3 Tips for Meeting Tax and Philanthropic Goals Through Charitable Remainder Trusts

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Combining charitable giving with an ongoing income stream, a charitable remainder trust (CRT) can play an important role in your wealth and estate plan. A CRT is an especially effective way to convert low-basis assets such as stock and real estate into lifetime income, all while generating substantial tax savings and providing support for important causes.

How a Charitable Remainder Trust Works

The process for establishing a CRT is reasonably straightforward and is outlined in the process below:

1. **Draft the trust.** Work closely with your advisor and attorney to establish a trust framework, and draft the trust documentation.
2. **The person establishing the trust—called the "settlor"—donates assets into an irrevocable trust.** These donated assets are typically highly appreciated stock or real estate that have been held for more than one year and thus qualify for long-term capital gains treatment. By doing so, the settlor removes the assets from their estate and receives an immediate charitable income tax deduction.
3. **The trustee then sells the asset at full market value and reinvests the proceeds.** There is no immediate taxable gain on the asset that has been sold.
4. **The charitable remainder trust can give the noncharitable beneficiary payments for life—**often the joint lives of a husband and wife—or for a term of years. Children and other parties may also qualify as income beneficiaries. Depending on the terms of the trust, payments are a fixed amount or a fixed percentage.
5. **Upon the death of the beneficiary receiving the trust income or the expiration of the term of years,** the remainder goes to the designated charities.

The settlor may also serve as trustee for the CRT. Importantly, as the settlor also has the right to amend the trust to change the charitable remainder beneficiaries and to alter the amount or percentage of the remainder that is distributed to them.

Please note: CRTs are not for appropriate for all individuals or families. In many cases, CRTs are not economically feasible to create for amounts less than $500,000 - $1 million, depending upon individual financial situations. Consider speaking with your advisor about the best potential options, and important considerations to factor for when deciding if a CRT would be appropriate.

Advantages of a CRT

A charitable remainder trust offers several advantages and benefits. By establishing a charitable remainder trust, you can:

- Avoid immediate capital gains taxes on the sale of appreciated assets. However, future distributions to the income beneficiary may consist of capital gains. Therefore, the taxation of capital gains is not completely avoided, merely deferred.
- Obtain an income tax deduction for the year in which the assets are placed in the trust.
- Generate a steady stream of income.
- Increase income while diversifying your investment portfolio and reduce risk by replacing a single large concentrated investment asset with a portfolio of investments.
- Reduce real estate tax liabilities (if the asset transferred to the CRT is real estate). This can vary based upon jurisdiction, so be sure to consult an advisor to confirm what might be possible.
- Make significant future contributions to charities that are important to you.

In addition, the income earned within a charitable remainder trust is exempt from current income taxes, which allows for tax-deferred growth.

The top 3 tips for establishing a charitable remainder trust

While the basics of CRTs are easily understood, these trusts have intricacies that require the expertise of trusted professionals. That said, here are three important steps to take to ensure that you make the most of CRTs.

1. Define your objectives

Any decision you make regarding a CRT—including the decision to establish one—should be made as part of a comprehensive wealth plan. Factors to consider include:

- Estate planning objectives and what you wish to transfer to your heirs
- Anticipated income for beneficiaries that will be needed from the CRT.
- Taxes, including real estate
- Charitable giving objectives, including the causes you wish to support and their qualifications as 501(c)(3) organizations
- Income derived from all sources
- Investment guidelines, benchmarks, and vehicles for assets invested in the CRT

2. Select optimal assets for the CRT

You may use a wide variety of assets for a CRT, including publicly traded securities, unmortgaged real estate, and private company—but not S-Corp—stock. Cash may also be used. Selecting appropriate securities is one of the paramount considerations for the creation of CRT. It is recommended and considered a best practice to collaborate closely with your advisor to identify securities that would be most appropriate. There are many unique points to consider when selecting these assets, and your advisor should be able to present a holistic view of these options.

As mentioned earlier, a low-basis asset that has appreciated significantly can be especially attractive for funding a CRT. Holding a significant portion of a family's wealth in one or a few assets is risky, but selling the asset and reinvesting the proceeds would result in a sizable capital gains tax. Also, while making a big donation to a favorite cause may be an important goal, ensuring that there is an ongoing income stream to sustain family members for the future is also a critical consideration. In this situation, a CRT may be the perfect solution to meet your overall income, tax, and philanthropic objectives.

3. Determine income recipients and the appropriate type of CRT

Trust income could be paid to you or beneficiaries for over a lifetime or, if you choose, for a term of years (not to exceed 20). Married couples may select payments for as long as either partner lives. The income may also be paid to your children over their lifetimes or to other parties. However, the remainder actuarial value must be more than 10% of the initial contribution, and the minimum payout rate is more than 5%, so when accounting for assumed lower interest rates, younger age beneficiaries may not qualify for receipt of income.

After determining who the income recipients will be, you will need to decide on the type of CRT:

Charitable remainder unitrusts (CRUTs) distribute a fixed percentage of trust assets. The amount of your annual income will fluctuate, depending on investment performance and the value of the trust, which is revalued at the beginning of each year. Additional contributions can be made.

Charitable remainder annuity trusts (CRATs) distribute a fixed annuity amount each year—your income will not change regardless of the trust's performance. Additional contributions are not allowed.

With a unitrust, the amount of your income will increase if the assets grow. While an annuity trust does not provide inflation protection and the opportunity for higher income, many older beneficiaries prefer the income predictability that CRATs offer. With both types of CRTs, the annual payout rate stated in the trust cannot be less than 5% or more than 50% of the initial fair market value of the trust's assets, according to IRS requirements.

Learn more about charitable remainder trusts

A CRT can enable you to make substantial donations to your favorite charities while allowing you to achieve important tax and income goals. To ensure that you are meeting the necessary requirements and that a CRT is integrated with your overall wealth plan, you should work with objective, independent experts to create and fund the trust.

To learn more about how a charitable remainder trust can help you meet your goals, contact your Key Private Bank Advisor.

About the Author

As a senior financial planner with Key Private Bank, Tina Myers offers her clients sophisticated financial planning advice and a comprehensive set of strategies to grow and preserve their wealth. She collaborates with her team's Fiduciary Strategists, coordinates strategies with attorneys and accountants, and follows up on a regular basis to ensure the plan is performing optimally.