SOLID ROCK WEALTH MANAGEMENT
WealthGuide

The Charitable Remainder Trust: A Valuable Financial Tool for the Agricultural Family

An Educational Resource From
Solid Rock Wealth Management

By Christopher Nolt, LUTCF

Introduction

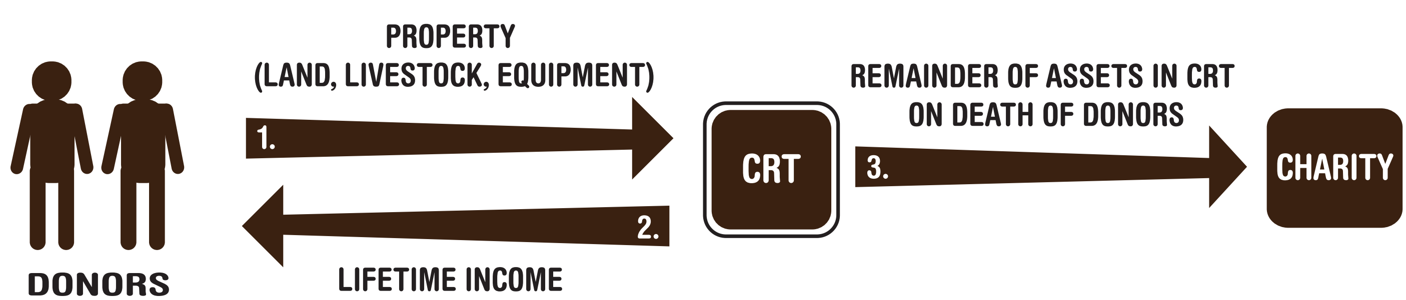
A charitable remainder trust (CRT) enables a family selling a farm or ranch to avoid or defer tax on the sale and generate lifetime income for retirement. In addition to saving taxes and generating a lifetime income, a CRT provides several other benefits:

- Potentially reduces estate taxes.
- May generate an immediate income tax deduction and a state income tax credit.
- Provides a vehicle to diversify assets for retirement income.
- Help support your favorite church and/or charities.
- Allows you to leave behind a lasting legacy.

How it works:

A donor establishes a CRT and then transfers appreciated assets (e.g., land, livestock, equipment) to the trust, removing the assets' values from the donor's estate. The trust then sells the assets and, since it is a tax-exempt entity, there are no taxes due upon the sale. The proceeds from the sale are then invested within the trust in a manner designed to provide a lifetime income for the beneficiaries. Two sets of beneficiaries are established, the income beneficiaries (generally the donor and his or her spouse), and the remainder beneficiaries (the charity or charities that will receive the principal, or "remainder", of the trust after the income beneficiaries die.)

One does not have to contribute their entire farm/ranch in a CRT. A portion of land and/or livestock and equipment may be contributed to and sold by a CRT with the rest of the property sold for cash, and/or through a 1031 exchange. Combining a CRT with a direct sale and a 1031 exchange may offer the best combination of benefits.



Types of Charitable Remainder Trusts

There are two primary types of charitable trusts. The Charitable Remainder Annuity Trust and the Charitable Remainder Unitrust.

The Charitable Remainder Annuity Trust (CRAT)

A charitable remainder annuity trust pays a fixed dollar amount each year to the beneficiaries. The trust continues for the life of all income recipients, or for a specified term of years not to exceed 20. Upon the death of all beneficiaries or the end of the specified term, the remainder goes to the charity or charities named. Since charitable remainder annuity trusts provide for only a fixed amount being paid out each year, this type of trust cannot take advantage of future growth or higher earnings of the assets in the trust. However, this trust does offer the security of consistent income, even in a flat market. Due to the fixed income payout obligation, additional contributions to an existing CRAT are not allowed.

The Charitable Remainder Unitrust (CRUT)

The charitable remainder unitrust pays a percentage of the trust's value each year to the donor or to others named. The donor selects the percentage at the time the trust is created. The percentage must be at least five percent and not more than 50 per cent of the fair market value of trust assets, as re-valued annually. Following the death of the lifetime beneficiaries, or at the conclusion of the term specified in the trust, the trust property goes to the charity or charities named. Some charitable remainder unitrusts offer a "make up" clause. If the trust does not have enough income to make the annual payments, the shortfall will be added to the following year's distribution. Additional contributions to a CRUT are allowed.

The Internal Revenue Code requires that at least 10% of the net fair market value of property contributed to a charitable remainder trust, as of the date of contribution to the trust, must pass to charity.

