

ESSENTIAL PLANNING OPTIONS FOR OLDER CRTs

Prepared by CRT Experts, LLC

Over the last two decades, the team at CRT Experts has reviewed more than 10,000 charitable remainder trusts (CRTs), and where misalignments were found, helped advisors implement planning to resolve them. In our experience – and as intuition would suggest – misalignments are most commonly found in older trusts, those created 10 to 15 years ago or earlier. This observation, coupled with recently released data from the IRS showing the age distribution of CRTs in existence today, leads to a clear conclusion: the majority of outstanding CRTs have reached a critical juncture in their lifecycle, where proactive secondary planning is not just appropriate but often essential. For advisors, this represents both a timely opportunity and a professional imperative: revisit existing CRTs and ensure clients – especially those with older trusts – understand the flexible, often overlooked options available to them today.

In this report, you'll find:

- Background on the aging CRT marketplace
- Why secondary planning is more relevant now than ever
- Solutions for addressing CRT-client misalignments

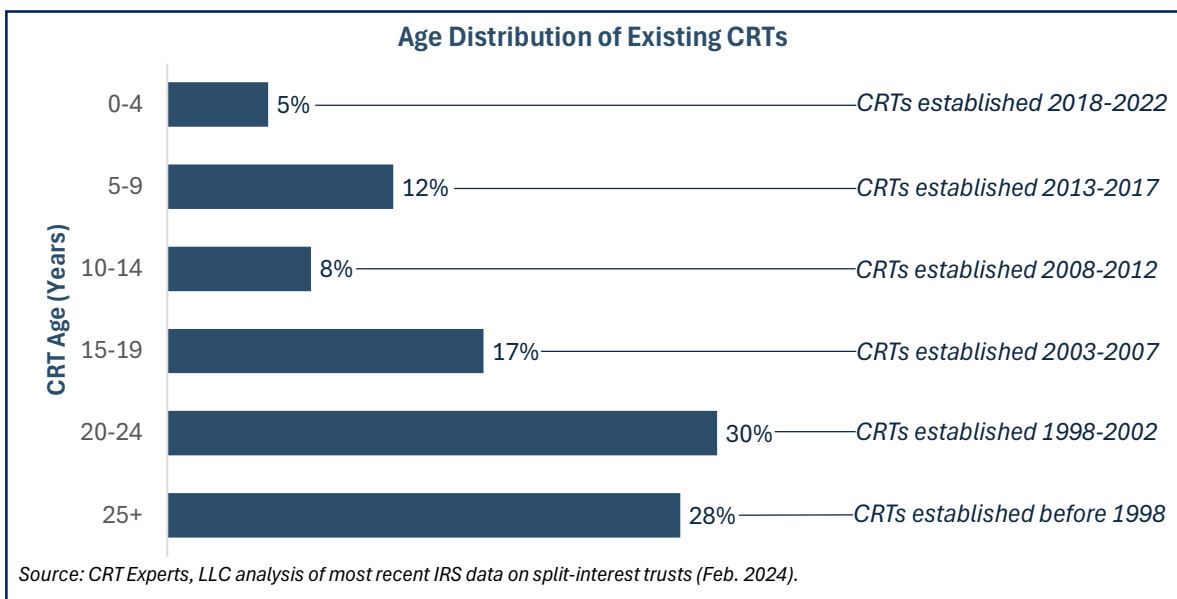


Background on the Aging CRT Marketplace

According to the latest IRS data, most CRTs in existence today are more than 20 years old. On the surface, this may seem counterintuitive. We would expect the percentage of outstanding CRTs to decline as trust age increases – the older the CRT, the more likely it is that the income beneficiaries have passed and the CRT no longer exists. But the opposite is true. The reason: fluctuations over time in the appeal of CRTs, and in turn, the number of CRTs created.

Several factors influence the creation of CRTs across different environments, but the most significant is an elevated capital gains tax rate. IRS data reveals that far more CRTs were established prior to 2003 than in the years since. The difference is so substantial that it outweighs the attrition of many pre-2003 CRTs that no longer exist. This trend aligns with the timing of the 2003 capital gains tax rate reduction, when the rate dropped to 15%, making the earlier spike in CRT formations unsurprising.

There are roughly 90,000 split-interest trusts – either charitable remainder trusts or charitable lead trusts – in the United States. The vast majority, approximately 93%, are CRTs. Of these CRTs, about 58% were established before 2003. Expanding the window to include those created from 2003 to 2007, and therefore at least 15 years old, raises the total to 75% of all active CRTs.



