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# WEALTH MANAGEMENT

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## CRTs and concentrated holdings

Among the potential benefits of a charitable remainder trust is the opportunity for tax-free diversification.

An acquaintance of ours has the good fortune of a potential tax problem. Back in the 1990s, he bought shares in a number in tech companies. One of these turned out to be a real winner—an investment of \$25,000 has blossomed into \$1.5 million! Although that sounds wonderful, the stock does not pay much in the way of dividends, which is a problem as the individual enters retirement and needs more income. If he sells some shares to raise cash, he will have to pay substantial federal and state capital gains taxes on the sale, so he has been reluctant to do that—he expects the value of the shares to go still higher. But he knows he’s running a big risk because his total stock portfolio is only \$2 million—the shares of this one company represent 75% of his investable assets.

Financial planners apply the term “concentrated holding” to any position that represents more than 10% of a portfolio. Such positions can be risky because a decline in the value of a concentrated holding can really damage overall portfolio returns. Strategies for reducing that risk include:

- selling all or part of the holding, and accepting the tax consequences; or
- hedging the position by buying a protective put option, selling a covered call option, or utilizing a collar, combining both of those elements. Options trading is not suitable for all investors, however, and presents risks of its own.

For those who have philanthropic aspirations, the charitable remainder trust offers a tax-efficient alternative.

### Elements of trust

A charitable remainder trust (CRT) is a permanent financial arrangement. The grantor transfers assets to the trust, which pays an annual income to lifetime beneficiaries, typically the grantor and/or spouse. The trust may continue for a specific term of years (up to 20), or it may last for the joint lives of the income beneficiaries. When the trust terminates, the assets pass to a designated charity.

The income interest in the charitable trust may be expressed as an annuity, a fixed dollar amount paid every year, or as a unitrust interest, which is a fixed percentage of the value of the trust, again paid every year. An annuity will not change over time, while the unitrust interest rises and falls with the value of the trust assets. During periods of economic growth or when inflation is high, the unitrust interest will often be preferred. The annuity interest, on the other hand, provides steady income even during economic downturns.

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For concentrated portfolios of assets with a low tax basis, the extra benefit of a CRT is the deferral of income taxes. When the trustee of a CRT sells an appreciated asset, there is no income tax for the trust or for the grantor. The full value of the proceeds may be reinvested in other income-producing assets. However, the taxes will be paid eventually. Lifetime payouts to the beneficiaries are taxable according to this protocol:

- ordinary income, to the extent that the CRT has ordinary income; then
- capital gain, to the extent of the CRT's capital gains for the year and undistributed gains from prior years; then
- other income, to the extent the CRT has other income from that year or prior years; then
- nontaxable return of principal.

Imagine our acquaintance places his \$2.0 million portfolio in a CRT paying a 5% annuity, \$100,000 per year. If the trustee sells half of the concentrated position, a capital gain of nearly \$750,000 will be created. It will take eight years of annuity payments to fully distribute that gain.

### More benefits

An income tax deduction is allowed for the creation and funding of a charitable remainder trust. The amount of the deduction will depend upon the terms of the trust and the age of the beneficiary

or beneficiaries. Estate and gift tax deductions are also allowed for the amounts that pass to charity.

These tax savings permit grantors to get “more bang for the buck” from their charitable giving when a CRT is employed for philanthropy.

Although charities always welcome outright immediate gifts, they also really appreciate being remainder beneficiaries of CRTs. Two reasons stand out.

Major financial support. The remainder interest in a CRT is typically larger than a series of annual gifts.

Certainty of future support. Planning for expansion and investment for future endeavors of the charitable organization can be undertaken with greater confidence when there is the certainty of a CRT distribution on the horizon.

### Choice of trustee

We facilitate philanthropy.

Many factors contribute to the success of a trust plan, such as a charitable remainder trust. One is the choice of fiduciary for asset management, tax reporting, and trust recordkeeping. That's our business—we are staffed for it; we know the legal and tax requirements; we do these things every day.

When you decide to move ahead with trust implementation, we can provide the services to guide the plan smoothly and effectively.

Give us a call to learn more.



## Charitable giving fell slightly in 2022

According to *Giving USA 2023: The Annual Report on Philanthropy for the Year 2022*, a publication of Giving USA Foundation, 2023, researched and written by the Indiana University Lilly Family School of Philanthropy, total charitable giving fell in 2022 for only the third time in the last 40 years.

Charitable giving was strong during the pandemic years, breaking the \$500 billion mark for the first time in 2021. But in 2022, the total fell to \$499.33 billion.

### Key drivers of the decline in charitable giving likely include:

- a 40-year high in inflation, at 8%, putting the squeeze on family budgets;
- a 19.4% drop in the S&P 500, the first double-digit decrease since the 2008 Great Recession;
- declines in the stock market toward the end of the year, when many charitable gifts are made; and
- growth in personal income was down 0.1%, or down 7.5% after inflation.

Charitable gifts from individuals account for more than 60% of total giving, as follows:

- Individuals gave \$319.04 billion, down 6.4%;
- Foundations gave \$105.21 billion, up 2.5%;
- Bequests totaled \$45.60 billion, up 2.3%; and
- Corporations gave 29.48 billion, up 3.4%.

There were slight changes in the targets for charitable giving.