Tax Benefits From Contribution of Land to a CRT

Tax savings are one of the main benefits of charitable remainder trusts. These trusts can provide the following tax benefits on contribution of land to a CRT:

An immediate income tax deduction

Donors of land to a CRT receive an immediate income tax deduction based on the present value of the charity's remainder interest. This figure is based on a formula and calculated using planned giving software. The amount of the tax deduction depends on factors such as the value of the trust property donated to the CRT, the amount of income or the percentage of principal paid annually by the CRT, the age of those receiving income generated by the CRT, and discount rates set by the IRS.

The charitable deduction can be used to offset income in the year the gift, and any unused deduction can be carried forward up to five years. If appreciated property is donated, the deduction is limited to 30% of the donor's adjusted gross income.

Many people choose to leave assets to charity upon their death. While gifts to charity upon death reduce the value of an estate and may help reduce estate taxes, their income tax benefits can only offset any income in your estate. The advantage of giving during your lifetime is that you reduce the value of your estate for estate tax purposes and you fully benefit from an income tax deduction while you're alive.

State Income Tax Credit

In some states such as Montana, donors may also be eligible for a state income tax credit. Montana's tax credit, called The Montana Income Tax Credit for Endowed Philanthropy, provides a credit against state income tax liability in the amount of 40% of the present value of any planned gift to a permanent endowment of a Montana charity up to a maximum amount of $10,000 per year per taxpayer. [Applies to individual or business entity taxpayers.]

Taxes Bypassed on Sale

Assets contributed to a CRT can be sold free of any income tax and the Medicare Surtax to the donor. This is particularly significant if there are highly appreciated assets involved such as real estate. By saving capital gain taxes, the money that would have gone to paying tax can be used to generate income for retirement.

Federal estate and gift tax savings

Assets contributed to a CRT are removed from the donor's estate, thereby reducing the value of the donor's estate for estate tax purposes. Since the assets are not part of the donor's estate, future estate tax may be reduced or avoided entirely. Also, the CRT is not subject to executor's fees or other probate costs.

CRT is income tax exempt

A CRT itself is tax-exempt and pays no income tax or Medicare Surtax on interest, dividends, rents or capital gain. Thus, a CRT does not pay any federal income tax.

Taxation of income from CRT

The income donors receive from a CRT retains the character it had inside the CRT. Each payment is taxable in one of four categories, in the following order of priority:

- First, as ordinary income to the extent of the CRT's ordinary income for the year.
- Second, as capital gains to the extent of the CRT's capital gains for the year.
- Third, as tax-exempt income to the extent of the CRT's exempt income for the year.
- Fourth, as a tax-free return of principal.

Trustees of CRT's will generally provide you with information on how to report the CRT payments on your tax return.

Selling Livestock, Crops and Equipment in a CRT

In addition to land, livestock, crops and equipment can also be sold in a CRT.

Sale of Calves and Crops

Proceeds from the sale of calves and crops are treated as ordinary income and incur Self-Employment tax (Social Security tax and Medicare tax). The same calves and crops sold in a CRT may avoid or defer these taxes otherwise due on the sale. This allows the full proceeds from the sale of the calves and crops to be invested inside the CRT and generate lifetime income for the donors. Contribution of calves and crops to a CRT does not generate a charitable income tax deduction for the donor.

Sale of Cows

Proceeds from the sale of raised livestock such as cows are capital assets and incur capital gain tax and the Medicare Surtax. The same cows sold in a CRT may avoid or defer these taxes otherwise due on the sale. This allows the full proceeds from the sale of the cows to be invested inside the CRT to generate lifetime income for the donors. Contribution of cows generates a charitable deduction based on the donor's basis in the cows.

Sale of Equipment

The recapture of depreciation on the sale of machinery, equipment or other depreciated property is treated as ordinary income. These same assets sold through a CRT can avoid or defer this tax and the Medicare Surtax and the full proceeds invested to generate lifetime income for the donors. Contribution of equipment generates a charitable deduction based on the donor's basis in the equipment.