**75% of outstanding CRTs are more than 15 years old.
83% are more than 10 years old.**

What's significant about this fact from an advisor's perspective is that these older CRTs fall squarely within the timeframe when misalignments between the trust and the client's current circumstances are most likely to arise – making this the period when CRT secondary planning is not only most relevant, but often most necessary.

Why Secondary Planning Is More Relevant Now Than Ever

At CRT Experts, we've looked at more than 10,000 CRTs over the last 24 years. Our data indicates that, generally, misalignments start to occur 10-15 years from trust inception. This is when we recommend advisors start sitting down with clients to see if their CRT is still working as intended.

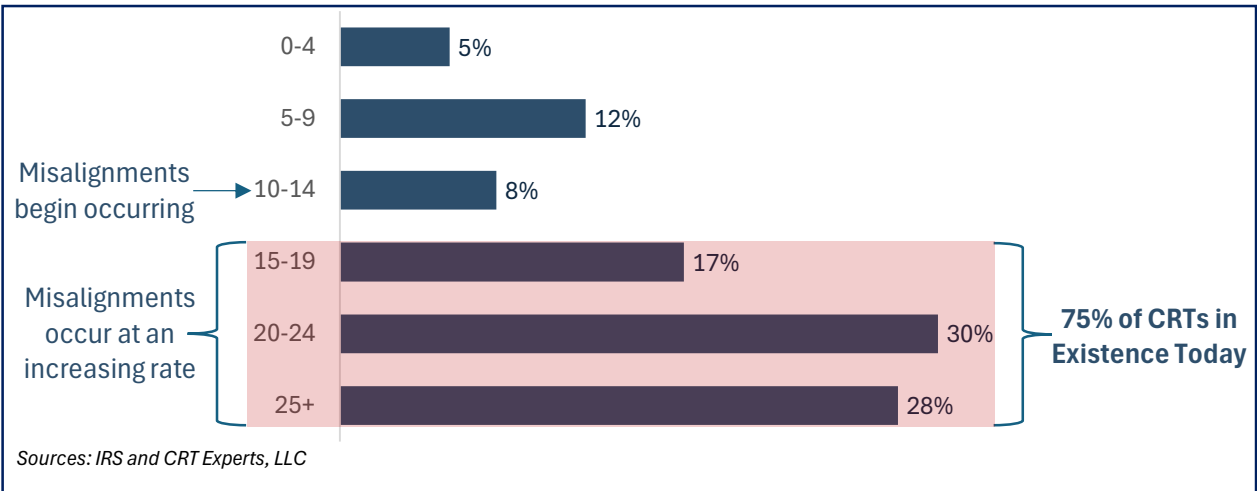
Moving forward (15 or more years since trust inception), the misalignments occur at an increasing rate. Again, this isn't surprising. The older the CRT, the further we are removed from creating the trust, the more things will have changed for the client, and the likelihood of a misalignment is greater.

Consider the prior two observations in tandem:

1. IRS data confirms that 75% of CRTs are more than 15 years old.
2. CRT Experts' data indicates that CRT misalignments begin occurring 10-15 years after the CRT's creation and subsequently occur at an increasing rate.

This leads to a clear conclusion: considering the age of most existing CRTs – and the clients who established them – the need for effective CRT secondary planning has never been more timely or relevant than it is today.

The conclusion is just as evident when viewed graphically. The following chart overlays the IRS data on existing CRTs with CRT Experts' findings on when CRT misalignments most commonly arise.



Clearly, a large majority of CRTs in existence today are of the age when misalignments between the CRT and the client’s current situation are most likely.

The Importance of CRT Reviews

In many ways, a client’s CRT planning is no different from their investment, estate or tax planning. As the client ages, the planning should be reviewed to ensure it is the optimal planning for the client’s situation at the current time, and adjustments should be made as necessary. For example:

- Financial advisors adjust investment portfolios as clients approach and enter retirement.
- Attorneys update trust and estate plans when clients experience significant life changes like births, divorces, remarriages, or shifts in wealth.
- CPAs help clients make strategic tax moves when changes in tax rates are anticipated.

Does any of this mean the previous planning wasn’t a good fit when it was implemented? Of course not. The advisor is simply adjusting the client’s planning so it is the best fit with their current situation. In this way, CRTs are no different, and evaluating the continuing usefulness of a client’s CRT should be a routine part of any regular financial or trust and estate review.

But when it comes to client awareness, CRTs are different. The irrevocable nature of the trust often leads to the (mis)perception that the trust is a “lifetime lockup,” and

because CRTs are relatively uncommon, there is not the general awareness that exists with more common types of planning. Clients know they can sell their house when they wish to downsize, adjust their investment portfolios as they grow older, and update their estate plans when grandchildren arrive. But most are unaware of the options they have concerning their CRTs.

