Halliday Private Trust
*Integrated Trust Solutions for Clients*

# Trust Connection

A Monthly Report of Trust News and Information June 2017

Welcome to *Trust Connection*, our monthly newsletter highlighting Trust news and information. Each month we will feature timely articles of interest.

## About Us

At Halliday Private Trust, it is our mission to assist our clients in the process of providing solutions, specifically through a wide range of financial advice.

Since 1982, we have utilized a full spectrum of financial services to help our clients navigate every major hurdle in their financial lives. Because we are an independent financial services firm, we utilize an open architecture approach to locating the most suitable investment options for our clients.

Our role is to help clients make smart decisions about their money. We understand that each client has unique needs and requires personalized solutions based on their goals, objectives and concerns.

## Selling Assets without Incurring Capital Gains Tax

A common occurrence in the investment world, whether an investment in securities, real estate, artwork, business, or baseball cards, occurs when an asset has appreciated greatly in value and the sale of the asset cannot be considered because of capital gains tax. For nearly 50 years, the option of creating a Charitable Remainder Trust (CRT) has been available to help taxpayers avoid paying capital gains tax upon the sale of a highly appreciated asset and reinvest the full proceeds of the sale to generate a greater income flow.

CRTs have been out of favor for many years now for a number of perfectly valid reasons, several of which have recently changed, bringing this old technique back into focus for many trust advisors.

### *Example of the Impact of a CRT*

Doris and Don Small, ages 66 and 67 respectively, own a piece of property that was purchased for $200,000 and is now worth $2,000,000. If they choose to sell the property, it would generate $1,800,000 in long-term capital gain. That gain, at a 23.8 percent tax rate would cost $428,400, leaving $1,571,600 net to invest. At a 5 percent return, that should produce an annual income of $78,580 for life.

If they could sell the property without capital gains tax, they would generate 5 percent on $2,000,000, which equals $100,000 per year. Losing $428,400 to capital gains tax reduces their potential income by $21,420 per year. If they could save the $428,400 in capital gains tax, earn another $21,420 annually, as well as reduce their estate tax by $800,000 and receive an income tax deduction of around $500,000, would it be something to consider?

### *Who should consider a CRT?*

While certainly not right for everyone, in the proper circumstances a CRT is worth consideration. So what qualifies as a proper circumstance?

- Willingness to sell highly appreciated asset(s)
- Desire to convert an asset into an income stream
- Desire to get tax advantages
- Desire to benefit a cause
- Willingness to give up future flexibility for these advantages

### *How a CRT works*

The CRT is an irrevocable trust. The Internal Revenue Code gives certain tax advantages, but they are for special circumstances and special behaviors.

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A LOCAL TRUST SOLUTION

Call us today at (800) 786-1598 to learn more about working with Halliday Private Trust.

For information and assistance, please feel free to contact one of our Trust Advisors:

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When assets are given away, their cost basis is generally transferred as well. There is no exception when assets are given to an irrevocable trust, which now holds the highly appreciated asset. The trust then sells the property for diversification and/or income production purposes and triggers the capital gains tax. But, by the magic of trust accounting, the gain is attributed to the remainder beneficiary and thus taxed to the trust, not the income beneficiary in the year of sale. Since the remainder beneficiary in a CRT is always charity, the trust is tax exempt and the gain is not taxed in the year of sale. The trustee is then free to reinvest the capital to achieve greater diversification and often greater income or more consistent total return objectives. The payout amount is defined in the document and not related to the actual income earned by the trust.

In general, the older the client, the higher the payout is allowed, assuming a life expectancy payout. So that addresses the capital gains tax savings and increased income stream. The estate tax savings is due to the fact that the CRT transfers to charity and the estate receives a 100 percent estate tax deduction versus a taxable transfer. This is a deterrent to some who have little charitable intent and would like to have the assets to pass to family after death, yet this can often be achieved by taking some of the excess income and gifting it into an irrevocable life insurance trust (ILIT) whose proceeds benefit the family and which, when properly structured, will keep the insurance out of the estate of the decedent.

Finally, consider the income tax deduction, which is easy to understand but hard to calculate. The grantor has irrevocably set aside money for benefit of charity under a formula specified in the Internal Revenue Code and therefore gets an income tax deduction today for a transfer to charity that will take place in the future. The deduction amount is the present value of the future interest dedicated to charity.

### *What changed to make CRTs attractive again?*

CRTs do best with the sale of a highly appreciated asset, and therefore the recent financial crisis and market turmoil in virtually every asset class did no favors to the market value of assets in general. But with the stock market at record highs and real estate recovering, there is broad reason to believe that many who held their assets through the depressed values of the crisis may be looking to sell during the recovery.

CRTs provide some of their greatest benefits in times of high tax rates, especially the long-term capital gains tax rate. Recently, when long-term capital gains were taxed at 15 percent, the advantages of a CRT were not as dramatic as when the rate increased to 20 percent, or when the Affordable Care Act added another 3.8 percent in high incomes for a total of 23.8 percent. The higher tax rates are, the more dramatic the savings and the greater the impact of the income tax deduction and estate tax savings.

A factor that is just beginning to change is interest rates. CRTs calculate the greatest benefit in high interest rate periods because this return assumption plays a key role in validating the trust through the multiple tests it must pass to ensure that charity will receive a benefit, and the value of that benefit, and therefore the tax deduction, is predicated on the assumed earnings in relationship with the annual payout. Given the multiple versions of CRT, the law allows that there are ways to offset these effects.

### *Summary*

If you are considering the sale of an appreciated asset that you would like to convert into an income stream, make sure to ask your advisors about a Charitable Remainder Trust and whether the benefits of this type of trust might be appropriate for your situation.

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