Business Continuation Using A Charitable Remainder Trust Presentation

Business Continuation

Do you identify with the following?

You are a Business Owner …

- Who is beginning to think about disposition of their closely held family business;
- Who might consider a lifetime sale of the business, but you are concerned about capital gains;
- Who is concerned about the inclusion of the business in the gross estate at death;
- Who lacks estate liquidity to pay potential estate tax liabilities because the business is the primary asset of the estate;
- Who would like to create a ready market for the sale of the business;
- Who desires current income tax deductions;
- Who is charitably inclined as long as it does not adversely affect the family's financial situation;
- Who will need income for retirement once the business is transferred or sold;
- Who desires a continued income stream for your spouse if you die;

If this sounds familiar, you may want to consider transferring your business using a Charitable Remainder Trust.

What is a Charitable Remainder Trust?

A charitable remainder trust (CRT) is an irrevocable trust that allows the donor to claim a charitable deduction for a split interest gift. The CRT pays a specified amount to one or more noncharitable beneficiaries at least annually. The income payout from the CRT may last for a term of years – not to exceed 20 years – or it may last for the lifetime of the donor and/or other specified beneficiaries. Upon the termination of the noncharitable income interest, the named charity receives the remaining trust principal.

CRTs are popular planning tools because they permit donors to make meaningful gifts to charity and receive significant advantages such as:

- An immediate charitable deduction for the present value of the remainder interest that the charity will receive
- An income stream for a period of years or for life
- Reduction in estate tax as the assets placed in the CRT are not included in the estate of the donor
- Avoidance of capital gains tax on appreciated assets transferred to the CRT and subsequently sold

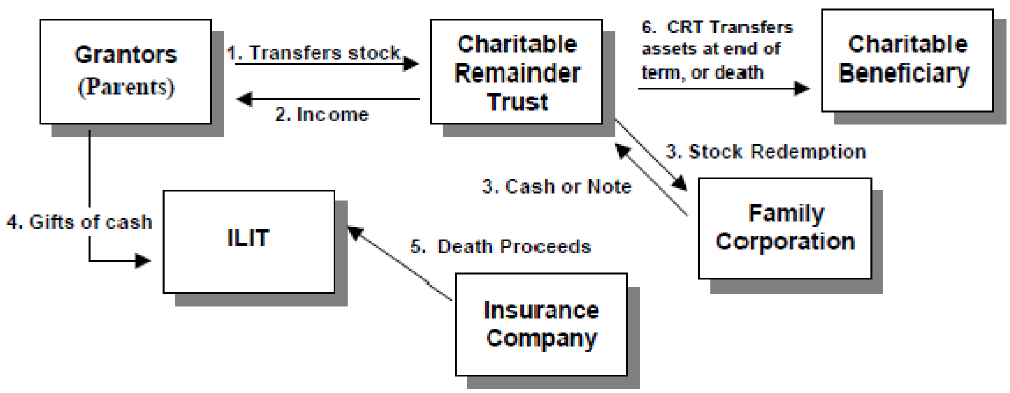
Since a CRT is irrevocable, assets donated to the trust are lost to the donor and his/her heirs. Frequently, the donor also establishes an irrevocable life insurance trust (ILIIT) concurrently with the CRT to provide heirs with a replacement for the value of the gifted asset; to ensure liquid funds for estate taxes; or to equalize inheritance among family members.

Charitable remainder trusts may be an appropriate business continuation tool when the grantor:

- Is the primary owner of a closely held corporation;
- Desires that younger family members continue the family business;
- Desires to provide for a charitable organization;
- Has a need for him or herself, or for the grantor's family to have income for a specified period of time, or for life;
- Has a large estate potentially subject to significant estate settlement and tax costs and desires to reduce the taxable income;
- Wishes to minimize probate and maintain privacy; or
- Has a business with significant appreciation, which would result in recognition of sizeable taxable gains if the business were sold.

Business Continuation

Business Continuation Using A Charitable Remainder Trust (CRT)



1. The grantor(s)/parent(s) create a CRT and transfer their stock in the family corporation into the CRT receiving an immediate income tax deduction for the present value of the remainder interest passing to the charity.

   Note: Prior to the transfer it is important for the children to have a small percentage ownership in the family corporation for this technique to be effective.

