BakerAvenue
Wealth Management

Charitable Remainder Trust

Tax Mitigation Strategies

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Secure a Lifetime Income, Save Taxes, and Benefit a Charity

A Charitable Remainder Trust (CRT) lets you convert a highly appreciated asset like stock or real estate into lifetime income. It reduces your income taxes now and estate taxes when you die. You pay no capital gains tax when the asset is sold. It also lets you help one or more charities that have special meaning to you.

Benefits of a CRT

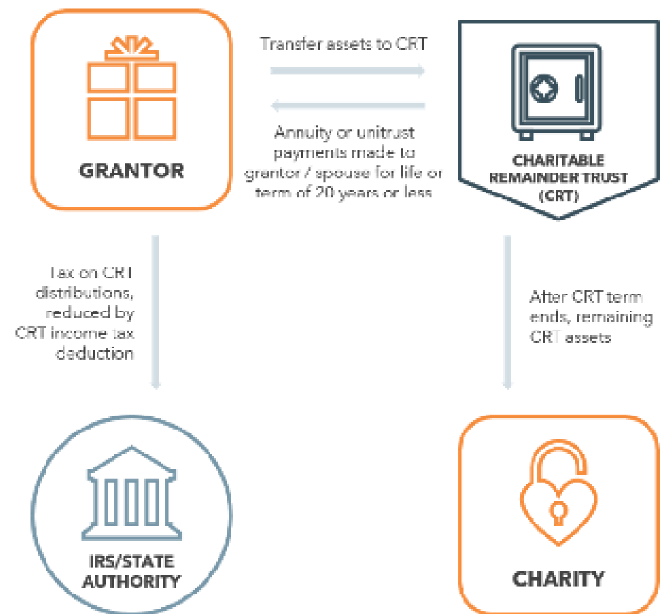
- Convert an appreciated asset into lifetime income
- Reduce your current income taxes with charitable income tax deduction
- Pay no capital gains tax when the asset is sold
- Receive more income over your lifetime than if you had sold the asset yourself
- Reduce or eliminate your estate taxes
- Gain protection from creditors for the gifted asset
- Benefit one or more charities
- Leave more to your children or others by using a life insurance trust to replace the gifted asset

How does a CRT work?

You initially fund the CRT with low basis, highly-appreciated assets. You transfer the appreciated asset into an irrevocable trust. This removes the asset from your estate, so no estate taxes will be due on it when you die. You also receive an immediate charitable income tax deduction.

When the CRT sells the highly appreciated assets, the CRT itself is not subject to capital gains tax, thus preserving the full value of the appreciated assets to reinvest in a diversified portfolio.

For the rest of your life, the trust pays you an income. The capital gains taxes will be spread out and payable as the beneficiaries receive payments from the CRT. When you die, the remaining trust assets go to the charities you have chosen. That is why it is called a charitable remainder trust.



What kinds of assets are suitable?

The best assets are those that have greatly appreciated in value since you purchased them, specifically publicly traded securities, real estate, and stock in some closely held corporations. (S corporation stock does not qualify. Mortgaged real estate usually will not qualify, either, but you might consider paying off the loan.) Cash can also be used.

Example analysis of a hypothetical $1 million contribution to a CRT:

Duration	Optimal Distribution Rate	Amount Received	Charity Receives	Tax Deduction
5 Years	37.0%	$989,782	$146,683	$100,000
10 years	20.6%	$1,118,322	$205,225	$100,000
20 years	10.9%	$1,466,914	$404,702	$100,000
Lifetime*	6.4%	$2,800,403	$1,153,533	$100,000

Source: https://www.estateplanning.com/Understanding-Charitable-Remainder-Trusts

Income choices:

- **Charitable remainder unitrust where you can receive a fixed percentage of the trust assets**.
  With this option, the amount of your annual income will fluctuate, depending on investment performance and the annual value of the trust.

  The trust will be revalued at the beginning of each year to determine the dollar amount of income you will receive. If the trust is well managed, it can grow quickly because the trust assets grow tax-free. The amount of your income will increase as the value of the trust grows.

