Allianz Life Insurance Company of North America
Allianz Life Insurance Company of New York

The charitable remainder trust

Benefit a charity while receiving income

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Contents

The charitable remainder trust

A way for you to transfer assets to your favorite charity while receiving income from those assets

When properly set up and administered, a charitable remainder trust (CRT) can do all of these things:

- Benefit your favorite charity.
- Provide you with income for life, or for a set term of years (up to 20 years).
- Give you an income-tax charitable deduction for the value of the remainder interest that goes to the charity.
- Defer your capital gains tax on the transfer of an appreciated capital asset to the trust.
- Change an illiquid asset (i.e., one that is not readily salable) into a diversified portfolio without immediate tax consequences.
- Reduce your estate tax bill (if you have an estate over the federal estate tax exemption amount).

If you could benefit from most or all of these features, this type of trust may be appropriate for you.

However, you should note that there are costs to using this strategy. To fund the CRT, you must give substantial assets irrevocably to the trust. That means those assets will not be available to you should your situation change.

There will also be attorney's fees to set up the trust, along with annual administration fees to operate the trust.

So before you enter into a charitable remainder trust arrangement, you should first discuss all the costs and benefits with your estate-planning attorney and tax advisor.

Be sure to discuss all the costs and benefits with your attorney or tax advisor.

As an alternative, there are simpler and less expensive ways to benefit your favorite charity, including:

- Outright donations of cash or assets to the charity during life.
- Naming a charity as death beneficiary of an IRA or nonqualified annuity.
- Charitable bequests in your will of specific assets or cash.
- Donations to a private or public foundation, or donor-advised fund.

How does a charitable remainder trust work?

1. You first adopt an irrevocable CRT in accordance with your estate planning attorney's advice. You can choose a CRT that pays you income for life or for a term of up to 20 years.

2. You irrevocably transfer assets to the charitable remainder trust. The best choice of asset is generally a "low-basis" (i.e., low original cost) capital asset – for example, a piece of real estate that has appreciated in value.

Tax advantages: You don't have to pay capital gains tax upon the transfer of the property to the CRT. The property is removed from your taxable estate, which can lower your federal estate taxes if the value of your estate is otherwise over the federal estate tax exemption. And you'll get an income-tax charitable deduction that year, based on the estimated value of what the charity will receive when the trust ends (see the hypothetical example below).

3. The trustee of the CRT can sell the asset and reinvest in an income-generating portfolio.

4. The trustee pays a specified income to you for life, or for the set term of years. (We discuss the income payments below.) At the end of each year, the CRT will report these payments to you on a K-1 statement, and you may have to report the income on your tax return. Each payment to you is taxed under a 4-tier scheme:

Tier 1 Ordinary income	Tier 1 is the first money out; this is the CRT's ordinary income, and is taxed as ordinary income to you. Highest tax into ordinary income class is considered out first.
Tier 2 Capital gains	Tier 2 is the second money out; this is the CRT's capital gains, and is taxed as capital gain to you. Here is where you will pay the capital gains tax from when the CRT sold the illiquid asset you donated. Short-term capital gains are considered out before long-term capital gains.
Tier 3 Tax-exempt income	Tier 3 is tax-exempt income if the CRT holds any municipal bonds.
Tier 4 Tax-free basis	Tier 4 is tax-free return of basis (trust corpus).

5. When the trust ends at your death or after the term of years, the CRT distributes all the remaining assets to the charity you designated in the trust. You do not have to include the value of the CRT in your taxable estate.

Income payments for more than one person

You can choose a charitable remainder trust that pays income for your single life or a joint life with your spouse or another. You can even choose a CRT that pays income during your life, then your child's life, before it pays out to the charity.

