Charitable Remainder Trusts

A Charitable Remainder Trust (CRT) is an irrevocable trust to which a donor transfers assets and retains an income interest from the trust either for the donor's life or for a fixed term not exceeding 20 years. Upon the termination of the CRT, the principal passes to charitable organizations of the donor's choice.

Types of Charitable Remainder Trusts

There are two types of charitable remainder trusts:

Charitable Remainder Unitrust

The first and most common type is the charitable remainder unitrust. In the unitrust, the beneficiary receives a fixed percentage of the fair market value of the trust (not less than 5% of the initial fair market), valued annually. This annual payment is commonly referred to as the retained income interest. More than one contribution may be made to the unitrust.

The donor cannot change the annual percentage distribution after the trust is created and cannot receive more than the annual percentage distribution from the trust, even if there is need.

The donor can retain the right to change the charitable organizations which receive the trust assets at the donor's death.

Charitable Remainder Annuity Trust

The second type of charitable remainder trust is the charitable remainder annuity trust. In the annuity trust, the beneficiary receives a fixed dollar amount annually during the term of the trust which is a percentage (not less than 5%) of the value of the initial contribution to the trust. Only one contribution may be made to the annuity trust.

The donor cannot change the annual annuity payment after the trust is created and cannot receive more than the annual annuity payment from the trust, even if there is need.

The donor can retain the right to change the charitable organizations which receive the trust assets at the donor's death.

Tax And Other Benefits of a CRT

1. Upon creation of either type of CRT and upon later additional contributions to a charitable remainder unitrust, the taxpayer receives a charitable deduction for income tax purposes. The tax deduction is equal to the fair market value of the property contributed less the present value of the retained income interest.
2. The CRT is a tax-exempt entity so the CRT pays no capital gains tax on the assets contributed to the CRT and then sold. The CRT is therefore able to reinvest the gross proceeds of sale. If the donor sold the assets personally and paid capital gains tax, then the donor would be able to reinvest only the net proceeds of sale. By giving up access to the principal of the CRT, the donor is able to diversify the donor's portfolio without incurring capital gains tax and can achieve a larger return on the reinvested assets.
3. The CRT may invest proceeds for income and appreciation and compound its internal returns on a tax-suspended basis and the beneficiary pays income taxes only when the distributions are received.
4. Although assets of the CRT are includible in the donor's estate, the donor receives a charitable deduction for the assets distributable to charity at the donor's death, thereby avoiding estate tax at the donor's death on the trust assets.
5. The donor will have created a significant endowment for one or more charitable organizations.

Consequences to the Heirs

Because the assets of the CRT will eventually be distributed to charity, there may be a concern about reducing the inheritance passing to the donor's children and other beneficiaries. A solution to this is the establishment of a second trust that owns a life insurance policy on the life of the donor and of which the children are the beneficiaries. The proceeds of the insurance trust that go to the children are meant to replace the CRT assets that go to charity.

We maintain an estate planning glossary that further defines many of the terms used in this memo. If you wish to receive a copy of the glossary, please contact a member of your dedicated wealth management team.