Evaluating whether a client’s CRT still meets their needs should be a routine part of every financial or estate planning review. With most CRTs now decades old – and the clients who established them aging – this assessment is more critical now than ever.

Solutions for Addressing CRT-Client Misalignments

In most cases, CRT misalignments can be corrected through the use of proven techniques, collectively known as *CRT secondary planning*.

Although each CRT secondary planning technique leads to a different outcome for the client, from a tax and legal perspective, they are all possible because the IRS views the income interest in a CRT as a capital asset (see Rev. Rul. 72-243, 1972-1 C.B. 233). This means that, like other capital assets – such as stocks, bonds, and real estate – a CRT income interest can be sold, donated to charity, or used to create a new CRT with revised terms. In most cases, at least one of these secondary planning options can effectively resolve the CRT-client misalignment.

Option 1: Sale of CRT Income Interest

The sale option is a viable solution when a client wishes to exit a CRT for any reason. It is especially suitable when the client wishes to achieve the maximum value personally. The client receives cash that is taxable at the current capital gains rate. The income stream is redirected to a third-party buyer.

By selling, the client converts future CRT income into a cash payment today. They also lock in the capital gains rate on future CRT income and get rid of all of the CRT’s administrative responsibilities. The buyer gains an income stream and takes

over all future administrative responsibilities for the CRT.

The CRT itself does not change. The life of the CRT is still linked to the seller's lifetime, the payout rate remains the same, and the principal still goes to charity upon the seller's death. The only difference is that the buyer gets the future income in exchange for cash paid to the seller.

Why people choose to sell

The reasons people sell their CRT income interests far outnumber the reasons they initially set them up. Most CRT creations are driven, in one form or another, by tax considerations. Most sales of CRT income interests occur because something has changed since the CRT was created and the CRT isn't the perfect fit it was when it was created.

Often, this misalignment is simply the result of an unchangeable trust and the inevitable changes in the donor's life over the long duration of the trust. In these instances, the CRT is typically viewed as having "run its course," with no explicit dissatisfaction regarding its creation or performance over the years. In other cases, the root cause of the misalignment can be traced to one of two primary categories: personal circumstances or financial and tax-driven factors. Some common examples follow.

Personal

- Desire to simplify financial affairs
- Life changes (divorce/remarriage, death of a spouse, etc.)
- Desire to transfer more assets to family
- Change in health status

Financial/Tax

- Need for liquidity
- CRT is distributing income the client doesn't need, creating unnecessary taxable income
- Underperforming NIMCRUT
- Risk reduction (e.g., mortality, stock market)

No matter the reason, if the client's goal is to exit their CRT and receive the most financial value in the process, the sale is going to be the preferred option in virtually all cases.

Selling a CRT income interest works for clients who:

- Want to maximize the after-tax value they receive when exiting a CRT.
- Are looking to simplify their financial affairs.
- Prefer liquidity now over future trust income, to better position assets for heirs.

Option 2: CRT Rollover

A CRT rollover is a planning technique designed to meet the needs of clients who wish to change something about their existing CRT. Most are interested in finding ways their children or other family members can receive some or all of the remaining value from their CRT. Some are interested in deferring or forgoing unneeded income from the CRT to avoid the related tax. Others have a mix of these goals. With a rollover, these clients create a new CRT – with terms in line with their current objectives – and use their existing CRT income interest to fund/monetize the new CRT. Below are several situations, based on actual cases, which illustrate some of the benefits of a CRT rollover.

Adding Children/Income Deferral

Margaret and her late husband Steven established a 6% Standard CRUT (SCRUT) over 20 years ago. The trust worked well in its early years but had run its course. Margaret had two objectives: (i) remove the CRT's taxable income stream from her financial picture, and (ii) shift the CRT's remaining financial benefit to her children. By rolling the SCRUT to a Net Income with Makeup CRUT (NIMCRUT), she was able to add her children as successor income beneficiaries and defer her own income distributions, allowing the trust assets to grow tax-free. The rollover not only ensured future income for her children after her passing but also provided Margaret with an immediate income tax deduction and removed a taxable income stream she didn't need.

Remarried Man Adds Younger Wife

Victor established an 8% SCRUT as part of a strategy to sell appreciated real estate. At the time, he was divorced and named himself as the sole income beneficiary. Ten years later, Victor remarried – a woman 18 years younger – and grew concerned that she would suffer a cut in living standards after his death, when the SCRUT income would end. To address this, Victor rolled his existing SCRUT interest into a new SCRUT and added his wife as a beneficiary. While his annual income decreased slightly, the payments will now continue for his wife’s lifetime after his passing, ultimately resulting in significantly more income than he would have received under the original trust.

