



Speaking Hope to the World

## **THE CHARITABLE REMAINDER TRUST**

*A SPECIAL PLANNING  
REPORT TO ASSIST YOU  
IN YOUR ESTATE &  
GIFT DESIGN*

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## THE CHARITABLE REMAINDER TRUST

When you wish additional income, capital gains tax avoidance and income tax savings from your property that is free and clear, then I invite you to consider a charitable remainder trust, a gift which will extend far beyond your own lifetime.

Here's why.

### WHAT IS A CHARITABLE REMAINDER TRUST?

A charitable remainder trust is a transfer of cash or property to an irrevocable trust which provides current payments to one or more individuals, followed by a distribution to a charitable beneficiary at the end of the trust period.

The property which you transfer to a charitable remainder trust is managed as a separate trust fund, for your benefit, and never commingled with other funds.

The trust can be established so that payments will be received for life, or it can be established to make income payments for a period of years, up to twenty years.

Because a portion of the charitable remainder trust is actually a gift to Trans World Radio, the United States Congress has passed laws allowing a special charitable deduction to you for participating in such agreements.

### ADVANTAGES OF THE CHARITABLE REMAINDER TRUST

- You receive income payable as stated in the trust agreement (monthly, quarterly, semi-annually, annually).
- You receive income tax benefits, both now and in the future:
  - Because any assets remaining at the end of the agreement are a gift to Trans World Radio, a federal income tax charitable deduction is allowed in the year in which the agreement is established.
  - There is no capital gains tax payable on appreciated property at the time of transfer to the agreement.
  - There is no capital gains tax payable if your property is later sold under the agreement.
  - Many times, it is possible to receive favorable tax treatment of your income.
- You are guaranteed income for the entire agreement period, to the full extent of the value of your property.
- You may manage your own trust, or you may choose to have the assets transferred to your agreement managed by experienced and competent advisors, eliminating management or investment worries.
- You gain valuable advantages in the avoidance of estate taxes and probate costs.
- You can design your agreement to provide a hedge against future inflation.
- But most of all, you receive a "measure of immortality here on earth," for your gift supports ideals and programs of eternal worth that will long outlast your own life.



### USE OF A TRUST

It is important for you to know that your property is not transferred to Trans World Radio, but is placed in trust for your benefit, under the control of a trustee whom you select.

The trustee can sell the property and re-invest the proceeds in other income producing property. He continues to manage the investments in order to provide income to you until the termination of the trust.

With the exception of your income payments and operating expenses of the trust, no distribution is made from the trust until the end of the trust period, at which time any property remaining in the trust is distributed to Trans World Radio.

A charitable remainder trust (which is a legal contract) will be prepared for you, which provides a guideline for the payment of income and the management of your property. As additional security, your agreement is subject to very specific trust laws.

This document, backed by the experience and capability of your trustee and the strength of your property, becomes your security.

### TYPES OF AGREEMENTS

There are two types of agreements available.

#### Charitable Remainder Annuity Trust

Payments which you receive from a charitable remainder annuity trust are based upon a percentage of the initial fair market value of the property transferred to the trust. Payments can be for life or for a designated period, not to exceed twenty years.

#### Charitable Remainder Unitrust

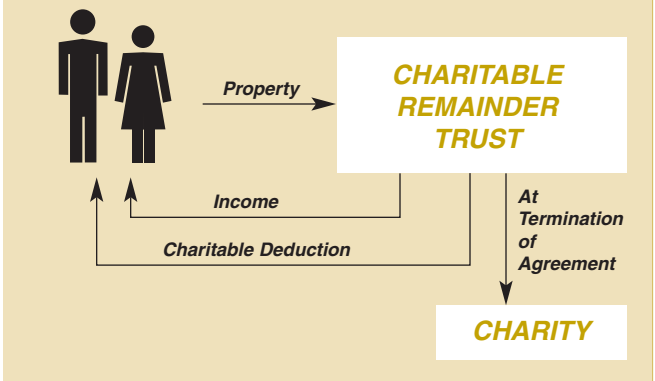
Income from a charitable remainder unitrust is determined as a percentage of the trust assets as valued annually, and will increase or decrease as the value of the trust assets changes.

