

# CPA Wealth PROVIDER

October 2007 For a Successful Financial Planning Practice

## Become a CPA Super Hero

**A new, patent-pending  
CRT management method called  
the CRT Split Advantage**  
By Ben L. Schaub

### *Ever dream of being a super hero?*

When a CPA can help his or her clients dramatically increase cash flow, pay less in taxes, and leave more to their heirs, a super hero is what he or she becomes. Throw in an opportunity to help clients become philanthropic and the result is what motivates any super hero—the quest to help others; and in this case, help others achieve a better, more meaningful life.

The United States has close to \$50 trillion of total assets and wealth. This statistic is backed by the much talked about \$41 trillion intergenerational transfer expected to occur over the next few decades. Approximately 60 percent or \$30 trillion of the \$50 trillion of U.S. assets can be characterized as highly appreciated property paying very little cash flow—in most cases less than one percent.

This phenomena create opportunities for CPAs to enhance their super hero status and grow their practices



by helping clients implement planning strategies designed to meet four objectives:

- 1) convert low-yielding assets to high cash-flow investments,
- 2) pay less taxes by avoiding capital gains taxes,
- 3) leave more wealth to heirs, and
- 4) help create philanthropic foundations.

A new, patent-pending method of managing Charitable Remainder Trusts (CRTs), the CRT Split Advantage™, offers an improved roadmap for CPAs to assist multiple generations—those who currently own the wealth and those who will later be recipients of that wealth. The CRT Split Advantage can be structured to fund family foundations.

## CHARITABLE GIVING

### *CASH FLOW IS NEXT TO GODLINESS*

For most clients, cash flow, or the lack thereof, is the single most important financial factor that impacts their lives and their standard of living. Because of this, I've often said that cash flow is next to godliness, and most CPAs and their clients quickly agree. The CRT planning method described in this article significantly increases cash flow, benefiting donors during their lives, as well as their children and heirs after they die. A secondary motivation for clients is the philanthropic benefits derived by creating their own family foundations. The family foundation can be the named recipient of the remainder interest of any Charitable Trusts that they might establish for lifetime tax and financial planning purposes. The new CRT Split Advantage, coupled with the family foundation, gives clients the "best of both worlds"—they can help themselves as well as others.

### *LESS TAXES, MORE CASH, BETTER LIFESTYLE*

It is a simple fact that people strongly dislike paying taxes and they believe the IRS is out to get them. With that said, most people have an intrinsic desire to manage their financial affairs in a way that minimizes their tax exposure. However, when we sell something for gain, we must pay taxes. Consequently, many people just don't sell.

Clients can be reluctant to sell their highly appreciated businesses, properties or stocks because they don't want to pay capital gains taxes. Unfortunately, many of these individuals become what we refer to as "asset rich and cash poor," which adversely impacts their lifestyle. Regardless of their desire to pass their wealth on to their families, many people don't properly reposition (sell) their assets in ways that would greatly increase their own cash flow and improve their own quality of life.

Clients also can be deterred from considering the CRT planning tool because of the notion that they would be giving major assets away to charity at the detriment of their heirs. However, if it didn't cost them anything, most people would jump at the chance to become philanthropists. By using the new CRT Split Advantage coupled with Wealth Replacement planning, there is no sacrifice or real cost. Clients can actually make more money through the increased cash flow while they are living, and then at their deaths leave more wealth to their heirs than they could through any other planning tool.

### *THE SECRET WEAPON*

CRTs are the only IRS-approved method of selling a highly appreciated property for the purpose of increasing cash flow without having to pay capital gains tax. As proof that it works, look to the most recent tax information reported from the IRS. There were more than 116,000 CRTs that filed returns totaling nearly \$88 billion in assets.

CRTs became available in 1969 as a means to motivate taxpayers to become more charitable. In exchange for the promise to make a future gift of trust assets, Congress gave living donors significant tax and financial benefits. The trust is tax exempt, resulting in the ability to sell appreciated assets without having to pay capital gains tax. While the donor and spouse are living, the trust pays them the income generated by the trust principal for their entire lifetimes. The income is naturally higher because, all things being equal, your client will be investing a larger principal amount without the reduction otherwise caused by taxes. The trust also generates additional income tax deductions and avoids estate taxes.

### *A BETTER WAY TO MANAGE CRTS*

Albeit, CRTs are growing in popularity, clients with existing CRTs are not maximizing their tax benefits because of the way traditional CRTs are currently managed and taxed. The first tax disadvantage clients face is that the IRS has a four-tier method of taxation on the income distributed to the donor. First, all ordinary income in the trust comes out and is taxed at the higher ordinary income-tax rate. Then, if there are any capital gains incomes in the trust, it is withdrawn next, followed by any tax-free income and finally, return of the principal. This pecking order of taxation creates a dilemma for trustees. Do I invest in riskier equity investments such as the stock market, resulting in fewer taxes for the donor because the distributions to the income beneficiary under this approach would be treated as capital gains, or do I invest in safer income investments, such as corporate bonds to preserve the principal for the remainder charitable beneficiary?

If the trustee chooses the latter, the trust payout rate will probably be much lower because of the typically lower yields generated by most fixed-income investments. Conversely, if the trustee chooses more risky equity investments and they do poorly, the value of the trust could deplete more rapidly, even though the beneficiary might receive income treated more favorably as capital gains. The reduction in trust principal and the subsequent reduction of income could be devastating.

For some trustees, the management of CRTs becomes a crap shoot.

