MAKING SENSE OF CHARITABLE REMAINDER TRUSTS (CRTS)

Charitable remainder trusts are a popular structure for charitably inclined individuals. In addition to helping an individual fulfill charitable intent, CRTs create an income stream and potential tax benefits for non-charity beneficiaries. Those beneficiaries can be both the creators of and donors to the trust.

Parties to CRTs

Like all trusts, CRTs involve several parties:

- **Grantor (aka trustor):** the individual that creates and funds the trust
- **Trustee:** the party responsible for carrying out the terms of the trust
- **Current Beneficiary(ies):** the individual or individuals who initially benefit from the trust by receiving distributions from it. The trust's Grantor is often named as its current beneficiary.
- **Remainder Beneficiary:** the people or entities, in this case always charitable entities, who receive the remainder of the trust when the trust terminates.

The Basic CRT Structure

While there are several varieties of CRTs, the basic structure is as follows:

1. A charitable remainder **trust document** is drafted by an attorney. This document names the parties above and defines distributions to be made to current beneficiaries, the length of time these payments are to be made, remainder charitable beneficiaries, etc.
2. The trust's **grantor** funds the trust with the property or securities of their choice
3. The **trustee** makes payments to current, non-charitable beneficiaries and performs other administrative duties such as recordkeeping, tax filing, etc.
4. Upon the termination of the trust, the trustee pays all remaining trust property to named charitable **remainder beneficiaries.**

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Other characteristics and terms of CRTs

There are certain characteristics of CRTs that make them particularly attractive to individuals who wish to give charitably and reduce their taxes, particularly from the sale of highly appreciated assets. CRTs are tax-exempt entities, grantors often choose to fund them with highly appreciated assets that are sold by the trustee once donated. While capital gains are tracked by the trustee, no capital gain taxes are paid by the trust. In addition, the projected value of the remainder of the trust, that will ultimately benefit a charity, can be used as a charitable deduction by the grantor. There is a standard, albeit complex, formula based on the IRS's assumed rate of return, payout and other terms, that determines the eligible charitable deduction for the grantor.

The length of a CRTs term can be up to 20 years or the life expectancy of current, non-charitable beneficiaries. Payouts can range from 5% to as much as 50% of the trust annually. However, for a trust to qualify as a CRT, the projected remainder must be at least 10% of its initial and/or subsequent funding. Because of this a grantor may need to adjust their desired terms to assure that the CRT meets this test.

Last, while CRTs are not subject to taxation, distributions to current beneficiaries may be taxable. CRTs are required to file tax returns that determine the amount and character of its net income. This income is reported on form K-1 which lets beneficiaries know how much of the distribution that they received is taxable and its character (ordinary income, LT capital gain, ST capital gain, etc.). Any undistributed income carries forward to subsequent years.

Different CRTs for Different Needs

There are two primary types of CRTs and a third variation which has grown in popularity over the years.

- Charitable Remainder Annuity Trust (CRAT)
  - Current beneficiary distributions are defined as a fixed dollar amount that remains the same throughout the term of the trust.
  - Annual distributions must be at least 5% of the trust's initial funding.
  - After the trust's initial funding, no additional funding is allowed.
  - While this provides a stable distribution flow, the buying power of distributions tends to decline over time due to inflation.
- Charitable Remainder Unitrust (CRUT)
  - Current beneficiary distributions are defined as a percentage of the trust's value and therefore fluctuate year to year.
  - Distributions must be a minimum of 5% of the trust's funding.
  - Distributions are generally recalculated each year as defined by the governing trust document.
  - Additions to the trust, which can produce additional tax benefits, can be made after the trust's initial funding.
  - Because of the fluctuating nature of CRUT distributions, they provide a less stable distribution flow. However, they may provide a better hedge against inflation for beneficiaries depending on the payout level and market conditions.
- Net income charitable remainder unitrust (NIMCRUT) with makeup provisions
  - The NIMCRUT works like a CRUT, but the trustee pays beneficiaries the lesser of the trust's annual income or the unitrust amount.
  - Any shortfalls are made up in years when income exceeds the unitrust amount.
  - By investing in non-income producing investments, a grantor who is also a beneficiary may delay the trust income until after peak earning years.

Trustee Considerations

An important decision the grantor of a CRT must make, in addition to structure, payout terms, etc., is the decision about who or what will serve as the trust's trustee. A trustee can be a family member, friend, attorney or other professional or individual. It can also be a corporate trustee, which is always regulated as a bank at either the state or national level. There are pros and cons to each option:

	Pros	Cons
Friend or family member	▪ Viewed as the least expensive option ▪ Generally, a highly trusted individual	▪ May not have the expertise or the desire to serve ▪ Will likely need to engage outside professionals for support which can negate cost savings ▪ Death or disability can be disruptive to beneficiaries
Attorney/other professional	▪ May have trust expertise ▪ Trusted and respected	▪ Cost of service may be unknown ▪ Death or disability can be disruptive to beneficiaries
Corporate Trustee	▪ Has specific expertise in this area so need for outside expertise, if any, is minimal ▪ Fee schedules are published, so cost is known and bundled ▪ As a perpetual entity, there is no risk of disruption to beneficiaries due to death or disability	▪ Viewed as potentially costly

Summary

While they can provide certain benefits for the right people and circumstances, charitable remainder trusts are not for everyone. They are irrevocable arrangements that involve a considerable investment as well as certain related expenses. Individuals considering CRTs should consult with qualified estate planning counsel. However, for individuals seeking to leave a charitable legacy that can benefit from certain tax benefits and an income stream for themselves or loved ones, a CRT may be worth considering.

For more information speak with your investment professional or estate planning attorney.

DBA Name
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