

Charitable Remainder Trusts



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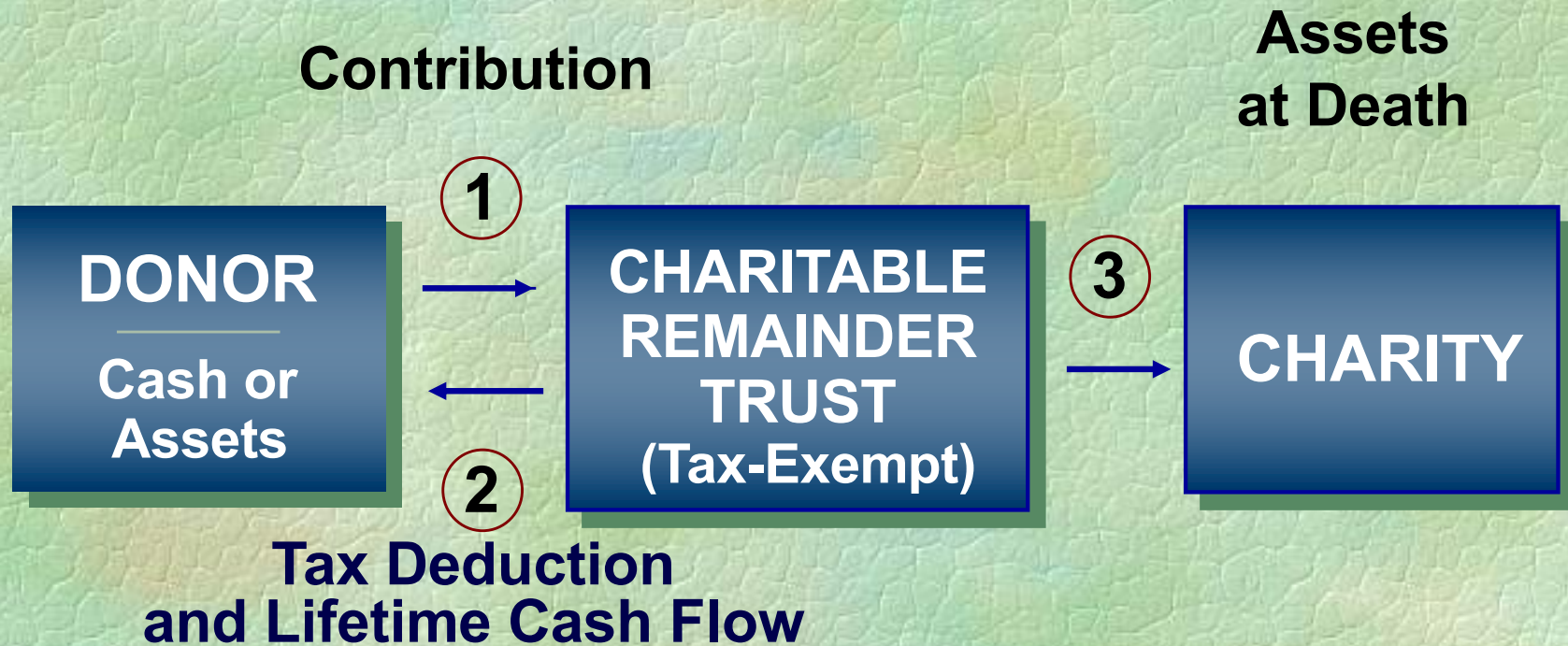
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What Is a Charitable Remainder Trust?



Basics of CRTs

- **Operated pursuant to a trust document that complies with state and federal law. IRC §664.**
- **See model CRT template documents provided by IRS (www.irs.gov) to offer a “safe harbor” so long as substantially followed. Counsel can add state trust code powers of trustee, etc.**

Basics of CRTs

- Donor and/or others designated by donor receive income for life or a term of years not to exceed 20 years.
- Fixed income payout percentage between 5% and 50%.
- Established during life or at death.
- Remainder to charity is irrevocable. But donor may retain right to change the recipient charity(ies)

