



Closely Held Business Sale Using a CRT

Do you have clients who have built a successful business, who are considering retirement and are quite upset at the “diminishing effect” taxes will have on their future lifestyle? Then read on...

The Facts: After years of hard work building their business, Vi and Tom are looking forward to their retirement. After an initial meeting with their advisors to discuss a potential sale of the business, they are very discouraged. They are beginning to wonder how they will ever achieve their economic and family goals with so few after-tax dollars.

They own 100% of their \$5,000,000 business (a C corporation). Their basis for tax purposes is near zero, so a sale to a third party will trigger significant capital gains tax.

They would like to have an arrangement that offers:

- An immediate income tax deduction
- Reduction of estate taxes
- The ability to limit or avoid capital gains tax
- Retirement income
- A meaningful gift for charity
- An inheritance for their children

The Solution: A charitable remainder trust may be a viable solution.

A charitable remainder trust (CRT) is an irrevocable trust where income is paid to trust beneficiaries for a term of years or for life, with the remaining assets going to charity. Since a CRT is a tax-exempt entity the trust is not subject to tax. So if the CRT sells the stock, no capital gains tax will be paid, leaving a larger sum for re-investment and payout to trust beneficiaries. In addition, the donor(s) receive a charitable deduction when the asset is transferred to the trust.

First, Vi and Tom gift their low-basis stock to a CRT, naming themselves as income beneficiaries and their church as the remainder charity. An expert appraisal will be required to establish accurate values that can be

substantiated if the Internal Revenue Service (IRS) should question the transaction.

The gift of stock to the CRT generates an immediate charitable income tax deduction equal to the present value of the charity’s remainder interest. The amount that can be deducted by Vi and Tom for income tax purposes depends upon the application of percentage rules that relate to the taxpayer’s “contribution base.” With this in mind, Vi and Tom have timed the transaction well, as they intend to work for five more years and will use the current allowable deduction and any carryovers to offset income taxes on their salaries

Vi and Tom have chosen a third party trustee for the CRT. This gives evidence of independence to the transaction and helps to avoid a challenge of a prearranged sale. Vi and Tom are confident that interested buyers exist and that the CRT should have no problem finding a willing buyer.

At retirement, Vi and Tom will begin to receive annual payments, payable as long as either is alive. Since their interest is a life annuity, there will be no estate inclusion at their deaths. Their goal of reducing or eliminating estate taxes is met. In addition, their church receives a legacy. However, there is a price for avoiding capital gains and estate taxes on the business – the CRT assets ultimately pass to a charity and not to their children.

The Role of Life Insurance: Some or all of the tax savings and increased cash flow gained by the use of a CRT can be used to purchase insurance in an irrevocable trust for the children’s benefit. The irrevocable life insurance trust (ILIT) is typically referred to as a wealth replacement trust (WRT) because the life insurance in the trust is structured to help replace the value of the asset gifted to the charity. If the ILIT is properly drafted, designed, and funded, the death benefits will pass free of estate and income taxes (under IRC § 101(a)).

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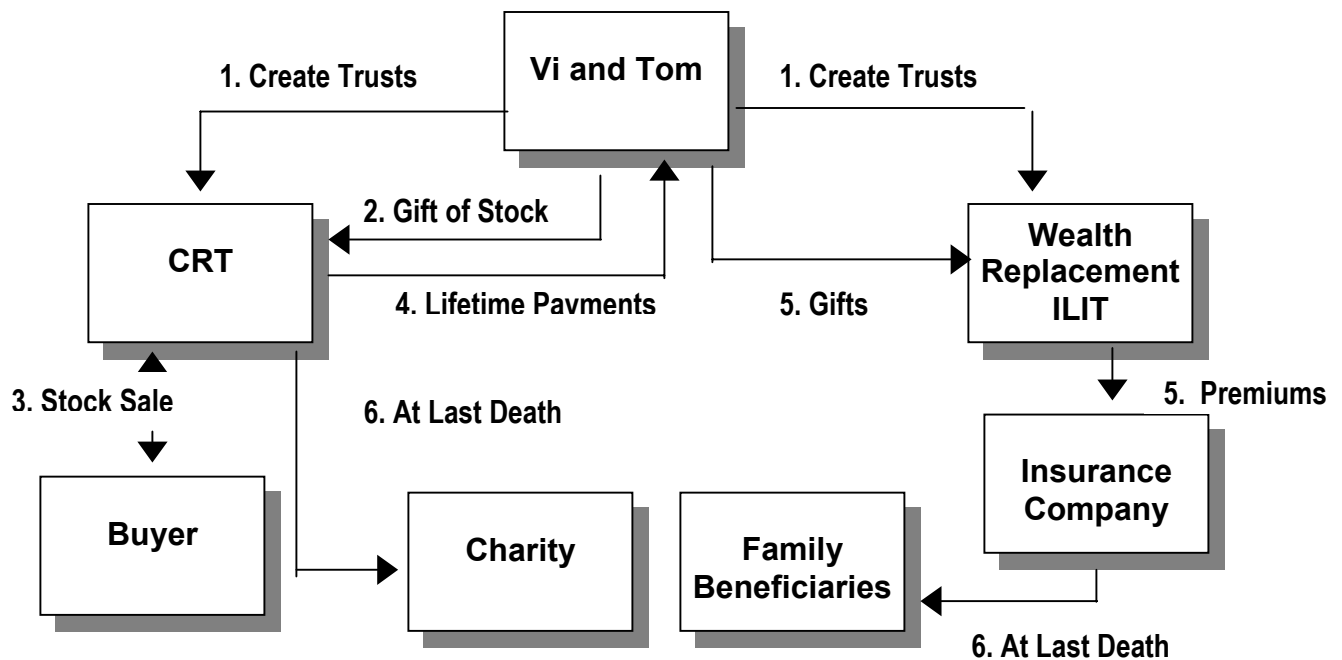
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1. Vi and Tom establish and fund two trusts: A Charitable Remainder Unitrust (CRT) and an Irrevocable Life Insurance Trust (ILIT) typically known as a Wealth Replacement Trust (WRT).
2. Vi and Tom gift their C Corporation stock to the CRT, receiving an immediate charitable deduction. They will be the income beneficiaries of the CRT with their church as the remainder beneficiary.
3. The CRT finds a buyer and sells the stock free of any capital gains tax, reinvesting the proceeds in income- yielding assets.
4. Vi and Tom receive annual lifetime payments from the CRT.
5. Using the tax savings from the contribution to the CRT and the increased income produced by the CRT, VI and Tom make premium gifts, measured by available Crummey powers, to the Wealth Replacement Trust (WRT) naming family members as trust beneficiaries. The WRT purchases a survivorship policy on VI and Tom.
6. After Vi and Tom's deaths, the remaining principal in the CRT passes to the charitable beneficiary, their church. In addition, the family heirs receive their inheritance through the receipt of estate and income tax-free death proceeds under IRC § 101(a).