- **Charitable remainder annuity trust where you can elect instead to receive a fixed income**.
  This means that, regardless of the trust's performance, your income will not change.

  This option is usually a good choice at older ages. It does not provide protection against inflation like a unitrust does, but some people like the security of being able to count on a definite amount of income each year. It is best to use cash or readily marketable assets to fund an annuity trust.

Who can receive income from the trust?

Trust income can be paid to you for your lifetime. If you are married, it can be paid for as long as either of you lives. The income can also be paid to your children for their lifetimes. Or to any other person or entity you wish, provided that the trust meets certain requirements.

In addition, there are gift and estate tax considerations if someone other than you receives it. Instead of lasting for someone's lifetime, the trust can also exist for a set number of years (up to twenty).

Do I have to take the income now?

No. You can set up the trust and take the income tax deduction now but postpone taking the income until later. By then, with good management, the trust assets will have appreciated considerably in value, resulting in more income for you.

How are distribution amounts determined?

IRS rules require the amount be at least 5% but no more than 50% of the trust assets. The maximum distribution amount depends on the length of the CRT term or for lifetime CRTs, the Lead Beneficiaries' life expectancies.

Is income tax imposed on the distributions?

CRTs are exempt from income tax. The CRT assumes the grantor's adjusted cost basis and holding period in the property. If the CRT sells appreciated property, neither the grantor nor the CRT will pay immediate income tax on the sales. However, when the Lead Beneficiaries receive payments (at least annually), those payments are subject to income tax.

Do I get a charitable deduction?

Yes, the grantor receives an immediate income tax deduction equal to the present value of the projected remainder interest that passes to the charity.

The deduction may be limited to 30% or 20% of AGI for the year, depending on the type of property you give to the CRT (short term v. long term capital gain property) or the type of charitable organization named as remainder beneficiary (church/school/public charities/donor advised funds v. family private foundations). The good news is that you may carry over any unused charitable deduction amount from any year in which the remaining deduction surpasses these limits, up to 5 years.

How long can the CRT last?

A CRT may last for the Lead Beneficiaries' joint lives or for a term of years (the term may not exceed 20 years). In addition, the actuarial value of the CRT remainder left to charity must be least 10% of the initial CRT value, determined at time of funding. This "10% test" creates a floor as to how young the Lead Beneficiaries can be. If the Lead Beneficiaries are too young, the CRT will fail the 10% test. For a lifetime CRUT, the Lead Beneficiaries must be at least in their 40s and for a lifetime CRAT, the Lead Beneficiaries need to be at least in their mid-70s.

Who can be the trustees?

- Often, grantors will name themselves or their spouses as trustee.
- The grantor's other family members may also act as trustees.
- An independent trustee may be needed if CRT holds unmarketable or hard to value assets such as closely held stock or artwork, or if the grantor thinks he may want to change the charitable beneficiary later.

Do I still have control?

Yes. For as long as you live, the trustee you select—not the charity—controls the assets. Your trustee must follow the instructions you put in your trust. You can retain the right to change the trustee if you become dissatisfied. You can also change the charity (to another qualified charity) without losing the tax advantages.

Are there restrictions on what charity can be named as remainder beneficiary?

Yes, the charitable remainder beneficiary must be an organization described in Internal Revenue Code Section 170(c), such as a public charity, donor advised fund, religious organization or a private foundation.

You may change the charitable beneficiary during your life, but it is best to give an independent trustee this power to avoid risk of the CRT being included in your taxable estate.

Your private foundation can be the remainder beneficiary, but the income tax deduction will usually be less.

Do I have to pay gift tax when I set up a CRT?

Generally, no. However, if someone other than grantor or his spouse receives the payments, then the grantor has made a taxable gift to that someone equal to the present value of the annuity or unitrust amounts paid to that person over the trust term, calculated when the CRT is created.

Is the CRT includible in my estate?

Generally, by gifting assets to a CRT, a grantor removes those assets from his taxable estate. The remainder passing to the charities is not includible in the grantor's taxable estate. There is no estate tax consequence so long as the grantor and her spouse are the only Lead Beneficiaries.

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