Charitable Remainder Trusts: Combining Lifetime Income and Philanthropy

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Executive Summary

- Charitable remainder trusts provide an immediate tax deduction for a future charitable gift, while providing an income stream for the grantor, his or her heirs, or others.

- The trusts are wealth transfer and philanthropic vehicles providing estate, gift and income tax efficiency, particularly by deferring income taxes on appreciated assets.

What is a charitable remainder trust (CRT)?

• An irrevocable trust with two or more beneficiaries: 1) the grantor or other non-charitable beneficiaries who receive regular income distributions; 2) a charity that receives the remaining assets when the trust terminates.

• Two types of CRTs distribute to beneficiaries in different ways.

1. Charitable remainder unit trust (CRUT) pays the beneficiary a fixed percentage of the trust at least annually, often for life or a period up to 20 years.

2. Charitable remainder annuity trust (CRAT) pays the beneficiary a fixed amount, or annuity, for the term of the trust.

• A trust can be created during the grantor's lifetime or at death.

• A trust can be funded with almost any type of property that can be properly valued. Variations on a standard CRUT can be used successfully for non-income producing or non-marketable assets, such as real property, limited partnerships and oil and gas rights.

Benefits of charitable remainder trusts

• Transfer wealth with a high degree of estate, gift and income tax efficiency for people who also have an interest in philanthropy. Fulfill a donor's goal to make a more significant gift to charity than might be possible through an outright donation. The gift is made, but the donor can still receive income payments.

• Defer or eliminate capital gains tax on highly appreciated assets. The trust itself never pays income or capital gains tax. Payments to the beneficiary are taxed in the year they are paid. The taxation of IRA income can be stretched out for years.

Providing income for living expenses

• Trusts can provide the grantor or beneficiaries with a steady source of income for life or a period of years. The required minimum payment to a CRUT beneficiary is 5% annually.

Philanthropy

• A tax-efficient vehicle for donating to a designated charity. When the trust terminates, the charity receives the remaining assets. At inception, the assets that will go to charity must be at least 10% of the trust's initial value. At termination, the actual amount paid to charity may be larger or smaller, depending upon investment performance.

Tax planning

• Highly appreciated assets gifted to the trust can be sold (or IRA assets withdrawn) by the trustee without incurring immediate capital gains tax or income tax.

• Grantor receives an immediate income tax deduction for the present value of the assets — determined by IRS tables based on current interest rates — that will eventually go to the designated charity.

• Income tax payments from the sale of appreciated assets are spread over the period that payments are made to the non-charitable beneficiary.

• A CRUT (but not a CRAT) offers flexibility to contribute additional assets to the trust after initial funding, increasing the non-charitable beneficiary's income stream and the grantor's tax deductions.

Estate planning

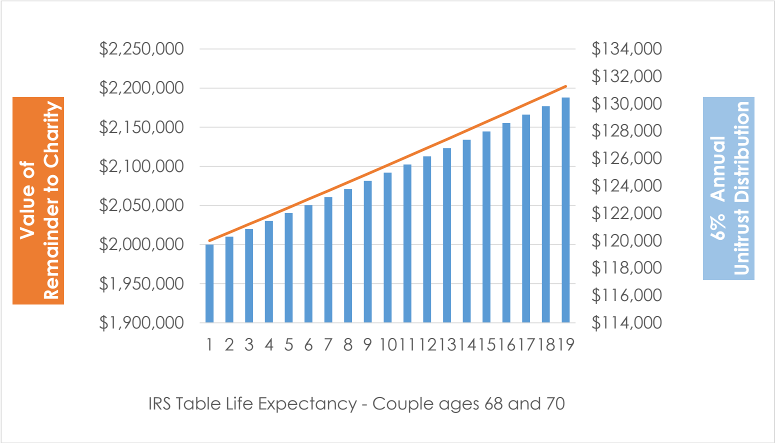
• An IRA beneficiary can receive income payments for life, rather than having to receive 100% of the assets within 10 years of the owner's death, as current tax law requires for most non-spouse IRA beneficiaries.

• A CRUT may have multiple or successive beneficiaries. The trust can provide income to a married couple or to a group of siblings — and to their heirs.

Examples of how a Charitable Remainder Trust can be used

• Figure 1 shows the example of a retired couple, ages 68 and 70, who own $2 million of stocks with a cost basis of $100,000. Rather than sell the stocks and pay taxes on $1.9 million of capital gains, they contribute the stock to a CRUT. The couple receives 6% of the trust as income annually for their lifetimes and, based on IRS tables as of February 2020, take an immediate income tax charitable deduction of $656,000.

Figure 1: Charitable remainder trust example
Increase in charitable remainder value and income payments reflect assumed 6.5% annual growth rate.*



**Growth rate is for illustration purposes only and is not predictive of actual growth.*

• A single parent has a $3 million IRA, which she plans to leave to her two children. However, she is concerned about the new tax law requiring the children to withdraw all of the IRA funds and pay the income taxes within 10 years of her death. By contributing the IRA to a CRUT, the children can receive the funds gradually over their lifetimes and postpone most of the taxes.

Key considerations for a Charitable Remainder Unitrust (CRUT)

- The trust is irrevocable. Although the designated charitable beneficiary can be changed, no other changes are allowed. When the trust terminates, the remaining assets go to the designated charity.

- Since the income payments are a percentage of the trust assets, a decline in asset value due to poor investment decisions would reduce the beneficiary's annual income distribution.

- Administration can be daunting and generally requires the expertise of a corporate fiduciary, who can calculate the annual income payments, file income tax returns for the trust and meet other requirements.

Key considerations for a Charitable Remainder Annuity Trust (CRAT)

- The fixed annual income payment does not fluctuate as trust assets increase or decrease.

- After initial funding, no additional assets can be added to the trust.

- Advantages over a CRUT: easier to administer, works well when interest rates are high.

- Disadvantages: higher risk for beneficiaries. Beneficiary payments are not affected by inflation or increases in trust value, which will go to the charity. Low current interest rates make the trust unattractive for philanthropy — the gift component is significantly reduced.

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