- Religion, up 5.2% to \$143.57 billion;
- Human services, down 0.6% to \$71.98 billion;
- Education, down 3.6% to \$70.07 billion;
- Health, up 5.1% to \$51.08 billion;
- Public-society benefit, down 8.4% to \$46.86 billion;
- International affairs, up 10.9% to \$33.71 billion;
- Arts, culture and humanities, up 2.9% to \$24.67 billion; and
- Environmental and animal organizations, down 1.6% to \$16.10 billion.

There was some concern in 2017 that two of the tax reforms that year might have a negative effect on charitable giving. The rough doubling of the standard deduction meant far fewer taxpayers were itemizing their deductions, and they would get no tax benefit from their charitable gifts. The doubling of the amount exempt from federal estate tax was feared to have a similar effect. The fact that bequests are still growing, and that individual giving rose strongly in 2020 and 2021, suggests that the concerns may have been unjustified.





## The “death box”

Settling an estate is no easy task. It starts with the will, which every financially responsible person should have, but that is only the start. Retired estate planner Joan Burda, in an article for the American Bar Association’s *Senior Lawyer* magazine, discussed something she likes to call the “death box,” though the name given to the repository is not important. It’s the location of all critical documents that will be important for the end of life and for winding up an estate: funeral instructions, medical and legal documents, financial accounts, and the like. Interestingly, she warns against putting funeral instructions in the will, because in most cases the will is not read until after the funeral. In that case, the instructions are not likely to be followed.

The point of the death box is that everything is in one place, which will greatly simplify the job of the executor.

### Candidates for inclusion

Here’s a partial list of items that belong in a death box.

- Personal information, including Social Security number
- Military service information
- Tax returns
- Monthly utility bills, with
- contact lists
- Subscriptions
- Debts—mortgages, auto loans, personal loans
- Credit cards, including card numbers and approximate balances
- Safe deposit box keys
- Bank accounts
- Retirement accounts
- Brokerage accounts
- Annuities, if any
- Trusts, if any
- Insurance policies—auto, homeowners, life
- Health insurance provider, and primary physicians
- Medicare card
- Long-term care insurance
- Disability insurance
- Real estate deeds
- Copy of the will
- Power of attorney
- Advance medical directive
- Name and contact information for attorney
- Birth certificate
- Marriage license
- Computer passwords
- Passwords or passkeys for mobile electronic devices, such as cell phones
- Social media accounts, including passwords
- Funeral arrangements, including location of the burial plot and any prepaid funeral arrangements
- Obituary
- Pet care arrangements
- A list of family members, friends, and organizations that should be informed of the death

### The last word

Another idea for the death box is a final letter, or a series of letters to friends and loved ones. This is where family values might be articulated, and remembrances of life’s high points and significant events. One might express the hopes for the family’s future, for what might be accomplished with various bequests.

Ms. Burda reports that some people find the idea of last letters to be morbid, and such letters can be difficult to write, but “sometimes I hear from the families and am told how much that letter from mom or grandpa meant when they received it.”

She also suggests giving consideration to having a “farewell party” instead of a traditional wake. Instructions for the party may also be included in the death box.

## Estate taxes and gifts

Richard Spizzirri, a successful lawyer and investor in the biotechnology sector, was married four times in his life. He was still married to wife number four, Holly, at his death in 2015, but he had been estranged from her for several years. The couple's antenuptial agreement addressed the financial consequences of death or divorce, noting that Richard brought between \$24 million and \$27 million to the marriage in 1997, and Holly brought \$1.25 million as well as three children from a prior marriage.

The antenuptial agreement required Richard to execute a will making provisions for Holly and her three children, but he never did. Instead, the will he executed in 1979, long before he had met Holly, was probated. That will, which largely divided his estate among the four children from his first marriage, included four codicils added in 2014. The first three codicils made provisions for sons that Richard had fathered outside of marriage. The fourth concerned a condominium he had purchased jointly with another woman.

Holly challenged the will, hoping to enforce the terms of the antenuptial agreement. Because of the controversy, Richard's estate asked for an extension to file the federal estate tax return, which was granted. A second extension was refused by the IRS. Eventually a settlement was reached, and the estate paid each of Holly's children \$1 million.

When the federal estate tax return was filed late, Richard's gross estate was reported as \$81 million. An estate tax of over \$10 million was paid. The estate had claimed a deduction for the payments to Holly's children as claims against the estate. The estate also did not report any taxable gifts.

Unfortunately, there were taxable gifts. In the years from 2011 through 2014, Richard had made payments to five different women, ranging from \$50,000 to \$90,000. He paid about \$85,000 to the mother of one of his sons born outside of marriage, and \$90,000 to the woman with whom he co-owned the condo. He also made smaller gifts to a daughter and stepdaughter.

Taxable gifts are taken into account in determining the final taxable estate. In addition, the IRS disallowed the deduction for the \$3 million paid to the stepchildren.

In the Tax Court, the estate argued that the payments to the women were for "care and companionship services," not taxable gifts. If so, the Court wondered, why Richard never filed any 1099s or W2s for those services. Why did he not report the payments with his tax returns? The fact that none of the women were called as witnesses by the estate suggested an inference that they might not have backed the estate's story. The payments were held to be gifts.

The payments to the stepchildren were in the nature of bequests, not payments for adequate consideration, so the deduction was denied. A late filing penalty was added to the bill because even though the settlement with Holly had not yet been reached, the estate did have sufficient information to file a return.

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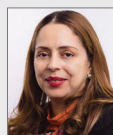


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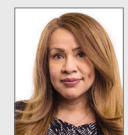
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