An option provides for payment of the actual trust income each year, whenever the income is less than the stated percentage. When income exceeds the stated percentage, the excess is used to make up deficiencies in distribution from prior years, or is reinvested in the trust to produce increased income in future years.

Either trust is available as:

- A single life agreement, which will provide income to you for as long as you live,
- A joint and survivor agreement, which provides income to you and another for life, with payments continuing to the survivor for life,
- A survivorship agreement, which provides income to you for as long as you live and continues to pay income to a survivor for life, or
- A term of years agreement, which provides payments to be made for the entire trust period, not to exceed twenty years.

#### HOW A CHARITABLE REMAINDER TRUST WORKS



## **TAXATION OF A CHARITABLE REMAINDER TRUST**

### *Charitable Contribution Deduction*

You will be entitled to a charitable contribution deduction on your federal income tax. This can be deducted up to 50% of adjusted gross income in the year the agreement is established, providing it is funded with cash or property which has not appreciated in value.

If your property has appreciated in value, your contribution is deductible up to 30% of adjusted gross income. If the amount of the deduction exceeds this percentage, any "excess" can be carried over for up to five additional years.

When funding your agreement with appreciated property, it is possible to increase the 30% limitation to 50% of adjusted gross income (with a five year carryover for any "excess"). To qualify for the increased percentage, you must reduce the charitable deduction by the taxable portion of the appreciation. You must also make this election regarding all contributions of long term appreciated property during the year, and long term appreciated property gifts being carried over.

You should consult your own advisers for the method which would be most advantageous to you.

### *Avoidance of Capital Gains Tax*

Because your agreement qualifies as a charitable remainder trust, there will be no capital gains tax payable at the time of transfer of appreciated property to the agreement. Neither will there be any capital gains tax payable when the trustee sells the property.

There are capital gains tax implications when the gain is distributed in the form of income.

### *Taxation of Income*

The taxation of your income retains the character it had in the trust. Therefore, it will vary from year to year, depending upon the management of the trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust's ordinary income for the year (and any undistributed ordinary income from previous years).

Second, as capital gain to the extent of the trust's capital gain for the year (and any undistributed capital gain from previous years).

Third, as tax-exempt income to the extent of the trust's exempt income for the year (and any undistributed exempt income from previous years).

Fourth, as tax-free distribution of principal.

With proper design of the investment strategy, it is possible for the income received to be taxed at capital gains tax rates, rather than ordinary income tax rates. Under current tax law, this can result in income being taxed at 15% (plus state capital gains tax), rather than a maximum of 35% federal income tax rate (plus state tax). Over the life of the trust, this can provide substantial tax benefit.

The trustee will provide you with the data needed to report your trust income for federal income tax purposes.

### *Federal Gift Tax Implications*

When a husband and wife are the only beneficiaries of a charitable remainder



trust, there are no gift tax implications. However, when your agreement provides a life interest other than to a spouse, there is a taxable gift of the value of that beneficiary's interest. It is often possible to design the trust so that the gift is not deemed to be made during lifetime, by reserving the right in your will to revoke the beneficiary's interest.

### **Federal Estate Tax Implications**

There are no federal estate tax implications when a husband and wife are the only beneficiaries of a charitable remainder trust.

However, when another individual, other than a spouse, is named to receive income from the trust, the value of his or her right to receive income is taxable in the estate.

### **CASE STUDY — MR. AND MRS. JONES**

Mr. and Mrs. Jones are both 64 years of age, and are looking forward to retirement. They have been very successful in their real estate investments, and own free and clear property which has an appraised value of \$240,000. The property was purchased for \$80,000 in 1985.