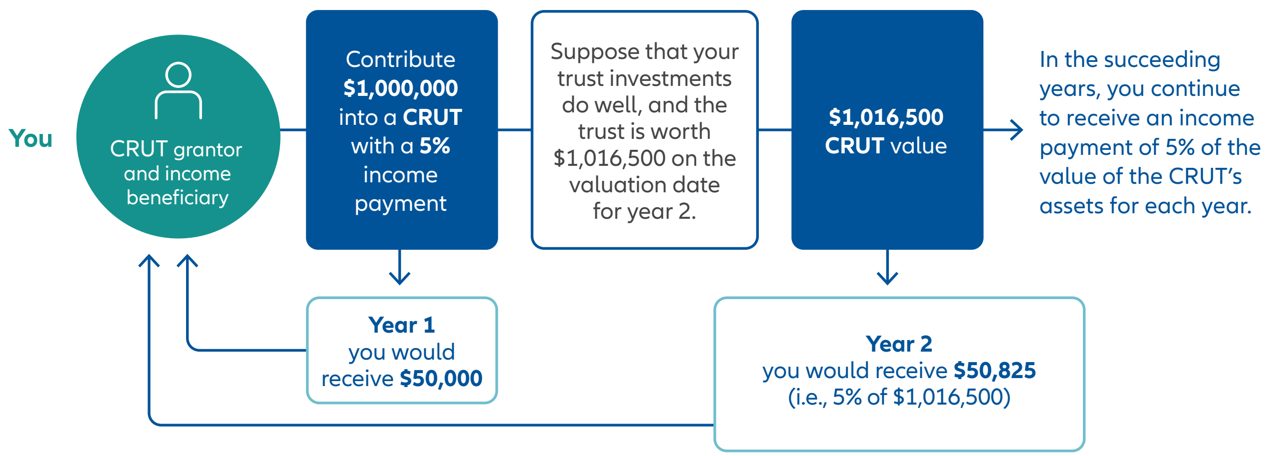
The two kinds of charitable remainder trusts

CHARITABLE REMAINDER UNITRUST (CRUT)

A CRUT promises to pay you a set percentage of assets from the trust as they are valued each year. The payment will go up if the value of the assets increases, or go down if the value of the assets decreases.

Because additional contributions are possible and the payments can increase as assets increase – and thus provide an inflation hedge – the CRUT is far more popular than its alternative, the CRAT (see next section).

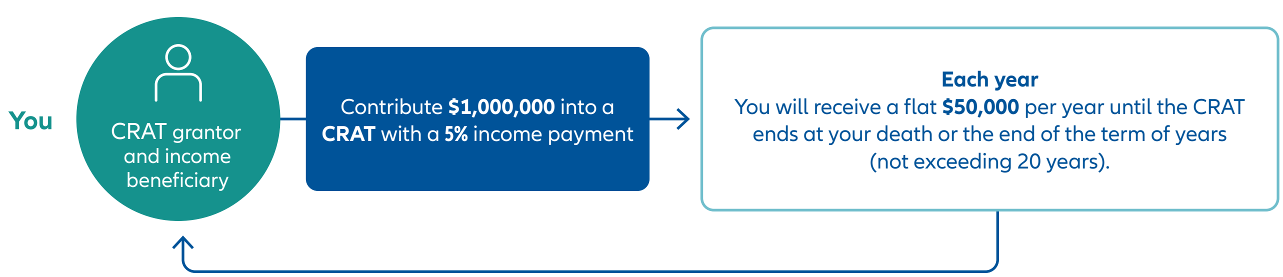
If you have a less immediate need for income – for example, if you're more interested in income after retirement – you could consider a net income with make-up CRUT, also called a NIMCRUT. With a NIMCRUT, each year you're paid the lesser of trust income or a fixed percentage (at least 5%) of the annual value of trust assets. In later years, the NIMCRUT can pay you more to make up for any income shortfalls of earlier years.



CHARITABLE REMAINDER ANNUITY TRUST (CRAT)

A CRAT promises to pay you a flat dollar amount each year for life or a term of years (not exceeding 20 years). Since no additional contributions are permitted and payments are a flat dollar amount, there is no opportunity for increased payments as asset values rise.

Under IRS rules, you're limited on the percentage of income you can choose in a CRUT or a CRAT. This is to ensure that the trust won't be completely depleted by payments back to you, and that there will be something left for charity. However, your income rate will be at least 5%.



These examples are hypothetical and are for illustrative purposes only.

How an annuity can turn CRT income off or on

An annuity is a contract between you and an insurance company that may help you reach your long-term financial goals. In exchange for a premium payment, the insurance company provides you with income, either starting immediately or at some time in the future.

Today's annuities offer a range of features and benefits that may help you accumulate assets for your retirement, preserve what you've accumulated, turn those assets into a guaranteed stream of income, and help pass on a financial legacy to your loved ones.