Income Payments

- ☞ Beneficiaries pay income tax.
- ☞ Reported on K-1.
- ☞ Income taxation on a worst-in, first out (WIFO) basis in tiered system.
- ☞ Before any tax-free income is paid, all pre-gift capital appreciation is accounted for and taxed as income as paid to the beneficiaries.
- ☞ For excellent resource, see *Charitable Remainder Trusts*, Planned Giving Design Center, www.pgdc.com

Tax Benefits of a CRT

- **Income tax charitable deduction for present value of charity's future interest.**
- **Income tax deduction value must be at least 10% of original value of donated cash or assets.**
- **Donated cash or assets removed from taxable estate.**
- **Assets donated to CRT are sold without capital gains tax liability since CRT is a tax-exempt trust.**

Planning Opportunities

- **Sell assets without capital gains tax.**
- **Transforms non-income producing property into income for retirement or for loved ones.**
- **Trust document may define income to include realized capital gain at the discretion of the trustee.**
- **As trust principal value grows, so does income with unitrusts.**
- **Removes worry of property management.**

Planning Opportunities

- ☛ Charities should be cautious about serving as trustee. Requires board approval.
- ☛ Donor may be trustee.
- ☛ Common minimum of at least \$100,000.

Example

- ☛ Donor age 65
- ☛ \$500,000 property value/\$200,000 cost basis
- ☛ 5% payout; 7% assumed investment return
- ☛ 5.0% AFR rate
- ☛ \$213,210 income tax charitable deduction
- ☛ \$771,873 income paid over lifetime (projected)
- ☛ Avoid capital gains tax
- ☛ Removed from taxable estate

When AFR Drops

☞ Increase in tax deduction for Remainder Interest in Residence or Farm.

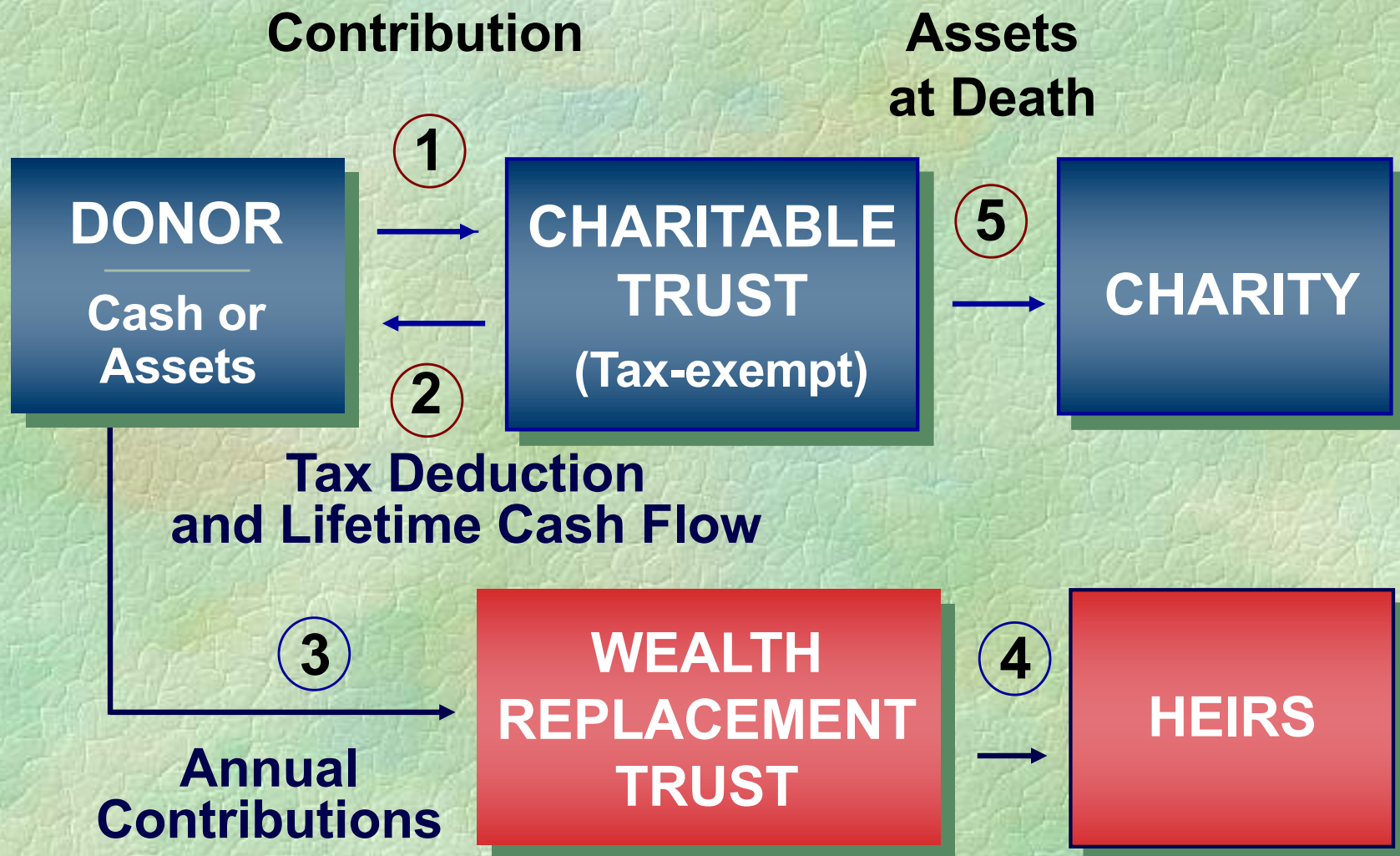
☞ Reduction in gift or estate tax liability for Charitable Lead Trust.