While Mr. and Mrs. Jones believe the property to be an excellent investment, it does not meet their retirement income needs. After reviewing a comparison of the agreements, Mr. and Mrs. Jones decided that a charitable remainder unitrust would help them meet their immediate and long-range financial goals.

Mr. and Mrs. Jones will choose the percentage payout they wish to receive from their trust, based upon their long-range objectives, current income needs, and present tax position. The higher the payout, the lower the charitable deduction which will be available, and there will be less potential for future growth.

The following summary is designed to help them determine the payout from their trust.

### **Charitable Deduction**

When property is transferred to a charitable remainder trust, Mr. and Mrs. Jones will receive an income tax charitable deduction.

Based upon a transfer of \$240,000, the charitable deductions available at various payout rates are listed in the chart below.

Percentage Payout	Charitable Deduction
5%	\$81,295
6%	66,223
7%	54,178
8%	44,527
9%	36,756
10%	30,487

### **Future Growth of Income**

The trustee will work very closely with Mr. and Mrs. Jones to design an investment plan to meet their current needs.

In making the following projections, we have assumed a 10% total return within the trust. Because the amount of income earned in excess of the annual payout will accumulate tax-free, we can project the values to increase as follows:



Year of Trust	5% Payout		7% Payout	
	Income	Remainder	Income	Remainder
Year 1	\$12,000	\$240,000	\$16,800	\$240,000
Year 5	14,586	291,721	18,909	270,123
Year 10	18,616	372,319	21,920	313,146
Year 15	23,759	475,185	25,412	363,023
Year 20	30,324	606,471	29,459	420,841
Year 25	38,701	774,026	34,151	487,870

### Summary of Benefits

To summarize these benefits, let's assume that Mr. and Mrs. Jones establish a trust with a 7% payout.

- They will receive income equal to 7% of the trust assets, as valued annually. This provides initial income of \$16,800, increasing to over \$35,000 in 26 years, assuming 10% total return.
- In addition, they receive a federal income tax charitable deduction in the amount of \$54,178, which will provide a current income tax savings of approximately \$22,750 in their 42% combined federal and state income tax bracket.
- Assuming an \$80,000 cost basis in the property, Mr. and Mrs. Jones would have a capital gain of \$160,000 if they sold the property. However, when they transfer it to a charitable remainder unitrust, they pay no capital gains tax on the appreciation at the time of the transfer, nor when the property is sold by the trust. This will provide an additional tax savings of approximately \$35,200, assuming that they are in a 22% combined federal and state capital gains tax bracket.

- Mr. and Mrs. Jones also have the satisfaction of knowing that property which they have accumulated during their lifetimes will eventually be used to help provide financial security for the future of Trans World Radio.

### A "Flip" Trust

Since Mr. and Mrs. Jones are funding their trust with real property which must be marketed, the cash flow from the property may not be sufficient to meet the immediate payout required by the trust.

Their trust will be designed so that they receive only the income earned until the property is sold. Once the property is sold, the trust will change so that it will pay a standard percentage of income, regardless of the actual earnings in any given year. This is called a "flip trust."

### Use of Tax Savings from Charitable Deduction

The above illustration does not take into consideration the savings which Mr. and Mrs. Jones receive from the charitable deduction.

An obvious use of this tax savings would be to increase their spendable income. However, if they desire to replace the property value for personal beneficiaries,



this can be accomplished. They can gift the tax savings and increased income during lifetime directly to family members or to an irrevocable trust established for their benefit.

This will possibly allow accumulation at a lower tax bracket, and remove property from the probate and taxable estate, saving estate taxes of 41% to 55% of the property value.

Another practical use of the income tax savings would be to purchase life insurance, to replace all or a portion of the value of the property in the estate for personal beneficiaries. If life insurance is purchased, it should either be gifted to family members, or placed in an irrevocable life insurance trust, so that it will be distributed to personal beneficiaries estate tax free, at death.