Using CRUT for Grandchildren’s College

Ron and Susan have five grandchildren, ranging in age from 2 to 10, and want to support their future college expenses. To do so, they rolled their 7% SCRUT into a new Flip CRUT. The trust is structured to “flip” into a SCRUT when their eldest grandchild turns 18. At that point, income distributions will begin going to the grandchildren and be taxed at their generally lower rates. Until then, while the trust operates as a NIMCRUT, the assets can grow tax-deferred, maximizing potential value for future education funding.

A CRT rollover works for clients who:

- Don’t need the income their CRT is currently distributing and would prefer to avoid the associated taxes.
- Are not interested in converting future CRT income into a lump-sum cash payment (sale option).
- Would rather see the trust benefit children or other family members instead.

For clients in this position, a CRT rollover can be an effective solution. It repurposes their current income interest to benefit children or other family members, lowers their own taxable income, and generates an immediate tax deduction equal to the IRS value of the new CRT’s remainder interest.

Option 3: Gift of CRT Income Interest

Clients who do not wish to receive any value for their income interest can gift it to the CRT's charitable beneficiary. This doesn't create any taxable income for the client, and creates a charitable deduction equal to the IRS value of the income interest donated. The result is termination of the CRT with all of the assets going to the charitable beneficiary.

In order to claim the charitable deduction, the client will need to file a Form 8283 (for the non-cash contribution) and obtain a qualified appraisal, even if the CRT holds only cash and marketable securities.

Gifts of a CRT income interest to charity works for clients who:

- No longer need the income the CRT is distributing and want to avoid the associated taxes.
- Are not interested in converting future CRT income into a lump-sum cash payment (sale option).
- Do not wish to transfer additional assets to heirs (rollover option).

Comparing the Objectives and Outcomes

Because each secondary planning option creates a distinct outcome and addresses a different set of client objectives, selecting the appropriate option is usually a straightforward process. Once the client is made aware of their options, a decision usually follows quickly and easily.

Client Objective	Best Option
Maximum to <u>Client</u>	Sale of Income Interest
Maximum to <u>Heirs</u>	CRT Rollover
Maximum to <u>Charity</u>	Gift of Income Interest

The key, of course, is making sure clients are aware of these options.

The Value of Regular CRT Reviews and Client Communication

Many clients don't realize that their CRT income interest is a capital asset, let alone that they have the flexibility outlined in this report. Because the trust is irrevocable, they often mistakenly view it as a lifetime lock-up. Helping them understand that their income interest can be treated similarly to investment real estate, publicly traded securities, or closely held stock can shift that perception and open the door to more informed decision-making.

To help determine which, if any, secondary planning option may be appropriate for a client, CRT Experts offers a complimentary, no-obligation review. No documentation or identifying information is required – just the nearest age of any income beneficiaries, the trust's payout rate, and the approximate trust value. With that information, we provide a detailed written analysis. There is no charge for the review; we are only compensated if a sale or rollover is completed.

Each secondary planning option addresses a distinct set of circumstances. If a client's situation aligns with one of these strategies, we're glad to work with you and the client to explore it further and assess its suitability. If the client decides not to proceed, they'll gain a clearer understanding of the available options – knowledge that may prove valuable if circumstances change in the future.

To initiate a review, call us at 703-520-2275 or email us at experts@crt-experts.com.

The key components of a CRT review:

