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The DC and the Charitable Remainder Trust

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A number of years ago medical practitioners far and wide owned pension plans. Typically they would earn significant amounts of money, place a substantial portion of their earnings into the pension plans and not have to pay any income tax whatsoever on the funds placed until the time the money was withdrawn at retirement. Further, the accumulations earned by the funds were tax deferred as well.

If the situation arose where the doctor needed to withdraw from the fund, he often would accomplish this in the form of a loan from the fund to himself (under extremely favorable terms).

Unfortunately, the tax laws are much different today. With tax regulations becoming more and more stringent, most deductions eliminated, the home interest deduction under attack, and with a president who breaks his campaign promises with respect to not raising taxes, it becomes more critical than ever for the DC to look for alternative means to generate a substantial retirement income.

There have been radical changes in pension law. No longer is an employer allowed to "discriminate" as to who enters a qualified plan and who does not. No longer can an employer defer funding the plan for a long period of time as there are strict minimum funding requirements. Further, the pension plan which is "top heavy" in favor of the doctor but allows his employees entry at a much lesser rate is non-existent as Congress has enacted laws which restrict the highly compensated to much smaller percentage amounts which makes entering into such a plan financially unfeasible.

As a result, many doctors have terminated their qualified plans even though, generally speaking, the amounts input into a qualified plan are tax deductible to the company in the year paid.

Some doctors have found that the problem is solved through the utilization of the charitable remainder trust (to be used in lieu of a pension plan).

The charitable remainder trust is a "creature of statute" and as such, the party placing money or other assets into the trust is called the "grantor." Let us assume the grantor is a DC who transfers his assets to a middleman called a "trustee." The trustee retains the property within the trust to benefit the "beneficiary." One of the key features is that as the res (assets) of the trust earn interest, that is paid over to the designee of the grantor. At the expiration of the trust, the res then passes to a charity. The charity must be one which "qualifies" under the rules of the Internal Revenue Code.

Needless to say, appropriate professionals need to be consulted in order to create such a complex legal structure. It can be achieved, however, with relative ease by a knowledgeable attorney in the field. Typically this would be accomplished not with the existing assets owned by the DC but as a result of a large bonus paid by the DC's professional corporation to the DC (who is an employee of his own corporation). If the charitable remainder trust is correctly established, the owner should receive an income tax deduction in the amount of the present value of the charitable remainder interest. The benefit is that along the way the income from the asset would be paid to the DC during his lifetime.

Hypothetically, Dr. Fakename has had a very good year. His profits have been excellent to the point where he is able to declare a bonus of $150,000 for himself. He has established the charitable remainder trust, and gives the $150,000 (and rental property throwing off $10,000 per year in net income) to the charitable remainder trust.

It could be written that the trust would pay him an amount per annum for life with the remainder to pass through to the charity. The owner should be able to claim an immediate deduction of the $150,000 as well as a substantial amount for the net appraised value of the hard asset as well. This could be accomplished in the year the money is placed into the trust.

The beauty of this arrangement is that (as with a qualified retirement plan) the trust itself is exempt from income tax.

The DC must realize that the distributions to him on a monthly or semi-annual basis are taxable to the beneficiary of the trust because the trust itself does not pay tax.

Needless to say there are also estate tax implications. An estate planning attorney would need to be consulted as well. It would seem that there would be some relief on state tax to the extent of the charitable deduction estate tax given (for the value of the trust property at the time of the owner's death).

Of course, when many valuable assets are placed into a trust to benefit a charity on death, they are not available for the use of the family upon the death of the grantor.

The purchase of ample life insurance, however, would solve this problem and the cost should be offset many times by the tax savings realized as a result of giving assets into the trust.

The charitable remainder trust is not for every doctor. A qualified pension plan is still a viable option particularly if the DC has a small staff. Notwithstanding, this author favors the utilization of charities in order to benefit the charity and benefit the donor to the charity as well.

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