What is a Charitable Remainder Trust?

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A charitable remainder trust is an irrevocable trust used to reduce the taxable income of an individual. A charitable remainder trust distributes income to the noncharitable beneficiary for life or a term of 20 years , then donates the remaining balance of the trust to designated charities. A charitable remainder trust is one way to gain diversification in a concentrated position, without facing large tax liabilities.

How Charitable Remainder Trusts Can Help Save on Taxes

When a donor contributes to a charitable remainder trust, they receive an immediate income tax deduction equal to the amount of the present value of the remainder interest that will pass to the charity or charities. Excess deductions can be carried forward for up to 5 years. The power of a charitable remainder trust is that it is tax-exempt. The income paid throughout the trust's term however, is taxable according to the 4 tier ordering rule. It is taxed in the order of the CRT's income: ordinary income, capital gain, other income and corpus.

The value of a charitable remainder trust will be included in the estate of the donor once they pass away but, the estate will also receive a charitable tax deduction. The remainder of the trust is not taxable to the charity to which it is distributed. A charitable remainder trust is most useful if the grantor has a low basis asset that needs to be sold, without facing large capital gains.

The Basics of Charitable Remainder Trusts

There are 4 factors the donor must take into consideration when creating a charitable remainder trust.

1. The Trust's Term. A charitable remainder trust's term can be either the lifetime of the noncharitable beneficiaries or a set period of time, not exceeding 20 years.
2. The Payout Rate. The payout rate can be no less than 5% and no greater than 50% of the initial contribution to the trust. The higher the payout rate, the lower the present deduction for the donor's individual income tax.
3. The Funding Amount. What is the fair market value of the initial contribution to the charitable remainder trust? A charitable remainder trust must pass a 10% remainder test, meaning that there must be an estimated 10%, at a minimum, of the initial contribution left at the end of the trust's term to distribute to the designated charity.
4. The Type of Asset. Securities, real estate and cash are all examples of types of assets that can be used to fund a charitable remainder trust.

The four variables above are what determines the donor's income tax deduction.

What is the Difference Between a Charitable Remainder Unitrust & a Charitable Remainder Annuity Trust?

The main difference between a charitable remainder unitrust (CRUT) and a charitable remainder annuity trust (CRAT) is the consistency in the payout amount and the flexibility to make additional contributions to the trust. With charitable remainder unitrusts, the noncharitable beneficiaries will receive a variable payment based on the revaluation of assets each year. A CRUT is also more flexible as it can accept additions throughout the trust's term. With charitable remainder annuity trusts, the beneficiaries will receive a fixed payment regardless of any changes in asset value. In addition, a CRAT cannot accept additions after the initial funding of the trust.

Contact Premier Trust to Learn More

Charitable remainder trusts can be useful tools in estate planning. When utilized properly, a charitable remainder trust can greatly reduce the tax liability of an individual and their estate, leaving more of the donor's assets for generations to come. Premier Trust can run gift illustrations for clients and their advisors. To learn more about charitable remainder trusts and which one might be right for you or your client, call us at 702-577-1777 or send us an email at info@premiertrust.com.