If the trust document allows, a charitable remainder trust can purchase a nonqualified annuity. The CRT would own the annuity and you would be the annuitant. All annuity withdrawals would go to the CRT, not directly to you. However, the CRT can use these funds (alone or with funds from other investments) to make the payments to you. The best approach is to avoid having the annuity be the sole asset in the CRT. If the annuity is the sole asset, the trust may incur withdrawal or surrender charges to get the funds to make the required payments. It is important to understand how the annuity will be valued each year for CRT purposes.

If you want to delay income from the trust until you retire, by choosing a net income with make-up CRUT (NIMCRUT) that's funded with a nonqualified deferred annuity, the trustee can control the timing and amount of the income distribution to you.

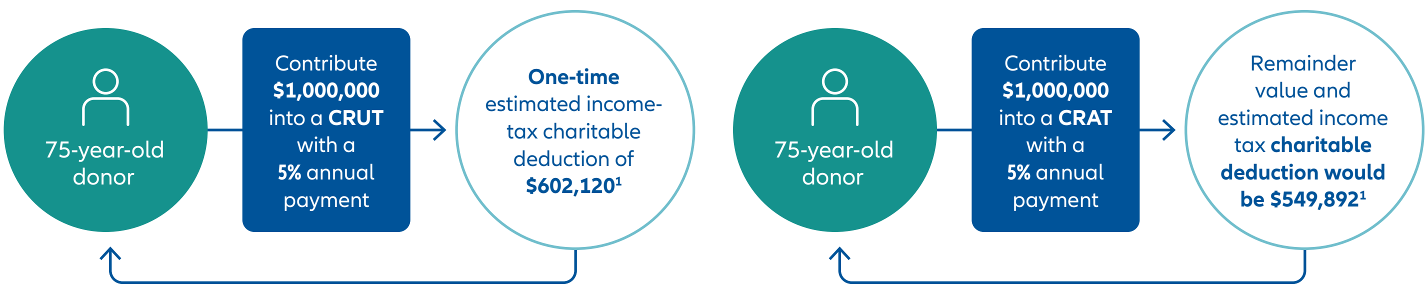
In this case, the trustee does not withdraw funds from the annuity, so the NIMCRUT does not have income to distribute to you. Instead, the trustee keeps track of the amounts it has not paid out (based on the set yearly percentage) in a "make-up" account.

When you are retired and ready for NIMCRUT income, the trustee takes annuity partial withdrawals based on the trust's income payment rate, and also pays you funds from the make-up account.

It's best that the trustee of a CRT does not rely only on an annuity to make the income payments to you. That's because a time could come when the allowed annuity withdrawal falls short of the income payment promised to you. If that's the case, the CRT trustee might incur a surrender charge to withdraw enough to make the payment. In addition, the CRT could fail to qualify under IRS rules if there is nothing left in the CRT to give to the charity. To avoid this, it helps to have other assets besides the annuity to make the income payment. Also, it is important for the trustee to understand how the various withdrawal options in an annuity contract operate, including why annuitization payments and lifetime income riders may not work well and may cause rule violations for a charitable trust and may put the qualification of the CRT as a tax-exempt trust under Internal Revenue Code Section 664(c)(i) at risk.

Hypothetical example of the income-tax deduction

Suppose a 75-year-old donor put **$1,000,000** into a **CRUT** promising a 5% annual payment. The donor would get a one-time estimated **income-tax charitable deduction of $602,120**[1] (based on the estimated value of the remainder that the charity will receive when the trust ends). If the donor put the **$1,000,000** into a 5% **CRAT**, the remainder value and estimated income tax **charitable deduction would be $549,892.**[1]



Keep in mind that you can deduct only 30% of your adjusted gross income each year if you contribute certain appreciated property to the charitable remainder trust – or 60% of your adjusted gross income if you contribute cash and the trust meets other IRS regulations. Any unused deduction can be carried forward for an additional five years.

Please note: If you have a low income and transfer a large amount of assets to the CRT, you might not get the full value of the deduction. If you can't get full use of the deduction, you might want to consider one of the alternative charitable options discussed earlier. Itemized deductions are subject to phase-outs for high-income taxpayers. See your tax advisor for more information.

FIND OUT MORE by asking your estate-planning attorney and tax advisor

For high-net-worth individuals, a charitable remainder trust can provide you with an income, and benefit the charity of your choice.

[1] These numbers would change monthly with changes in interest rates. Here we assume a 3.0% applicable federal rate. Your tax advisor must calculate your deduction at the time you transfer the property to the CRT.

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