### COMPARISON OF SALE WITH TRUST

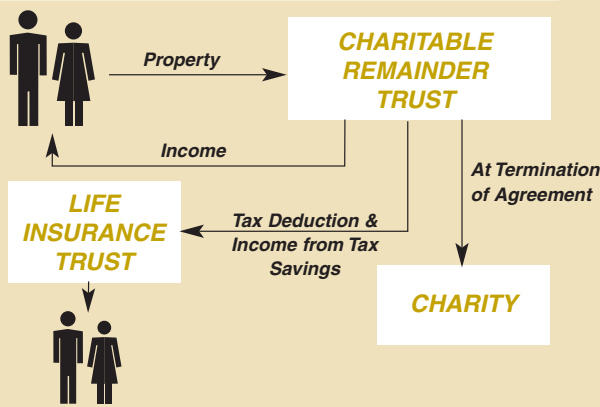
To further illustrate the benefits of the charitable remainder trust, let's compare a sale of the property with a transfer to a unitrust. To make an "equal" comparison, we will assume in both illustrations that income is distributed and compounded after tax, for life expectancy. We will also assume payout from the trust equal to trust earnings.

Our comparison will be based upon the following data:

<b>Fair Market Value of Property</b>	<b>\$240,000</b>
<b>Cost Basis of Property</b>	<b>80,000</b>
<b>Combined Income Tax Bracket</b>	<b>42%</b>
<b>Combined Capital Gains Tax Bracket<sup>1</sup></b>	<b>22%</b>
<b>Life Expectancy</b>	<b>26 years</b>

	<b>Sale Without Trust</b>	<b>Sale With Trust</b>
Tax on Gain	\$35,200	\$ 0
Charitable Deduction	0	30,487
Tax Savings	0	12,805
To Invest	\$204,800	\$252,805
Compounded Return at 10%	21,445	26,472
Retained Property Value	\$204,800	\$ 0
Tax Savings	0	12,805
Income Accumulation	1,313,389	1,621,246
Total Personal Value	\$1,518,189	\$1,634,051
Charitable Gift	0	240,000
Total Charitable and Personal	\$1,518,189	\$1,874,051

#### USE OF LIFE INSURANCE TO REPLACE ASSET VALUE



## HOW A CHARITABLE REMAINDER TRUST IS CREATED

The steps to establish a charitable remainder trust are:

- A proposal is made for your consideration and that of your personal, legal and tax advisers.
- After you have determined which agreement is desirable and beneficial to you, a request for trust is forwarded to Trans World Radio, along with information about the funding property.
- A charitable remainder trust is prepared and presented to you for review by your legal and tax counsel.
- In your attorney's office or the bank trust office, you sign the charitable remainder trust and transfer title of your property to the trustee.
- At the end of the first pay period (monthly, quarterly, semi-annually, annually), you receive your first income payment, and regular payments continue until the end of the agreement.
- You receive from your trustee all the necessary information to assist your tax advisers in claiming your income tax charitable deduction and reporting your income.

## CONCLUSION

I hope that this information on the charitable remainder trust is of interest and value to you. You will notice that it provides many tax advantages, while at the same time allowing you the opportunity to make a substantial gift to Trans World Radio.

## QUESTIONS FREQUENTLY ASKED

***Q. Are charitable remainder trusts designed for wealthy people?***

**A.** No. While the tax advantages available to people in higher income tax brackets may make the agreements more attractive from the financial point of view, many people establish the agreements with little or no tax advantage, either because of their desire for additional income or because of their charitable desires.

***Q. How financially secure is Trans World Radio?***

**A.** While Trans World Radio is financially secure, it is important to understand that the financial security of the organization is immaterial to the financial security of the agreement. Property is held by a trustee for your benefit and the strength of the property held by the trust is what provides the financial security.

***Q. Are my income payments always the same?***

**A.** With a charitable remainder annuity trust they are. With a charitable remainder unitrust, your income is determined by applying a fixed percentage to the value of the trust assets, as valued annually.

***Q. What happens to my agreement upon my death?***

**A.** If the charitable remainder trust is for your life only, upon your death the assets held in the agreement are made available to the charity to carry out its programs.

