



ESTATE PLANNING

CHARITABLE TRUSTS

Charitable Giving as Part of Your Long-Range Financial Plan

Understanding the factors that influence your giving is crucial to ensuring your charitable giving is aligned with your overall wealth transfer planning.

Making a gift to support a cause you believe in can be more than a reflection of your personal values. Thoughtful, planned giving can play an important role in your overall financial strategy or estate plan. Some people choose to make gifts outright during their lifetime. Some decide instead to remember a charity in their will.

Others elect to make a gift by establishing a charitable trust. In addition to the satisfaction of giving, a charitable trust may help:

- Reduce income tax,
- Eliminate capital gains tax and
- Lower taxes on your estate.

Is a charitable trust a good idea for you? Following are descriptions of the most common types of charitable trusts. You may find one of them suits your intentions exactly.

CHARITABLE REMAINDER TRUSTS

A charitable remainder trust is designed to pay annual income to the donor. In this case, the trust document provides that income earned by the trust goes to the donor and/or beneficiaries while the donor is alive, with the remainder going to charity upon the donor's death. Though cash or other property can be used to set up the arrangement, securities generally are the most common means of funding a charitable remainder trust. Once established, the trust cannot be amended or revoked.

Ultimately, at the donor's death, the charity named receives full ownership of the trust assets. In effect, you make a gift of these assets to the institution you choose, but retain the income they earn during your lifetime. (It is also possible to continue payments after your death to another beneficiary you specify.)

There are two types of charitable remainder trusts: the annuity trust and the unitrust.

The Annuity Trust

An annuity trust provides an annual income of at least 5% of the value based on a valuation that takes place at the time the trust is funded. In other words, you or the beneficiary you name receive periodic payments of a fixed sum that is determined when you establish the trust. This means you can count on a steady income that does not vary over time.

An annuity trust is most suitable for a donor who wants to give away property but also wants to retain a dependable stream of income. And, since the amount of the distribution paid by the trustee does not vary, it is an uncomplicated arrangement for both you and the trustee.

The Unitrust

Closely related to the annuity trust is the unitrust. In this case the payments received by the donor are not fixed amounts, but rather a fixed percentage (minimum 5%) of the assets, based on an annual valuation. This means that,

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particularly if the unitrust is funded with assets likely to increase in value, as these assets appreciate so will the amount of income distributed to the donor.

Some people prefer a variation of this arrangement in which they receive the income earned or the fixed percentage, whichever is less. In this case, a special “makeup” provision can be included in the trust document. If the income earned in a given year is less than the fixed percentage, the makeup provision allows the difference to be added to distributions made in subsequent years when income earned exceeds the fixed percentage.

CHARITABLE REMAINDER TRUSTS: TAX ADVANTAGES FOR YOU

Charitable remainder trusts offer important tax advantages. The trustee frequently sells assets used to fund the trust in favor of higher-yielding investments. As the donor, you are not liable for capital gains tax on the sale of these assets because they have been transferred to a trust that is not liable for this tax.

For example: a common practice is to establish a charitable remainder trust with a gift that includes low cost-basis stock with a low current yield. In turn, your trustee sells the stock and uses the proceeds to purchase securities that are more consistent with your portfolio’s overall objectives – thus benefiting both you and the charity you choose.

In addition, you may be able to take a current charitable deduction on your federal income tax return (subject to certain percentage limitations on the amount of charitable deduction that can be taken each year).

THE CHARITABLE LEAD TRUST

If your financial situation allows, you may want to consider a charitable lead trust as a way of making a significant gift. A charitable lead trust pays income to the charity, with the remainder ultimately passing to the donor’s beneficiaries. Thus, this type of arrangement is suitable if you want to benefit a charity with income derived from assets currently not needed – but wish your family members or heirs to own these assets eventually.

A charitable lead trust remains in place for a specified number of years, during which the charity annually receives a certain percentage of the overall value of the trust.

CHARITABLE LEAD TRUSTS: TAX BENEFITS

Generally speaking, a charitable lead trust is used as a tool for reducing gift and estate taxes rather than as a means of reducing income tax. In the case of a charitable lead trust, the donor pays gift or estate tax only on the actuarial present value of the remainder interest, rather than on the full value of the property that eventually will go to the donor’s beneficiaries. This is because the value of the transfer is determined at the time the trust is funded. Thus, a charitable lead trust can be an effective way to transfer property that is likely to increase in value, since any appreciation of these assets passes to your beneficiaries free of estate tax.

Once the charitable period expires, the trust distributes directly to the beneficiaries named by the donor in the original document.

Generally, no income tax deduction is available for a charitable lead trust – though trust income is excluded from the donor’s taxable income. An exception, however, applies if the charitable lead trust is structured as a “grantor trust” for federal income tax purposes. In this case, the donor receives an immediate tax deduction for the present value of the income that will be paid to charity. On the other hand, all trust income is taxed to the donor each year during the charitable period, just as if no trust existed. (And, if trust assets are invested in municipal bonds, for example, taxable income would be reduced.)

ACHIEVING YOUR GOALS

It’s important to realize that making any type of charitable gift means loss of real control over how your assets will be invested. If one

of your objectives in making such a gift is income flow or the accumulation of assets over time, it is essential that those in charge of investing your assets are aware of your wishes. A straightforward discussion of these matters and careful drafting of the trust agreement by your attorney will help ensure that your objectives are met.

HOW TO FIND OUT MORE

For more than a century we’ve been committed to helping individuals and families like yours achieve their financial goals. If you’d like additional information about charitable trusts, estate planning issues, or other financial services offered by Northern Trust, we’d be happy to help.

The foregoing discussion is general in nature and is intended for informational purposes only. Because the facts and circumstances surrounding each situation differ, you should consult your tax advisor and estate planning professional before making any changes to your estate plan.

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