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Romney Avoids Taxes via Loophole Cutting Mormon Donations

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In 1997, Congress cracked down on a popular tax shelter that allowed rich people to take advantage of the exempt status of charities without actually giving away much money.

Individuals who had already set up these vehicles were allowed to keep them. That included Mitt Romney, then the chief executive officer of Bain Capital, who had just established such an arrangement in June 1996.

The charitable remainder unitrust, as it is known, is one of several strategies Romney has adopted over his career to reduce his tax bill. While Romney's tax avoidance is legal and common among high-net-worth individuals, it has become an issue in the campaign. President Barack Obama attacked him in their second debate for paying "lower tax rates than somebody who makes a lot less."

In this instance, Romney used the tax-exempt status of a charity -- the Mormon Church, according to a 2007 filing -- to defer taxes for more than 15 years. At the same time he is benefiting, the trust will probably leave the church with less than what current law requires, according to tax returns obtained by Bloomberg this month through a Freedom of Information Act request.

In general, charities don't owe capital gains taxes when they sell assets for a profit. Trusts like Romney's permit funders to benefit from that tax-free treatment, said Jonathan Blattmachr, a trusts and estates lawyer who set up hundreds of such vehicles in the 1990s.

Near Zero

"The main benefit from a charitable remainder trust is the renting from your favorite charity of its exemption from taxation," Blattmachr said. Despite the name, giving a gift or getting a charitable deduction "is just a throwaway," he said. "I used to structure them so the value dedicated to charity was as close to zero as possible without being zero."

When individuals fund a charitable remainder unitrust, or “CRUT,” they defer capital gains taxes on any profit from the sale of the assets, and receive a small upfront charitable deduction and a stream of yearly cash payments. Like an individual retirement account, the trust allows money to grow tax deferred, while like an annuity it also pays Romney a steady income. After the funder’s death, the trust’s remaining assets go to a designated charity.

Romney’s CRUT, which is only a small part of the $250 million that Romney’s campaign cites as his net worth, has been paying him 8 percent of its assets each year. As the Romneys have received these payments, the money that will potentially be left for charity has declined from at least $750,000 in 2001 to $421,203 at the end of 2011.

Tax Returns

The Romney campaign declined to answer written questions about the trust.

“The trust has operated in accordance with the law,” Michele Davis, a campaign spokeswoman, said in an e-mail.

Paul Comstock, a financial adviser to LDS Philanthropies, an arm of the Mormon Church, said that while he wasn’t familiar with the trust, Romney and his trustee might arrange to compensate the church for the dwindling amount with other gifts.

“It may be that they’ve made provisions for the charity someplace else that will make up for what this isn’t going to give them,” Comstock said.

Bloomberg News obtained the trust’s tax returns from 2007 to 2011 from the Internal Revenue Service. Romney hasn’t disclosed the trust’s tax returns and is under no legal obligation to do so. He did make some disclosures about the trust’s investments in Massachusetts filings from 2002 to 2007 and as a presidential candidate in the current campaign.

After Death

Funds held by Romney’s trust are scheduled to be distributed after the death of Romney and his wife to “a charitable organization to be designated by Romney,” according to the 2007 filing, disclosing assets he held while governor of Massachusetts. “In the absence of such a designation the funds will go to the Church of Jesus Christ of Latter-Day Saints.”

Davis declined to comment on whether Romney has designated another charity since then.

Romney has been an active member of the church, which expects members to donate 10 percent of their income. Over the years, he has donated millions of dollars of stock in Bain-owned companies to the church, securities filings show. The church recommends such trusts on its website as one of many options for donors.

"Probably one of the advantages of a charitable remainder trust is that it helps with capital gains tax," said Carl McLelland, an attorney in the planned giving office for LDS Philanthropies.

Capital Gains

CRUTs were more common in the 1990s when capital gains rates were higher. In 1996, when Romney set up his trust in Massachusetts, the federal rate was 28 percent, compared with 15 percent today. At the time, a Massachusetts state resident who sold shares for a gain of $1 million could have faced a combined state and federal capital gains tax of as much as 40 percent, reducing his take to $600,000.

By contrast, if he contributed the stock to a CRUT, and it sold the shares, it typically wouldn't owe any tax since it is a charitable trust. The CRUT could reinvest the $1 million and earn a return on the full amount.

"The power of this is the tax deferral," said Jay A. Friedman, a partner at accounting firm Perelson Weiner LLP in New York. "The money is all growing tax free and he only pays tax on what is distributed to him."

Concerned that CRUTS weren't sufficiently philanthropic, Congress mandated in July 1997 that the present value of what was projected to be left for charity must equal at least 10 percent of the initial contribution. Existing CRUTS weren't affected by the new law.

Dwindling Principal

Romney's trust was projected to leave to charity an amount with a present value of a little less than 8 percent of the initial contribution, according to an analysis by Friedman. Thus, the specifics of Romney's trust wouldn't have passed legal muster if it had been set up 13 months later, he said.

Because the trust's investments have been earning a return far below its annual payouts to the Romneys, its principal has dwindled rapidly.

In 2001, five years after it was established, the trust had a value of between $750,000 and $1.25 million. Since then, it has pursued a conservative investment strategy -- regardless of the ups and downs of the stock market -- buying a mix of money- market funds, federally-backed bonds and federal bond funds. Since 2007, it has moved its assets entirely into cash. By 2011, its investments earned a return of $48, down from between $60,001 and $100,000 in 2001. It paid $36,696 to the Romneys in 2011.

Romneys Favored

The current investing strategy favors the Romneys over the charity because they get a guaranteed payout, said Michael Arlein, a trusts and estates lawyer at Patterson Belknap Webb & Tyler LLP.

"The Romneys get theirs off the top and the charity gets what's left," he said. "So by definition, if it's not performing as well, the charity gets harmed more."

The trustee for Romney's CRUT is R. Bradford Malt, chairman of the law firm Ropes & Gray LLP, and manager for Romney's various family trusts as well as his personal attorney. Ropes & Gray has also been for years the main outside counsel for Bain Capital.

If the CRUT maintains the same investing strategy, assets will continue to shrink, said Jerome M. Hesch, a tax and estate planning attorney at the law firm Carlton Fields. The trustee acted prudently in protecting against losses during a stock market decline, he said.

Nevertheless, "what's going to go to charity is probably close to nothing," Hesch said.

To contact the reporter on this story: Jesse Drucker in New York at jdrucker4@bloomberg.net

To contact the editor responsible for this story: Jonathan Kaufman at jkaufman17@bloomberg.net