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Tax Reduction or Tax Evasion?

Looking for a way to eliminate ordinary income and/or capital gain taxes on the sale of property?

The IRS is warning taxpayers that despite what promoters may say, misusing Charitable Remainder Annuity Trusts are not the way to do so. The IRS is cracking down on abusive arrangements involving Charitable Remainder Annuity Trusts (CRATs) promoted as a means eliminating taxes on donations and receiving tax free income from the Trust.

Charitable remainder annuity trusts, or CRATs, are irrevocable trusts that let individuals donate assets to charity and draw from the trust a specific dollar amount each year as annual income for life or for a specific time period.

1. Transfer of property to a CRAT does not result in an increase in basis to fair market value as if the property had been sold to the trust.
2. Grantors receive a partial income tax deduction based on calculation of the anticipated remainder distribution to the charitable beneficiary.
3. When the trust sells property used to fund the trust, it must recognize any gain over the original basis as trust income. That income is taxable to the grantor when withdrawn as annual income.
4. With a deferred annuity, IRS rules state that you must withdraw all of the taxable interest first before withdrawing any tax-free principal.
5. The trust is required correctly report trust income and distributions to beneficiaries, file required tax documents and follow applicable laws and rules.

Taxpayers, the IRS warns, “are legally responsible for what is on their tax return, not the practitioner or promoter who entices them to sign on to an abusive transaction. The IRS may assert accuracy-related penalties ranging from 20% to 40% of an underpayment of tax, or a civil fraud penalty of 75% of any underpayment of tax” related to such transactions associated with CRATs.

While Charitable Remainder Annuity Trusts may help donors make certain they do not run out of money in retirement and that any remainder goes to a charity one supports, you need to make certain and work with qualified investment and tax professionals in setting up the Trust. The IRS has flagged CRATs for additional scrutiny and the penalties for an abusive CRAT are substantial.

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