Do Well by Doing Good

Reduce Your Income Taxes Without the Help of Congress

By ANN I. WEBER, Esq.

Everybody knows what income is, right? It's what you get in your paycheck, and it's what you don't get from your CDs, and you pay tax on it like everyone else. But sometimes income (and the tax you have to pay on it) can sneak up on you when you least expect it, like when you sell something that wasn't worth as much when you bought it.

When that happens, it can be expensive because you have to pay all of the tax on the gain from the sale in the year of sale.

Even though you will pay at capital-gain rates which are relatively low (maximum 15% under current law and a fiscal-cliff rate of 23.8% in 2013) compared to the rates for ordinary income (maximum 36% this year and maybe 39.6% next), the capital-gains tax must be paid in one lump sum. To add insult to injury, if you are receiving Medicare, the taxable gain can also increase your Part B premium.

However, if you have charitable inclinations, you may be able to structure your gifts through a charitable trust or annuity and reduce your taxes significantly. Following are some examples.

Charitable Remainder Unitrust (CRUT)

Mrs. Gotrocks owns the stock her great-aunt Eunice gave her in 1990 when Auntie's company was just starting out. Now it's worth $100,000, but it was valued at zero at the time of the gift. If Mrs. G sells it this year, she will pay capital-gains tax of $15,000 this year and maybe $23,800 in 2013.

Instead, if she gives it to a 5% CRUT, the trust can sell the stock and pay no capital gain because the trust is a charitable entity. Mrs. G will receive 5% of the value of the trust each year for the rest of her life, and she will also receive a charitable deduction of $55,250 this year, which translates to a cash value of $19,388 in her pocket as a result of the deduction against her ordinary income.

Thus, in year one, she will receive $5,000 plus the $19,388 reduction in taxes. The next year, if the trust is worth more, her payment will be 5% of the increased value or, if less, 5% of the reduced value. But if the trust principal goes down significantly, so does her payment.

She will pay tax on what she receives each year over the lifetime of the trust at the rate based on the type of income generated. Because most of her annual payment will be from capital gain, she will pay at that rate on the bulk of each payment. At her death, the charity gets the remainder, and any accumulated capital gain remaining in the trust is never taxed.

Sometimes income (and the tax you have to pay on it) can sneak up on you when you least expect it.

As a result, Mrs. G will have (a) deferred capital-gains tax on the sale of her stock over her lifetime, (b) eliminated income tax on the remainder, (c) acquired a substantial deduction against her current income, (d) created a nice income stream for herself for her lifetime, (e) provided for an estate-tax deduction at her death of the amount remaining in the trust, and (f) created an eventual gift to the charity of her choice. That's a nice deal all around.

Net Income Make-up Charitable Remainder Trust (NIMCRUT)

Suppose Mrs. G wants to be sure the trust principal is preserved and her payment stays relatively level. In a higher-interest-rate environment, she could have created a charitable annuity trust, but, because the current income rate assumed by the government is 1.2% and the minimum payout is 5% of the original gift to the trust, this type of trust is not economically viable and is prohibited by the IRS.

However, a NIMCRUT would provide Mrs. G with the greater of trust income (which can include certain realized capital gain) or 5% of the trust principal. If income is low one year and higher in a later year, the deficit can be 'made up' in the higher-income year. This can result in a relatively stable income stream for the rest of her life. In addition, she receives the same income-tax deduction and cash value as with a CRUT.

Charitable-gift Annuity

These annuities are offered by many charities and can be a cost-effective way of making a charitable gift and retaining an income stream for life. Mrs. G could donate her stock to a charity, which sells it and pays her a 5.4% annuity of $4,383 annually for her lifetime. This payment will be taxed primarily at capital-gain rates, and Mrs. G will get a $36,697 income-tax deduction with a tax benefit of $12,844. At her death, the charity gets whatever is left.

So, consider a charitable trust or annuity, and do well by doing good. ■

Ann I. Weber is a partner with the Springfield-based law firm Shatz, Schwartz and Fentin, P.C., and concentrates her practice in the areas of estate-tax planning, estate administration, probate, and elder law, and has a particular interest in creative estate planning for authors, artists, farmers, and landowners. She is a board member and past president of the Estate Planning Council of Hampden County Inc., and is a former (and founding) board member and current member of the Massachusetts Chapter of the National Academy of Elder Law Attorneys. She has recently been named one of the Top Fifty Women Lawyers in New England by Super Lawyer magazine. She is a frequent author and speaker on issues regarding estate planning.