☞ Minimum impact on CRUTs.

☞ Gift Annuity income value increases but deduction decreases. Beware 10% deduction limit.

☞ Charitable Remainder Annuity Trust tax deduction decreases.
Beware 10% deduction limit and 5% probability test.

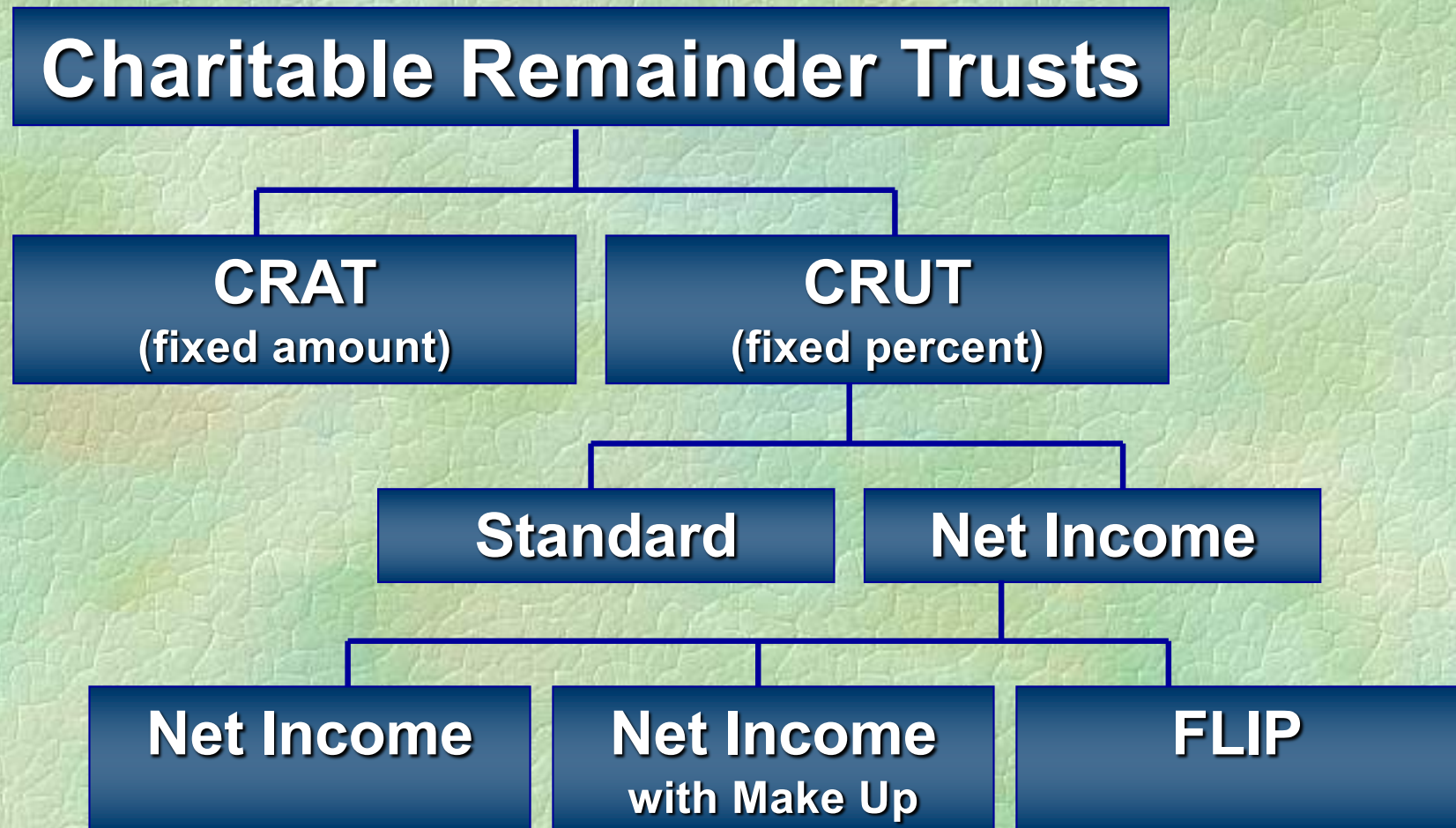
Enhancing a CRT Plan



Types of Charitable Remainder Trusts



Types of Charitable Remainder Trusts



Types of CRTs

- **Standard Unitrust (SCRUT).**
- **Net Income Unitrust (NICRUT).**
- **Net Income with Make-Up Unitrust (NIMCRUT).**
- **Flip CRT (begins as NICRUT or NIMCRUT and flips to a SCRUT).**
- **Annuity Trust (CRAT).**

Annuity Trust (CRAT)

- ☞ Pays fixed dollar amount determined by multiplication of fixed percentage (5% or more) by the value of assets donated to trust.
- ☞ No additional gifts allowed.
- ☞ Donated real estate must be sold – or use undivided interests - to fund annuity payment.
- ☞ 10% minimum deduction test as with all CRTs.
- ☞ Unique 5% probability test. The probability of trust depletion must not exceed 5%.






Standard Unitrust (SCRUT)

- ☞ Pays fixed percentage (5% or more) of trust value as annually re-valued. Most popular form.
- ☞ Payments may be made from income and/or principal at discretion of trustee.
- ☞ Additional gifts allowed.
- ☞ Donated real estate may be sold to allow for payments or in-kind payments of undivided portions.
- ☞ Income/principal defined in trust document per state law, e.g., income may include realized gain.

Net Income CRUT (NICRUT)