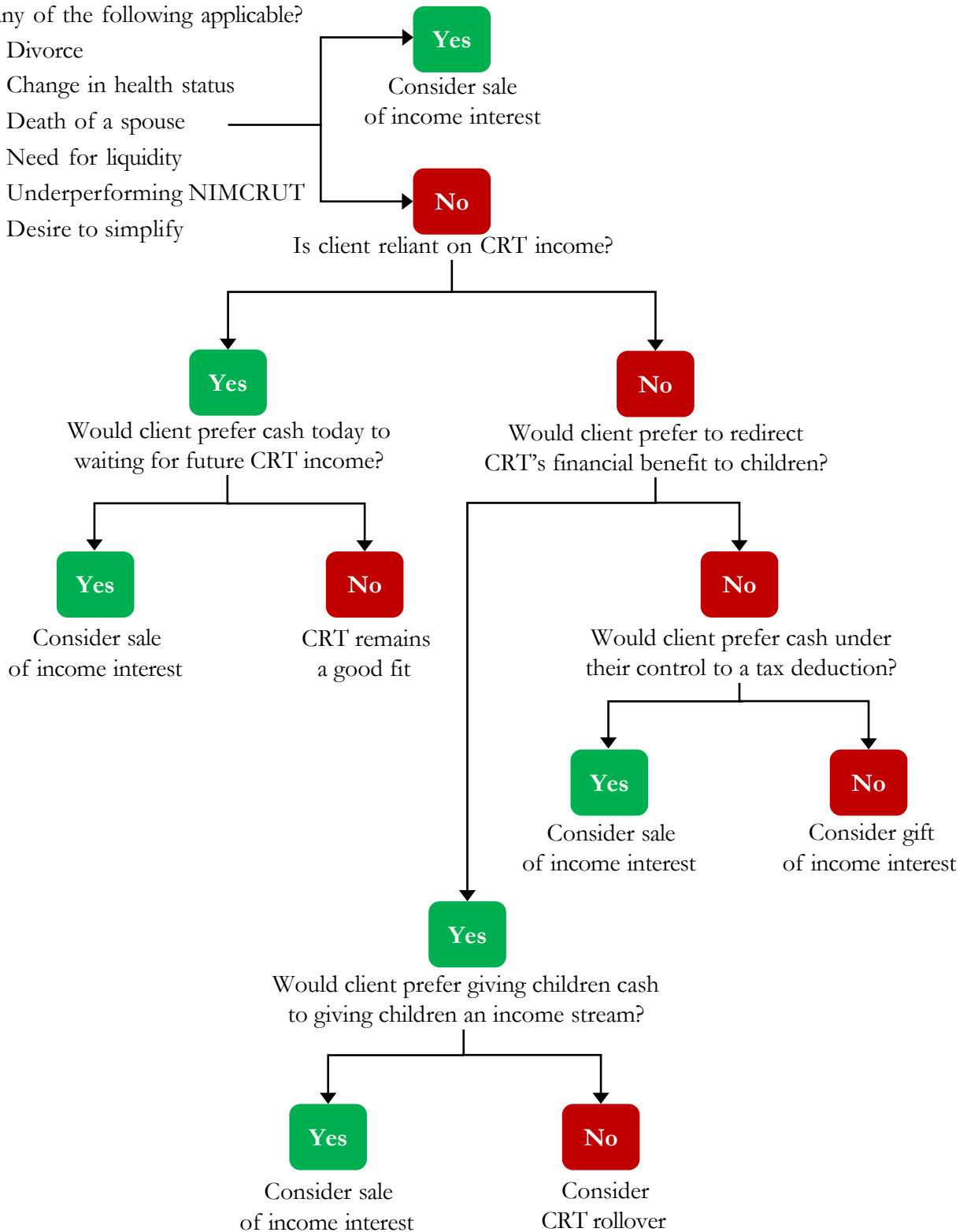
- Helping the income beneficiary understand all available options.
- Reviewing the income beneficiary's current situation and guiding them toward an informed decision about which – if any – secondary planning options may be a fit.
- Evaluating whether the chosen option makes sense from both a tax and financial perspective.

The following flow chart can be useful when initially assessing CRT-client fit.

Is CRT Aligned with Client's Current Situation?

Are any of the following applicable?

- Divorce
- Change in health status
- Death of a spouse
- Need for liquidity
- Underperforming NIMCRUT
- Desire to simplify



About CRT Experts

From up-front CRT design to complex CRT administration to sales and rollovers of CRT income interests, the team at CRT Experts bring unmatched know-how at every stage of the CRT lifecycle.

Our experience with CRT secondary planning – sales, rollovers, and gifts of CRT income interests – is particularly deep. Our founder and CEO (Evan Unzelman) helped develop the secondary market for CRT income interests in the early 2000s and today is largely regarded as the nation's foremost expert on sales and rollovers of CRT income interests. We work extensively with attorneys, CPAs and financial advisors to review their clients' CRTs for potential misalignments and have completed thousands of sales and rollovers over the last two decades.

Our team also has specialized expertise at the front end of the CRT lifecycle, creating and implementing CRTs that are custom built based on each donor's unique situation. We approach CRT design from the perspective of the property owner – the wealth creator – prioritizing both after-tax value and long-term donor flexibility. In most cases, this means structuring the trust as a NIMCRUT to allow for tax-free deferral during non-distribution periods when trust assets grow tax-free. We also frequently incorporate Life + Term trust duration provisions so that, following the lifetimes of the donor and spouse, the income stream continues to children and grandchildren. When properly structured, most CRTs have projected durations of 55 to 60 years and include two or three generations as income beneficiaries.

CRTs are all we do, and our goal is to be your first call when it comes to your clients' CRT needs.



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