Wealth Replacement: CRT and Life Insurance

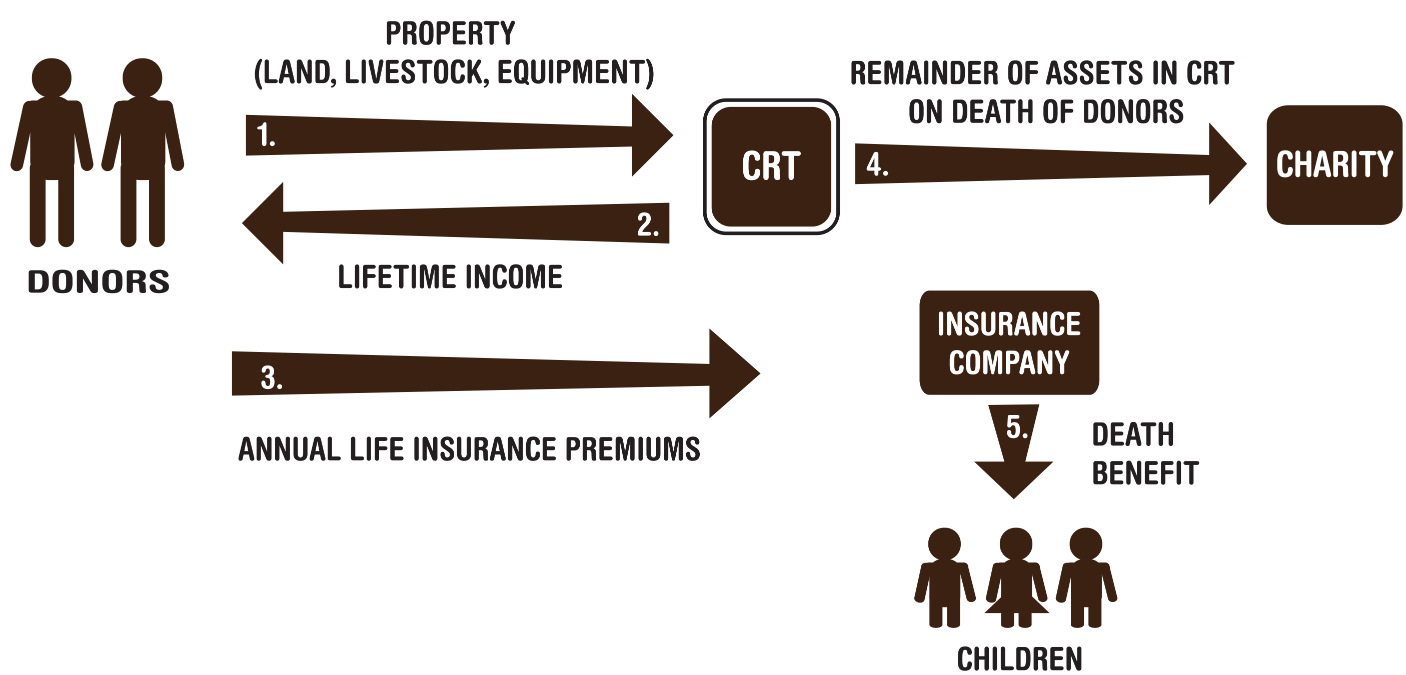
A common concern among those using a CRT is replacing the wealth given to a CRT for their kids. Life insurance is often used in conjunction with a CRT for this purpose. Donors can use income they receive from the trust to purchase life insurance on their lives with their heirs ultimately as beneficiaries. The life insurance premiums are largely offset by the higher income received from the CRT and through the savings from the income tax deductions.

Irrevocable Life Insurance Trust (ILIT)

There are ownership issues associated with life insurance that impacts whether or not the death benefit proceeds are included in an estate. The IRS states that if there are "incidents of ownership" in the policy, it will be included in a person's estate. Incidents of ownership can include the right to borrow on a policy's cash value, to change the policy's beneficiary, to change a settlement option, and the right to change the dividend selection. If the insured person(s) were to retain outright ownership or merely incidents of ownership in the policy, the proceeds of the policy would be brought into the estate for estate tax purposes. However, when an irrevocable life insurance trust owns a life insurance policy and the payments are structured properly, the death proceeds can be received by the family income tax free and not be included in the insured's taxable estate.

How it Works

1. Donors transfer property to CRT.
2. The CRT pays donors a lifetime income.
3. Donors pay annual life insurance premiums to an insurance company. (If an ILIT is used, donors gift the annual premium dollars to the trustee of ILIT and the trustee sends the premiums to the insurance company).
4. Upon the donor's death, the CRT terminates and the remainder of assets in CRT passes to charity
5. Upon death of donor(s), life insurance proceeds are paid to children (or to the ILIT and then the children).



Estate Equalization

A common dilemma with agricultural families is the challenge of how to provide a fair inheritance to all children. This is especially true in situations where there are multiple children and a farm/ranch is willed to a child who is working on the farm/ranch. Because most agricultural families have little assets outside of their farm/ranch to leave to their off-farm children, life insurance is often purchased with the off-farm children as beneficiaries. If an ILIT is structured correctly, proceeds from a life insurance policy are received by the heirs free of income and estate taxes.

If coming up with the cash each year for the annual life insurance is difficult, a family can sell a portion of their land through a CRT and use the income from the CRT to purchase the life insurance. While the family may not want to sell property to fund the life insurance, this may be the most effective solution for equalizing an inheritance among heirs.

