combinations of earning and the original trust corpus. In this case, part of the capital gains may be paid out to the beneficiary – fortunately this is taxed at capital gains rates (currently 15% or less).
- **Immediate income tax deduction.** At the completion of all income payments, South Seattle Community College Foundation will receive the remaining part of the original principal plus any undistributed earnings. Even though the Foundation may not receive that gift for years or even decades, you will receive a current, partial charitable income-tax deduction based on the ages of the life-income beneficiaries, the payout rate and the expected value of the charity’s remainder interest.
- **Avoid estate taxes.** Your estate will also avoid death taxes on assets transferred to the trust.<sup>1</sup>
- **Charitable impact.** You will have the satisfaction of knowing that you have made a charitable investment in the College and its students while reserving a stream of income for yourself and/or your beneficiaries.

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<sup>1</sup> Gift taxes may apply if beneficiaries other than the donor or spouse are selected. A lifetime gift tax credit allows taxpayers to avoid paying taxes on up to \$1 million of lifetime gifts.

## The Annuity Trust

The charitable remainder “annuity trust” provides for payment of a fixed-dollar amount — annually or at more frequent intervals — to the designated beneficiary or beneficiaries. The amount must equal at least 5 percent of the initial fair-market value of the trust. At the death of the last beneficiary, the trust principal is distributed to the named charity.

**Illustration:** At the age of 75, George Washington establishes a charitable annuity trust using \$200,000 in Boeing stock that he acquired some years ago for \$40,000. He receives a fixed annual income of \$10,000 a year for the life of the trust. On the date he established the trust George would receive an immediate income tax deduction of \$117,671 and would avoid or defer taxes on up to \$160,000 in long-term capital gains. If George lived for his expected lifetime of another 13 years, and the trust earned an average of 8% a year, the charity would receive \$316,916 at his passing.

**Advantages of an Annuity Trust** — If you create an irrevocable annuity trust during life:

- **Tax benefits.** The tax benefits of an annuity trust are similar to that of a unitrust. You will receive an immediate charitable income-tax deduction for the value of the College’s remainder interest. By establishing the trust, you will also avoid some or all taxes on capital gains associated with assets used to fund the trust. Estate tax advantages may also apply.
- **Regular income.** The principal advantage of an annuity trust is that the beneficiaries can be assured that payments to them will remain constant, regardless of the fluctuations of the marketplace. However, there is a corresponding risk associated with an annuity trust – depending on future investment performance, there is a chance that the entire trust value might be distributed as payments to the beneficiary, resulting in no subsequent payments and no remainder for the charity. For this reason most donors currently prefer the Unitrust.
- **Charitable impact.** You will have the satisfaction of knowing that you have made a charitable investment in the College and its students while reserving a stream of income for yourself and/or your beneficiaries.

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Please contact your attorney for advice about creating a charitable trust. Charitable trusts, because they incorporate an investment element, pose risk. A charitable gift planning officer is available to help you and your advisors develop ways that charitable gift opportunities, annuities and trusts could form part of your retirement or estate plan.