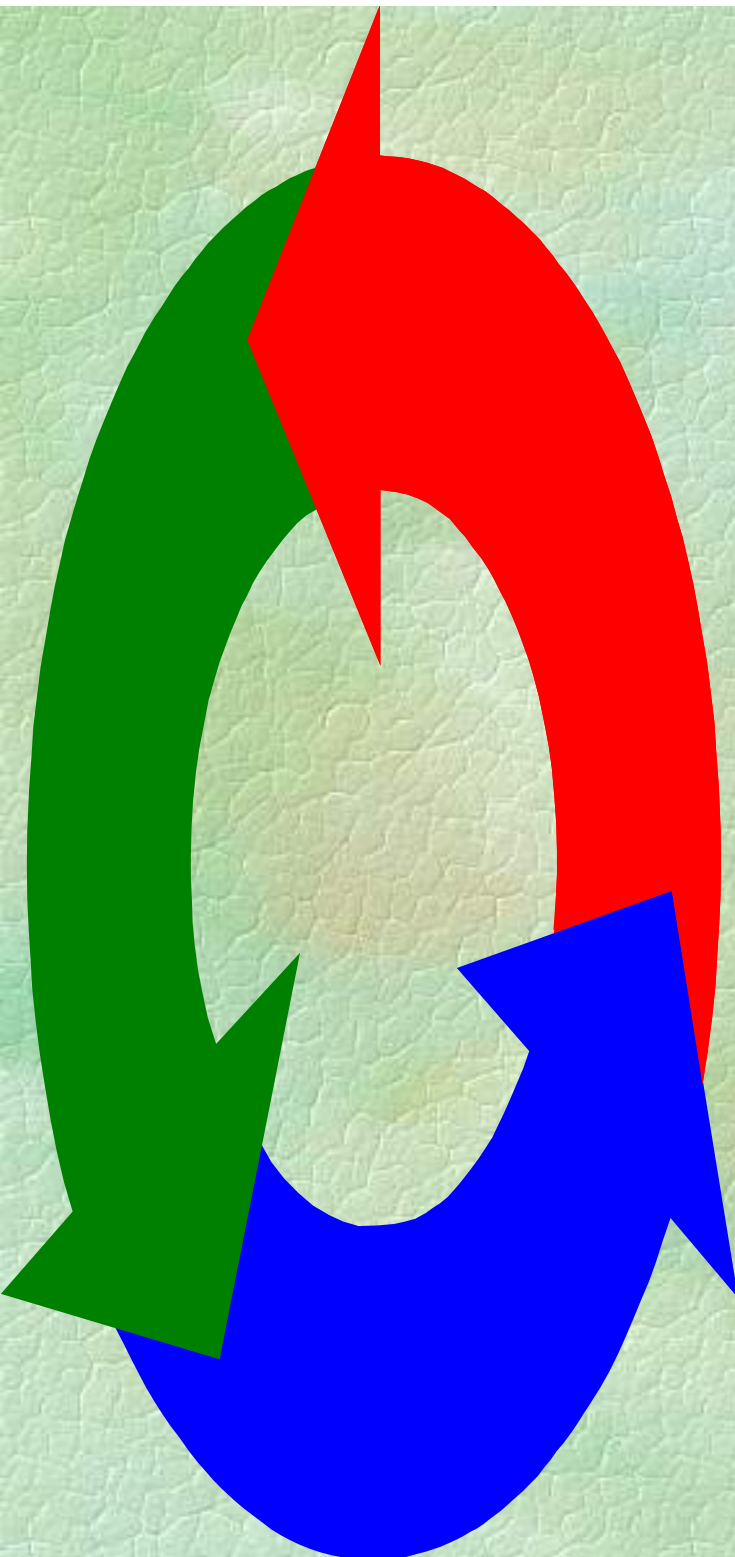
- ☞ Pays fixed percentage (5% or more) of trust value as annually re-valued.
- ☞ Payment for percentage amount or net income, whichever is less.
- ☞ No payment from principal.
- ☞ Additional gifts allowed.
- ☞ Income and principal defined in trust document per state law.
- ☞ Income may include realized gain.

Net Income with Make-Up (NIMCRUT)

-  Pays fixed percentage (5% or more) of trust value as annually re-valued.
-  Payment for percentage amount or net income, whichever is less.
-  In pay periods when net income exceeds the percentage amount, extra payment allowed to make-up for pay periods when net income was less than percentage amount.
-  No payment from principal. Additional gifts allowed.
-  Income and principal defined in trust document per state law. Income may include realized gain.