To learn more about using life insurance with an agricultural family, request Wealth Guide titled: Life Insurance: An Effective Estate Planning Tool for the Agricultural Family.

Hypothetical Example

The following is a hypothetical example of a married couple in Montana both age 65 selling a highly appreciated $5 million ranch through a CRT. An illustration below compares the sale of this ranch with and without a CRT.

Assumptions:

Beneficiary Ages	65, 65
Value of Ranch Land Donated	$5,000,000
Cost Basis of Property	$500,000
Payout Rate	7%
Payment Schedule	Quarterly

Benefits:

Charitable Deduction*	$1,113,100
Estimated Payments in First Full Year (future payments will vary with trust value)	$350,000

Comparison of selling ranch with a CRT and without a CRT

	Sale w/o CRT	Sale w/ 7% CRT
Taxes Due**	$1,246,000	$0
Est. Annual Cash Flow Before Tax***	$262,745	$350,000

*If a 6% payout was used in this CRT, the charitable deduction would be $1,364,600. If a 5% payout was used, the charitable deduction would be $1,679,550.

** Assumes 23.9% combined federal and state capital gains tax and 3.8% Medicare Surtax on all capital gains.

***Assuming 7% average annual return on investments inside and outside of CRT.

This example is for illustration purposes only.

Conclusion

A CRT provides many potential benefits for an agricultural family.

- It can be used to save tax on the sale of appreciated land and on the sale of livestock, machinery and equipment.
- The full sales proceeds can be invested which allows a family to generate more retirement income as opposed to investing after tax proceeds from a straight sale.
- Provides a vehicle to diversify assets for retirement income.
- It may reduce or avoid estate taxes.
- It can be used to fund a life insurance policy to equalize inheritance among on and off-farm heirs.
- It can benefit one's favorite church and/or charities.
- It can provide a lasting legacy for the donors.

If you would like to learn more about how a charitable remainder trust could benefit you, please call 406-582-1264 for more information. For a detailed analysis showing how a CRT can work with the sale of a farm or ranch, request the Wealth Guide titled Financial Strategies for Selling a Farm or Ranch.

Chris Nolt is the owner of Solid Rock Wealth Management, Inc. and Solid Rock Realty Advisors, LLC, with offices in Bozeman, Montana and Fountain Hills, Arizona. Solid Rock Wealth Management and Solid Rock Realty Advisors specialize in working with families who are selling a farm/ranch or other business and transitioning into retirement. We help our clients to save tax on the sale and to create passive income from sale proceeds. We employ a comprehensive planning approach with a team of financial professionals, which addresses retirement planning, investment planning, estate planning, tax planning, charitable giving and risk management. Our wealth preservation strategies are designed to help our clients reduce taxes increase retirement income and maximize the amount of wealth they pass on to their heirs and favorite charitable organizations.

Solid Rock Wealth Management

Solid Rock Wealth Management is an independent, fee-only registered investment adviser. We offer globally diversified portfolios of no-load, low-cost institutional asset class mutual funds and exchange traded funds. Are portfolios are diversified among as many as 15 asset classes and market sectors and are comprised of holdings in roughly 12,000 companies in 45 different countries. Our model portfolios range from conservative (100% fixed income) to aggressive (100% equities) and are designed to achieve optimal returns for your level of risk tolerance.

Solid Rock Realty Advisors

Solid Rock Realty Advisors assists investors who are seeking secure income producing real estate investments. We specialize in office buildings leased to the U.S. Federal Government and primarily work with investors who are purchasing properties through a 1031 tax-deferred exchange. These fee-simple real estate properties offer long-term leases guaranteed by the full faith and credit of the U.S. government with competitive cap rates and professional property management.

Chris Nolt, LUTCF

Chris grew up in Lewistown, Montana. He received a Bachelors degree in business from Montana State University in 1987 and entered the financial services industry in 1989. Working on ranches throughout his high school and college days, Chris gained a deep respect for the work ethic and character of the agricultural family. Having seen the effects from a lack of good financial planning among the agricultural community, Chris determined to help these families make smart decisions with their money so they could preserve the wealth they worked so hard to create. For over 25 years, Chris has been helping farm and ranch families to reduce taxes, invest wisely and preserve their wealth. Chris has earned the designations of Certified Retirement Financial Advisor and Life Underwriter Training Council Fellow.

For more information or to request other Wealth Guides, call 406-582-1264 or send an email to: chris@solidrockwealth.com

SOLID ROCK
WEALTH MANAGEMENT
PLAN • GROW • PRESERVE

www.solidrockwealth.com

SOLID ROCK
REALTY ADVISORS
SECURE INCOME PRODUCING PROPERTIES

www.solidrockproperty.com