

Charitable Remainder Trusts

How It Works

A Charitable Remainder Trust is set up in order to achieve both income and estate tax benefits for a donor and his or her beneficiaries. The donor can name himself/herself or others to receive an income stream for life with the principal remaining at the donor's death going to the charities. The donor receives an income tax deduction when he/she transfers the property to the trust, and reduces his/her estate size by the amount of property transferred. Naturally, there are restrictions placed on the non-charitable beneficiary's rights to income and the invasion of the trust principal. Only in this way can the designated charity be assured that it will eventually receive the property for which the donor is taking income tax deductions.

Two of the most utilized charitable remainder trusts are the charitable remainder annuity trust and the charitable remainder unitrust. Under the charitable remainder annuity trust, a fixed amount of income is paid annually to a non-charitable beneficiary. The grantor can take an income tax deduction based on the present value of the charity's remainder interest at the time the property is transferred to the trust. If the income generated by the trust is insufficient to make the required payments to the non-charitable beneficiary, then capital gains or trust principal must be used to make up any shortage. Conversely, if the trust income is greater than the amount required to make the payments to non-charitable beneficiaries, then any excess amount is reinvested in the trust.

Under the charitable remainder unitrust, a fixed percentage of the net fair market value of the trust is paid annually to the non-charitable beneficiary. The percentage cannot be less than 5 percent of the annual value of the trust. Income payable to the non-charitable beneficiary must be for a term of no more than 20 years or for life. If income is payable for life, then the older the non-charitable beneficiary, the greater the deduction. Any payments to a survivor will reduce the donor's amount of charitable income tax deduction.

Advantages of a Charitable Trust

- Probate and administrative costs are reduced.
- The grantor receives an income tax deduction equal to the present value of the charity's remainder interest.
- The donor receives a charitable estate tax deduction at death equal to the value of the interest given to the charity.
- Since the asset is usually sold by the charity, the donor may avoid or defer capital gains taxes upon sale of the asset.
- The donor receives an income flow that is stated in the trust agreement.
- Estate taxes can be reduced.
- The donor has the lifetime satisfaction of knowing that the property in trust will eventually pass to the designated charity upon death.
- Life insurance can be used to replace the wealth transferred to the charity during the grantor's lifetime.