Example: Charitable Remainder Trust

A charitable remainder trust can allow business owners to transfer their business to heirs with minimum income and transfer tax exposure, ensure retirement income, and create a permanent legacy. In this article from Family Business Magazine, Barton J. Bradshaw, J.D. explains how.

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Proactive succession planning can help you give something back to your community while also ensuring that your needs and your family's are taken care of. A mechanism called a "charitable remainder trust," which combines charitable giving with business succession planning, is a viable option for many business owners.

This type of trust allows you to transfer your business to family members with minimum tax exposure, ensure a comfortable retirement income for yourself and create a permanent charitable legacy.
In a nutshell, a charitable remainder trust is an irrevocable trust into which a donor transfers highly appreciated assets, such as closely held corporate stock. The donor receives an income tax deduction for the gift. The stock is sold by the trust without incurring capital gains, and the owner is paid an income interest for life or some other predetermined period. At the end of this period, the underlying assets pass to the designated charity.

A charitable giving succession plan is often a good option in the following situations:

- The business owners have most of their net worth concentrated in the stock of their company and want to diversify.
- The family business owner has widely scattered heirs who would be likely to sell the stock upon inheritance.
- The family business owner wants to sell his or her stock with more favorable tax treatment.
- Stockholders want to use partial redemptions to obtain preferred tax positions.

Keep in mind that there are many ways to structure such a trust, and you should look to your legal and financial advisers for specific guidance on what best fits your situation. That said, here is a step-by-step example of how it might work:

1. Establishment of a charitable remainder trust: You would establish a charitable remainder trust (CRT) naming your church or synagogue, a community organization or other favorite charity as the beneficiary. More than one charity can be designated as a beneficiary, and you can add or delete charitable beneficiaries over the active life of the trust.

2. **Gifting of corporate stock:** You would gift all or a portion of your company stock to the trust. This gift would generate a substantial tax deduction for you based upon such factors as the value of the transferred stock, your retained income interest, and your life expectancy.

3. **Sale of stock by the trust:** The CRT sells the stock at fair market value. Under the right circumstances, the buyer could be your family business, which would then retire the stock. Your heirs would have control of the business, since their minority interest would have changed to a majority

interest when your stock was retired. If your company is not in a position to buy the stock back, the trust will look for a qualified third-party buyer.

4. **Payment of income:** Once the stock is sold, the CRT will invest the entire sale proceeds—undiminished by tax on the gain —in a diversified portfolio of securities, mutual funds or other investments. A specified portion of the income generated from this portfolio will then be paid to you as retirement income.

5. **Establishment of a wealth replacement trust:** An irrevocable wealth replacement trust is established and funded with life insurance, so as to ensure that your heirs are properly cared for. At your death, the life insurance proceeds will be paid to your family undiminished by federal estate and income taxes. A good way to fund these trusts is to use the money available from the tax deduction you received as a result of the original CRT gift.

6. **Gifting of remaining assets:** When the CRT income payout period is over—usually when both you and your spouse have died—the trustee of CRT then transfers the remaining assets to the designated charity or charities.

Remember that there's no such thing as a "one size fits all" business succession plan. The charitable remainder trust is just one of many planning ideas available to business owners. A good financial planner can help you to understand all of your options and guide you to the one that will work the best for you and your family.

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