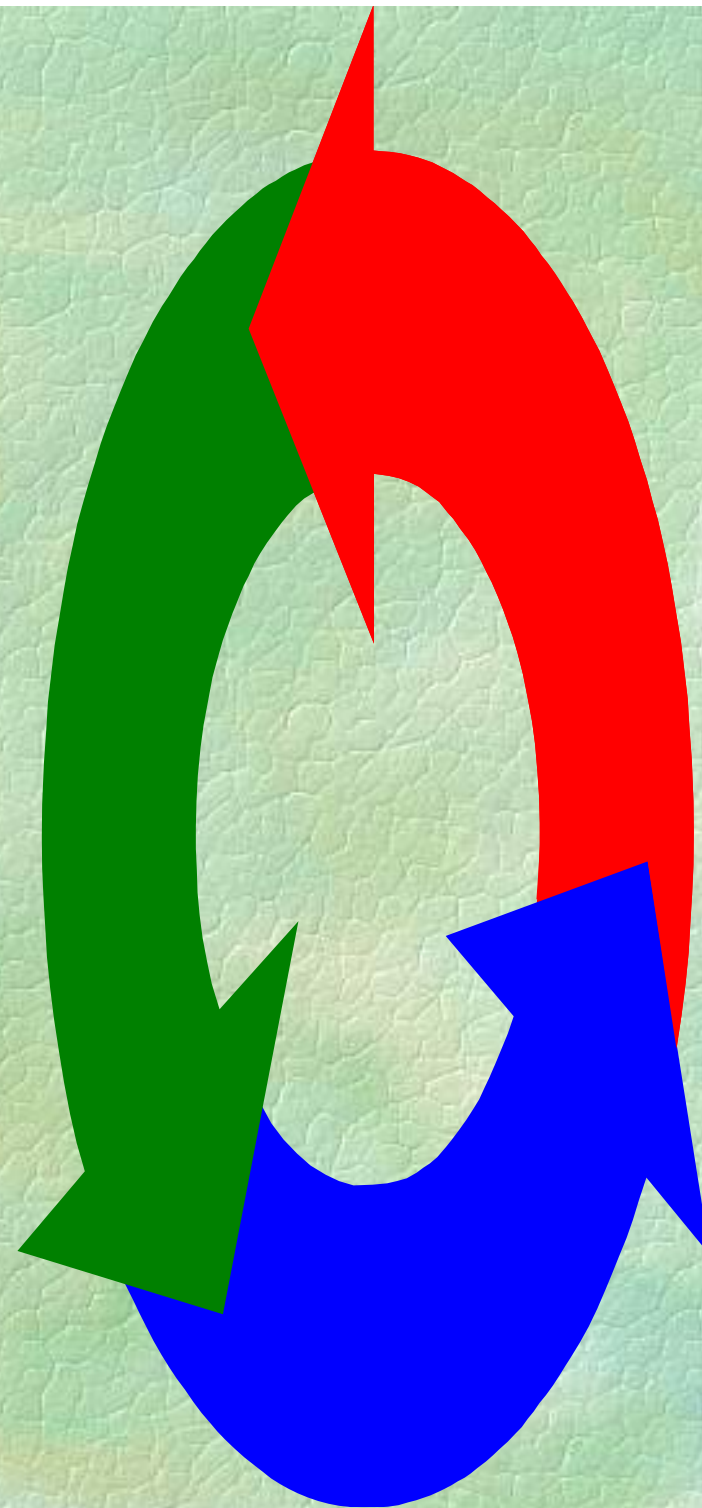
FLIP CRT

- Flip from NICRUT to Regular CRUT. Treas. Reg. §1.664-3(a)(1)(i)(c).
- Excellent vehicle to deal with real estate that may be slow to sell.
- Get income tax deduction when property is donated to trust.
- Pay income when asset is sold and proceeds reinvested and trust “flips”.



FLIP CRT

- **Flip stated in trust document.**
- **Triggered on a specific date or by an occurrence which is not discretionary or within the control of any person. The regulations provide specific examples. Treas. Reg. §1.664-3(a)(1)(i)(c).**
- **After conversion, no make-up provision (loss of any make-up).**



Testamentary CRT

- Testamentary provision in will or revocable trust.
- Funded with direct payment of proceeds from IRA or other qualified retirement plan.
- Income tax deduction for estate.
- Payments for lifetime of children/other heirs unlike ten year maximum for inherited IRA.
- Payments are taxable.
- CRT is tax-exempt.

Qualified Charitable Distribution for CRT

- Tax-free IRA charitable rollover (QCD) directly to CRT.
- \$54,000 in 2025 for one or \$108,000 for spouses from each IRA (annually indexed for inflation).
- Single year transfer from IRA.
- CRT cannot own any other assets.
- All income is taxed at the ordinary rate.

CRAT Documents

- 1. Rev. Proc. 2003-54**: inter vivos CRAT providing for annuity payments for one measuring life
- 2. Rev. Proc. 2003-55**: inter vivos CRAT providing for annuity payments payable consecutively for two measuring lives
- 3. Rev. Proc. 2003-56**: inter vivos CRAT providing annuity payments concurrently and consecutively for 2 measuring lives
- 4. Rev. Proc. 2003-57**: testamentary CRAT providing for annuity payments for one measuring life
- 5. Rev. Proc. 2003-58**; testamentary CRAT providing for annuity payments for a term of years
- 6. Rev. Proc. 2003-59**: testamentary CRAT providing for annuity payments payable consecutively for two measuring lives
- 7. Rev. Proc. 2003-60**: testamentary CRAT providing for annuity payments payable concurrently and consecutively for two measuring lives.