If your agreement covers the life of another individual who survives you, the agreement will continue for that life. At termination, the assets will be distributed to the charity.



On a fixed period trust, should death occur prior to termination of the trust, income continues to whomever you name to receive payments for the remaining trust period. Should you fail to name a beneficiary, trust payments will be payable to your estate.

**Q. Can I make additional contributions to my agreement?**

**A.** Yes.

**Q. When I establish a charitable remainder trust, can I withdraw the funds later?**

**A.** No. The agreement is irrevocable. To qualify for the income tax charitable deduction and avoidance of capital gains tax, the agreement must meet certain requirements, which do not allow withdrawals in excess of annual income.

**Q. Can I establish a charitable remainder trust and make another individual the beneficiary of the income payments?**

**A.** Yes, and this is often done as part of an individual's total estate plan. You should consult your tax adviser for gift tax implications.

**Q. Will my charitable remainder trust be part of my taxable estate?**

**A.** If the agreement covers your life only, the assets go directly to your charitable beneficiary at your death, avoiding estate taxes. If the agreement covers the life of a survivor other than a spouse, a portion (based on the age of the survivor) will be included in your estate. In either case, the agreement will be excluded from the probate estate.

**Q. What if my charitable deduction exceeds the maximum amount I am allowed to deduct from my income tax return in the year I establish the agreement?**

**A.** If your charitable deduction exceeds the amount deductible in the year you establish the agreement, you may carry over the excess for up to five additional years.

**Q. Is my income absolutely guaranteed?**

**A.** Under the terms of the agreement, the trustee has full responsibility to use the assets of the trust to guarantee your payments, even if this reduces the remainder for charity.

**Q. What secures my agreement when the property I transfer is sold?**

**A.** The trustee is required to reinvest the proceeds in "prudent" investments for your security. At no time is property transferred or sold without proper security in return.

**Q. I do not understand taxes. What assistance will I receive?**

**A.** You should rely upon your own counsel. However, as a service, we will provide information to assist your legal and tax counsel in securing the maximum deductions on your federal and state income tax returns. Also, the trustee will report to you annually how the income you receive should be reported for income tax purposes.

**Q. Can I remember a friend or relative by creating a trust in my will?**

**A.** Yes, you can insure that a safe, reliable income will be provided by establishing a charitable remainder trust in your will. Many times, this is better than leaving property outright.



## CITATIONS OF AUTHORITY

***Because this information is of a general nature only, and should not be interpreted as legal advice, we provide the following citations of authority for use by your legal and tax advisers, to verify its applicability to your specific circumstances.***

***Charitable remainder unitrust - description.*** Specifies that income beneficiary is to receive annual payments determined by multiplying a fixed percent (which cannot be less than 5%) by the net fair market value of the trust assets, as determined each year. On death of beneficiary (or survivor beneficiary, if more than one) charity gets the remainder. IRC §664(d)(2).

A variation calls for trustee to pay only trust income if actual income is less than stated percent. Deficiencies in distributions (i.e., where trust income is less than stated percent) are made up in later years if trust income exceeds the stated percent. Another variation provides that deficiencies are not to be made up. IRC §664(d)(3); Reg. §1.664-3(a)(1)(i)(b).

***Charitable remainder annuity trust - description.*** Specifies a fixed dollar amount (at least 5% of initial net fair market value of transferred property) which is to be paid annually to income beneficiary for life. On death of beneficiary (or survivor beneficiary, if more than one) charity gets the remainder. IRC §664(d)(1).

***How payments taxed to recipient.*** Amounts paid to the recipient retain the character they had in trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust ordinary income for the year and undistributed ordinary income for prior years;

Second, as capital gain to the extent of the trust capital gains for the year and undistributed capital gains for prior years;

Third, as other income (e.g., tax-exempt income) to the extent of the trust's other income for the year and undistributed other income for prior years;

Fourth, as a tax-free distribution of principal.