2. The CRT pays out an income stream for a period of up to 20 years, or for the life or lives of the parent(s) as either a fixed amount (Charitable Remainder Annuity Trust) or a fixed percentage of the trust assets (Charitable Remainder Unitrust).

3. The family corporation redeems the stock from the CRT in exchange for cash or a note.

   The children, as the remaining shareholders of the corporation, now have control of the business.

4. Using the money received from the CRT the parents establish an irrevocable life insurance trust (ILIT) naming family heirs as beneficiaries.

5. At the death of the grantor(s)/parent(s), the death benefit proceeds can be used to equalize the inheritance passing to family members; or where estate liquidity needs exist, money can be loaned to the parent(s)' estate.

6. After the term of the payout is completed, the property remaining in the CRT is transferred to the named charitable organization.

Business Continuation

Advantages to the Owner:

- The charitable remainder trust allows the donor to transfer stock in the corporation to family members without gift or estate tax while at the same time benefiting a selected charity.
- Where the stock in the family has little basis and significant appreciation, by using a charitable remainder trust the donor can avoid capital gains tax that would have been due upon sale.
- Removing the asset from the gross estate of the grantor generates estate tax savings.
- Additional estate tax savings may be realized when the income received from the CRT is gifted to the irrevocable life insurance trust (ILIT) removing it from the gross estate of the grantor.
- Life insurance held by the irrevocable life insurance trust can be used to equalize the estate, passing value to family members who are not in the business and/or to provide cash for estate liquidity.
- Properly structured, the life insurance policy held by the irrevocable life insurance trust will not be included in the gross estate of the grantor.

Advantages to Heirs:

- The grantor's heirs can redeem the stock from the CRT for cash or an installment note and become the sole shareholders of the corporation with little, if any, adverse tax consequences to the parents or themselves.

Tax Considerations:

- The successful use of a charitable remainder trust to transfer appreciated stock requires that the transfer to the trust and the subsequent redemption of the stock not be treated as a single integrated transaction taxable to the donor. In general, the Service has not raised this issue in fact scenarios where there is no prearranged agreement binding the trustee to redeem the shares at the time the trust is created. See *Palmer v. Commissioner*, 62 T.C. 684 (1974), aff'd (on other grounds) 523 F.2d 1308 (8th Cir. 1975); *Blake v Commissioner, 697 F.2d 473 (CA-2, 1982);* Rev. Rul. 78-197, 1978-1 CB 83; PLR 9452026 and PLR 9452020. However, more recently in PLR 9512016 and PLR 9512017, where the Service held that the disposition by the trust of the shares of stock contributed by the grantor did not result in income, gain or loss to the grantor, the trust agreement provided that there would be no redemption of closely held stock contributed to the charitable remainder trust and no acquisition of the shares by any related party for at least one year.
- A charitable remainder trust cannot be a shareholder in an S corporation. This technique should not be employed where the closely held business is structured as an S corporation or the business risks losing its S status election and the right to be taxed as a flow-through entity.
- Partnerships and limited liability companies (LLCs) have no restrictions on types of owners and exempt organizations,

including charitable remainder trusts, may be a partner/member. However, the CRT generally tax-exempt, will be subject to tax on any unrelated business taxable income (UBTI). UBTI generally includes income derived from a trade or business unrelated to the organization's purpose. Tax-exempt partners/members in partnerships/LLCs that earn both UBIT and other income may want the partnership/LLC agreement to provide that the UBTI is allocated to other partners and that the tax-exempt organization receives a greater portion of the partnership's/LLC's other income. In order for such a provision to be respected, it must have substantial economic effect.

- Stock in a closely held corporation may be difficult to value – as generally there is no readily available market data. Additional care must be taken that the proper valuation techniques are employed and documentation is created to substantiate the value of the gift for federal tax purposes. This may require the services of a professional appraiser.
- A charitable income tax deduction equal to the present value of the remainder interest is permitted at the time the assets are transferred into the trust. However, when evaluating the tax efficiency of a charitable deduction it is important to consider the various imposed limitations on the extent to which contributions are deductible currently against taxable income. These include limitations imposed by the individual's adjusted gross income; as well as limitations depending on the types of organizations to which the donor has made contributions, the types of property that has been contributed and in some cases how the contributed property is used by the charity.