Charitable Remainder Trust

Essentials 2018

A Charitable Remainder Trust (CRT) is an irrevocable trust designed to turn highly appreciated assets, like stock or real estate, into increased income and reduced current income taxes through a process of tax efficient asset transfers. When done correctly, these transfers allow clients to minimize estate taxes while leaving substantial gifts to their favorite charities. CRTs may also maximize the estate for heirs.

Benefits of a Charitable Remainder Trust

- Potential immediate (partial) tax deduction, based on the value of the eventual gift to charity.
- May eliminate capital gains tax for gifts of long-term appreciated securities, real estate, and other assets.
- Accepts many types of assets.
- Generates income for a beneficiary of the trust to live upon.

Best Type of Remainder Trust for Your Client

The key questions to ask are:

1. Do you foresee making additional contributions? Yes = Unitrust (CRUT)
2. Are you willing to tolerate fluctuating income? No = Annuity Trust (CRAT)

Charitable Remainder Unitrust (CRUT)

A CRUT requires the trustee to pay income beneficiaries a specified percentage of the value of the trust assets each year. If the value increases, the payout increases; if the value decreases, the payout will decrease accordingly. As with the CRAT, the specified payout must equal at least five percent and be no greater than 50 percent of the value of the trust assets. The value of the charitable remainder must be at least ten percent of the net fair market value of all assets transferred to the trust. One key advantage of the FRUT is the grantor can add assets to the trust at a future date.

Charitable Remainder Annuity Trust (CRAT)

A CRAT requires the trustee to pay a specified annual annuity to the donor or other designated individuals for a certain period of time. The annuity must be at least five percent and not be greater than 50 percent of the value of assets contributed to the trust. The amount projected to go to charity must be at least ten percent of the asset's value at the time the asset is transferred. Additionally, there must be a 95 percent probability that the charity will receive the ten percent remainder. The CRAT's income beneficiary must receive the required annuity payout each year regardless of the trust's return on its assets. This will sometimes require the use of principal. Donors cannot contribute additional assets to a CRAT.

How to Establish a CRT

1. Client establishes a CRT.
2. The client names beneficiaries of the trust. The client can be income beneficiary and the charitable institution that will inherit the property at the beneficiary's death will be named or a method to determine the charities provided.
3. Client transfers property to the trust and can receive income in the form of an annuity or unitrust.

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   a. Client can receive a tax deduction equal to the asset's fair market value minus the present value of the payments the income beneficiary is to receive from the trust.
   b. The interest rate used to determine the present value is the Internal Revenue Code Section 7520 Interest Rate. This rate changes monthly, however the donor has the option to use the current month's rate or one of the previous two month's rates. A higher rate creates a higher income tax deduction.
4. At the client's death or the end of the specified number of years, the assets in the trust are distributed to the charity. (This can also be triggered by the trust assets falling to ten percent of the starting value of the gifts made to the trust.)

Considerations

- When income is distributed, it is taxed to the recipient in the following order:
  1. Ordinary Income
  2. Capital Gain
  3. "Other Income"
  4. Principal
- If a client is interested in leaving the remainder interest to a private foundation, the charitable deduction could be limited to the cost of the asset contributed. The type of asset can also change the percentage limitation used in determining the income tax deduction allowed.
- When assets transferred to the CRT are subject to loans, it could create taxable income for the trust and donor.
- If an agreement is to sell the asset already in place, the donor would be required to recognize the capital gain and lose one of the key advantages of the CRT.
- Many times potential donors to a CRT are reluctant to give substantial assets away because of their concern for their heirs. One way to overcome this reluctance is to replace the asset with life insurance held in an irrevocable life insurance trust – sometimes called a Wealth Replacement Trust. When done correctly, the life insurance can be income and estate tax-free to the heirs. This can increase the net amount passed to heirs after tax. The combination of the tax deductions and cash flow from the CRT are often more than enough to fund the wealth replacement life insurance policy.

Essentially

A Charitable Remainder Trust is a great planning tool if, and only if, your client has charitable intent. Maybe they are passionate about their church, alma mater, or a cause such as breast cancer research. Charitable intent is necessary because CRT rules require that the present value of the remainder interest be at least ten percent of the fair market value of the assets transferred to the trust. Clients should not use this technique just for tax advantages. Tax advantages combined with charitable intent make the CRT a great planning tool.

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