CHARITABLE REMAINDER TRUSTS

A charitable remainder trust (CRT) is an irrevocable trust that provides income and estate tax benefits in connection with a charitable gift. The donor transfers assets to the trust, and the trust makes payments to the donor or other income beneficiaries for either a fixed period (up to twenty years) or for the lives of the beneficiaries. After the required income payments are complete, the remaining trust assets are distributed to one or more charitable organizations. The trust must comply with specific requirements and regulations of the Internal Revenue Code. The trust can be created by a trust agreement during the donor's life (an "inter vivos" trust) or by will at the donor's death (a "testamentary" trust).

Variations on Charitable Remainder Trusts

There are two basic types of CRTs: the charitable remainder annuity trust (CRAT) and the charitable remainder unitrust (CRUT). The CRAT pays a fixed amount each year that must be at least 5% of the initial value of the trust assets. The CRUT pays a fixed percentage (at least 5%) of the value of the trust assets, calculated each year. Because payments from a CRUT fluctuate with changes in the value of the trust, the trustee can manipulate the income payments by changing the trust investments. Additional contributions may be made to a CRUT but not to a CRAT.

While CRUTs generally provide more flexibility than CRATs, a CRAT may be less complicated to administer. For example, a donor could transfer $100,000 to a CRAT, specifying a 6% annuity. The trust would simply make payments of $6,000 a year to the donor for the donor's life, and then to the donor's spouse, and then to their child. At the death of the child, the remaining trust property would be distributed to the designated charity. If the trust grows more than 6% per year, the amount passing to the charity would be more than the original $100,000.

Income Tax Consequences

A donor who creates a CRT during life is entitled to an immediate income tax deduction for the actuarial value of the remainder interest destined for charity. In appropriate circumstances, any excess deduction may be carried forward to apply to income taxes in succeeding years. The trust itself is exempt from income tax, subject to certain private foundation rules, including prohibitions against self-dealing, excess business holdings, and unrelated business income. The annual payment to the beneficiaries is subject to income tax on a tier system different from the taxation of income from regular trusts.

Capital Gains Tax Savings

A CRT is often used to make gifts of appreciated property that would generate a capital gains tax for the donor if sold. Because a CRT is exempt from income tax, the trustee can

sell an appreciated asset without incurring income tax on the gain. The trustee can then invest the tax-free proceeds of the sale to pay the annuity or unitrust amount to the beneficiaries. This allows the donor to convert low-basis appreciated stock or real estate into a stream of income without paying capital gains tax on the conversion.

Gift and Estate Tax Deductions

The donor is entitled to a deduction from estate taxes (for a testamentary trust) or gift taxes (for an inter vivos trust) for the value of the remainder interest granted to charity. There will be no estate or gift tax liability with respect to the grant of the right to the income as long as the only income beneficiaries are the donor and the donor's spouse. If the income beneficiaries include anyone other than the donor and the donor's spouse, however, the grant of the income interest will generally be subject to estate or gift tax. The value of the income interest is calculated based on an actuarial formula.

Retirement Benefit Planning

Depending on the individual circumstances of the donor and the donor's spouse, a CRT might be a good choice for a beneficiary of an individual retirement account (IRA) or qualified retirement plan. Since the CRT is a tax-exempt entity, it can receive the retirement death benefit in a lump sum without paying income tax, unlike any other beneficiary. By minimizing or eliminating the combination of estate tax and income tax that is otherwise payable on retirement plan benefits, this technique can decrease the cost of making a charitable bequest.

Wealth Replacement

It is important to remember that the use of a CRT means that part of the donor's estate will ultimately go to a charity and not to the donor's family. To replace the assets that will be going to charity, an insurable donor might use some of the income from the CRT to purchase life insurance through an irrevocable life insurance trust for the benefit of the donor's family. With proper planning, the life insurance proceeds could pass to the donor's family free from estate tax.

Careful Planning

The potential benefits of CRTs include income tax deduction, capital gains tax savings, increased annual income, estate tax savings, and the ability to make a cost-effective gift to charity. To achieve these benefits, a CRT must be properly established and administered, and should be carefully integrated into the donor's overall investment and estate planning strategies.

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