CRUT Documents

- 1. Rev. Proc. 2005-52**: inter vivos CRUT providing for unitrust payments for one measuring life
- 2. Rev. Proc. 2005-53**: inter vivos CRUT providing for unitrust payments for a term of years
- 3. Rev. Proc. 2005-54**: inter vivos CRUT providing for unitrust payments consecutively for two measuring lives
- 4. Rev. Proc. 2005-55**: inter vivos CRUT providing for unitrust payments concurrently and consecutively for two measuring lives
- 5. Rev. Proc. 2005-56**: testamentary CRUT providing for unitrust payments for one measuring life
- 6. Rev. Proc. 2005-57**: testamentary CRUT for a term of years
- 7. Rev. Proc. 2005-58**: testamentary CRUT providing for unitrust payments payable consecutively for two measuring lives
- 8. Rev. Proc. 2005-59**: testamentary CRUT providing payments concurrently and consecutively for 2 measuring lives.

Investments

Investment standard: “Prudent Investor Rule”

- Differs from “Prudent Man Rule”
- Emphasis is on total return investing
- Permits delegation of investment management and oversight

Jeopardizing Investments - I.R.C. § 4944

- Same emphasis on reviewing the portfolio as a whole
- Nothing is *per se* a jeopardizing investment

Self-Dealing Considerations

- ☛ CRTs are subject to private foundation rules and excise taxes for self-dealing.
- ☛ CRT property cannot be used, sold, rented or exchanged to a disqualified person: donor or donor's family (spouse, ancestor or lineal descendant or spouse of lineal descendant).
IRC §4941(d)(1).
- ☛ Example: Cannot continue to live in house donated to a CRT

Effect of Debt: Disqualifies CRT

- Acquisition Indebtedness.
- No tax exemption (UBI).
- Act of self-dealing.
- Bargain sale.
- Grantor trust.
- Prohibited payment.

Ideas: Sell portion to pay debt. Convert to personal debt, or other property.

Exceptions: Contribution of Debt Encumbered Property to a CRT

- *“Five and Five Rule” No unrelated business income tax if the mortgage was placed on the property more than five years prior to the gift, AND the property was held by the trustor for more than five years prior to the gift.*
- *No self-dealing if the mortgage was placed on the property more than ten years prior to the gift.*

Unrelated Business Income

- *Formerly, a CRT receiving UBI would not be deemed a tax exempt trust in the year the UBI was received by the trust.*
- *Now, a 100% income tax on UBI for the year received, but the CRT remains tax exempt.*
- *UBI does not include investment income (e.g., rental income) with some exceptions.*

Termination of Income Interests:

Context

- ☞ Decline in distributions from under-performing charitable remainder trusts due to diminished stock values and interest rates.
- ☞ Less need for income.
- ☞ Accelerate remainder to charity to support a campaign, create an endowment for specific need, create a donor advised fund, etc.
- ☞ Whole or partial terminations allowed by IRS.
- ☞ Need for additional current income tax deduction.

Gifts of Income Interests

- ☛ May donate all or a portion of income interest. PLRs 200140027, 200207026, 9712013
- ☛ Legal counsel prepares and files with local court pursuant to state law a declaration to merge income and remainder interests, terminating all or a portion of the trust.

Gifts of Income Interests

- ☞ **Income tax charitable deduction equal to present value of income interest. Rev. Rul. 86-60. PLRs 200310024, 20020706.**
- ☞ **Gift of capital asset with zero basis subject to 30% AGI deduction limit. PLR 8613046.**
- ☞ **Beware of state law and spendthrift provision in trust agreement that may prevent this approach.**
- ☞ **Approval by Attorney General and local court with jurisdiction.**

Cashing Out

- ☛ Trustee and charity agree to terminate the CRT and distribute the relative income and remainder interests in accordance with the discount rate then in effect under Sec. 7520.
- ☛ No act of self-dealing.
- ☛ PLR 200208039

Questions?