### THE SOLUTION

In a nutshell, a CRT Split Advantage splits assets equally into two trusts: one is designated for growth and equity investments and the other for ordinary income investments. This split reduces the adverse impact which can occur when distributable ordinary income reduces the amount of capital gains income that could otherwise be distributed. This method also allows the trustee to implement a more balanced and fair investment portfolio for the benefit of both the lifetime income beneficiary and the Charitable Remainderman, without it being more risky to one or the other.

To demonstrate the magnitude of the CRT Split Advantage management technique, consider this: if all donors who presently have CRTs, totaling more than \$88 billion, moved their assets into a CRT Split Advantage, more than \$1 billion in additional net income could be generated for the income beneficiaries.

For a more detailed description and examples of the CRT Split Advantage, visit [www.americanfoundation.org](http://www.americanfoundation.org) and click the CRT Split Advantage link.

### THE NEW FAMILY FOUNDATION ADVANTAGE

The Family Foundation Advantage is a family foundation that is uniquely structured in the public charity format. The result generates even more benefits than the CRT Split Advantage alone, because it includes ongoing family direction over charitable assets after the life of the trust. At the same time, a family foundation also avoids some of the liabilities of asset ownership, including potential lawsuits, creditors, onerous taxation, and family feuding. With a family foundation, donors are empowered by creating their own charitable business that their heirs will continue to run in perpetuity. Instead of feeling like they are giving assets away, your clients are assured that they are transferring assets from one family pocket to another.

### "LIVING IN THE NOW"

Abundant cash flow can be created by converting low-income yielding, highly appreciated assets to liquid, high-income yielding investments.

CPAs are strategically positioned to provide this life changing assistance to valued clients because they have a keen awareness

of their clients' financial circumstances and their assets. Through the tax return process, CPAs can easily recognize the factors that indicate their clients are positioned to benefit from this planning strategy. A CPA also is likely to be privy to the planned sale of any properties, such as raw land, a shopping center, any business interest, appreciated growth stock, a valuable second home, any commercial property, or almost any other highly-appreciated valuable property.

The next step is for the CPA to notify and educate clients about how they can best convert their low- or no-income, highly-appreciated assets into liquid investments that provide tremendous cash flow. Most importantly, the CPA can be a hero and educate their clients about how they can sell their property without having to pay capital gains tax by using the CRT planning technique.

### CREATION OF A FAMILY FOUNDATION

Establishing an advantageous family foundation for your client is the first step in maximizing this new strategic plan. With a family foundation, your clients can become "owners" in philanthropy, rather than "renters." As an "owner," they will maintain direction over their charitable plan that functions similar to an endowment or private foundation generating annual income that is granted to family-selected charities every year. For The American Foundation, this means at least five percent of a family foundation's value is distributed to family-selected charities each year. It becomes a permanent and ongoing family endeavor. Conversely, a "renter" in philanthropy is someone who makes random gifts from their personal account, but it's usually only when they can afford it. After setting up your family foundation, it also becomes the Charitable Remainderman of your CRT Split Advantage.

A traditional CRT's remaining assets, after the lifetime of the donors, typically go to designated outside charities and the plan then terminates. Under the new CRT Split Advantage, your client's family foundation is named the Charitable Remainderman. The remaining assets in the CRT are then transferred to your clients' own foundation when they die.

This approach results in the creation of a family legacy for future generations, allowing the family foundation to be guided by the donors' heirs who are designated to carry out their parents' charitable wishes. (Note: Assets are not transferred from the CRT to the family foundation until after the deaths of the donors.)

### PROTECTING INHERITANCE

Wealth replacement planning provides your clients' heirs a greater inheritance than they would otherwise receive. And, it's easy to demonstrate to your clients how the government indirectly pays for this insurance benefit through the tax savings achieved with CRT planning. Typically, only part of the annual income alone, from the savings of capital gains tax, fully pays for the insurance. Done properly, using an Irrevocable Life Insurance Trust, the insurance proceeds also can transfer to heirs without estate tax and income tax. This results in the transfer of a significant amount of tax-free cash to heirs.

For example, if you have a \$1 million CRT that pays 10 percent or \$100,000 a year to your client, you can put a second-to-die \$1 million life insurance policy in place that will go to your clients' heirs for the typical cost of less than \$10,000 (actual insurance cost depends on age and health). The heirs can receive the insurance proceeds, free of both income and estate taxes. Your client gets more cash flow, and a larger inheritance goes to their children.

### THE NEW STANDARD

The CRT Split Advantage typically distributes between 5 to 10 percent annually to your clients, the income beneficiaries. These income payments can be structured for a term of years (not to exceed 20 years), or they can continue

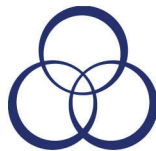
for the lifetime of the donor and then on to the surviving spouse, which is the most commonly used option. The CRT Split Advantage could potentially generate \$1 billion nationally in additional net income to the income beneficiaries of these trusts, and is expected to be a technique that will become the standard CRT management method of the future.

Whether your dream is to be Wonder Woman or Superman, whether your motivation is a sense of responsibility or a strong belief in humanitarian service, don't hide behind your super hero mask. Be sure to let your clients know you have an extraordinary capability through a new CRT and family foundation planning method that will help them dramatically increase cash flow, pay fewer taxes, leave more to their heirs, and help them become philanthropists.

CPAWP

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*Generating new and more effective philanthropy since 1982.*

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