IRC §664(b); Reg. §1.664-1(d).

***Charitable remainder trusts are exempt from taxation.***

But a trust is not exempt in any year it has income which would be taxable unrelated business income if trust was an exempt organization. IRC §664(c). Payments to income beneficiary taxed as above.

***Governing instrument requirements.***

To assure charitable deductions and avoid adverse tax consequences, governing instrument must contain specific provisions. See: Reg. §1.664-1 through §1.664-3; IRC §508(e); IRC §4947(a)(2); Rev. Rul. 72-395, 1972-2 CB 340; Rev. Rul. 82-128, IRB 1982-27, 7; Rev. Rul. 82-165, IRB 1982-40, 8.

***Income tax.*** Contribution deduction allowed for value of remainder interest, computed using Treasury tables. Unitrust- IRC §170(f)(2); Reg. §1.664-3(c) and §1.664-4; IRS Pub. 723B. Annuity trust - IRC §170(f)(2); Reg. §1.664-2(c); Reg. §20.2031-10; IRS Pub. 723A.

When funded with cash or non-appreciated property, remainder interest is deductible up to 50% of donor's adjusted gross income. IRC §170(b)(1)(A); Reg. §1.170A-8. Five year carryover allowed for any "excess." IRC §170(d)(1), Reg. §1.170A-10(a).

When funded with securities or real estate held long-term, remainder interest is



deductible up to 30% of adjusted gross income. IRC §170(b)(1)(C)(i); Reg. §1.170A-8(d)(1). Five year carryover allowed for any "excess." IRC §170(b)(1)(C)(ii).

Under election, donor can increase ceiling to 50% of adjusted gross income (with five year carryover for any "excess") by making the same gift, but:

(1) Reducing the amount of the deduction for all long-term property gifts during the year by the appreciation, and

(2) Similarly reducing the deduction for long-term property gifts being carried over from earlier years.

IRC §170(b)(1)(C)(iii); IRC §170(e)(1)(B); Reg. §1.170A-8(d)(2).

**Capital gain.** No capital gain incurred on transfer of appreciated assets to trust. Rev. Rul. 55-275, 1955-1 CB 295; Rev. Rul. 60-370, 1960-2 CB 203. Nor is there capital gain to donor on a sale by trust (except as taxable under four tier system, above). Exception: Gain taxable to donor if trust assets sold and invested in tax-exempt securities pursuant to express or implied agreement between donor and trustees. Rev. Rul. 60-370, 1960-2 CB 203.

#### **Estate tax [IRC §2055(e)(2)(A)].**

One life (donor is beneficiary). Fair market value of trust principal at death included in gross estate and then deductible as charitable contribution.

Two lives (funded with donor's separate property, donor is first beneficiary and another is to be survivor beneficiary). Fair market value of trust principal at donor's death included in gross estate but deductible as charitable contribution if second beneficiary not surviving. If second beneficiary survives, charitable remainder based on survivor's age at donor's death is deductible.

**Marital deduction.** Qualifies for unlimited marital deduction as qualified terminable interest property. IRC §2056(b)(8); IRC §2523(g).

**Gift tax [IRC §2522(c)(2)(A)].** Value of charitable remainder is fully deductible, thus charitable gift is immune from gift tax. Where there is a life interest other than donor's, a gift is made to non-charity beneficiary of value of beneficiary's life interest. Value of gift depends on type of property ownership and when beneficiary's payments begin. It is possible to draft trust so that a gift is not deemed made to non-charity beneficiary by reserving right by will only to revoke life beneficiary's interest. Reg. §1.664-3(a)(4). Rev. Rul. 74-149, 1974-1 CB 157.

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**Note:** The information in this planning report is of a general nature only, and should not be interpreted as legal advice. Illustrations were calculated using a 5% mid-term AFR rate. The rate in effect in the month of a transfer or in either of the two months preceding the transfer will be used to calculate the charitable deduction available for a specific gift.

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