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THE "NEW MATH" OF GIVING:

Division Equals Multiplication

Owners of appreciated assets sometimes confront the dilemma of being "locked in" to low-basis, low-yielding property. The "lock," of course, is the Internal Revenue Code, which exacts the usual "pound of flesh" if the owner sells such an asset in order to generate greater income. That's the dilemma: The <u>income</u> potential of the asset can't be realized unless a significant portion of the <u>principa</u>l value is shipped off to Washington, D.C., never to be seen again.

A planning tool known as a "charitable remainder trust" ("CRT") allows the owner to divide the asset into parts so that <u>more</u> than its full value can be realized.

Let's look at an example. In a typical case, Ben E. Factor owns 600 acres of farmland valued at $2,000 per acre. (Remember: This tool works with any kind of low-basis, low-yielding asset -- not just real estate. Family businesses are favorite "gifts" when a CRT is used.) Ben bought the land years ago at $200 an acre. He is ready to retire from farming, and there is no family member to step in and take over. He could collect rent from another farmer and earn 4% pre-tax return on his capital, or he could sell the farm and pay $200,000 or more in state and federal taxes. Neither alternative looks good.

The charitable remainder trust comes to the rescue. First, Ben transfers the farm to the trust. Since the trust itself is tax exempt, the trustee can sell the property without paying capital gains tax.

Then, under the terms of the trust, a division takes place: The trust provides that Mr. Factor (and other individual beneficiaries, if he wishes) will receive an annuity for life. That income is the <u>first</u> part of the trust.

The <u>second</u> part is what's still in the trust when the last life income beneficiary dies. The trust assets are then distributed to an institution qualified to receive tax-deductible contributions under the Internal Revenue Code.

Because the remainder beneficiary is a charity, Ben gets an income tax charitable deduction based upon the full fair market value of the farm when he first made the transfer to the trust. If the deduction is more than he could use (as it often is), he can carry it forward for five years.

He uses the additional cash generated by the tax deduction and by the income from the trust to pay the premium on a life insurance policy. The policy proceeds would be paid to an irrevocable trust, structured so that it would not be included in his taxable estate at his death. (Our occasional paper entitled "How to Start Your Own Bank" tells you about such trusts.) The irrevocable trust will thus pay Ben's children the same amount they would have received if Ben's will had left them the farm outright, except in that case, Uncle Sam would have been their "partner."

The results? Ben gets the full amount of the income he needs from the property. The charity gets the full value of the property after Ben's death. Ben's children get the full value of their after-tax inheritance.

Dividing the property enables everyone but the government to benefit from the multiplied value.

About the author . . .

BRUCE R. JOHNSON, ESQ.
JOHNSON & ASSOCIATES
35 THIRD STREET
DOVER, NEW HAMPSHIRE 03820
(603) 609-0155   (603) 516-0550 FAX
bruce@legacylaw.net