Should a CRT be part of your estate plan?

It brings a great deal of satisfaction to Joe that he has the ability to make substantial gifts to his favorite charity. However, after the last few years of economic uncertainty, he's become concerned that he may encounter cash-flow problems in the future if he continues to donate. Joe's estate planning advisor explains how a charitable remainder trust (CRT) can benefit his situation.

What's a CRT?

A CRT allows you to support a favorite charity while potentially boosting your cash flow, shrinking the size of your taxable estate, reducing or deferring income taxes, and enjoying investment planning advantages.

How does a CRT work? You contribute stock or other assets to an irrevocable trust that provides you — and, if you desire, your spouse — with an income stream for life or for a term of up to 20 years. (You can name a noncharitable beneficiary other than yourself or your spouse, but there may be gift tax implications.) At the end of the trust term, the remaining trust assets are distributed to one or more charities you've selected.

When you fund the trust, you're entitled to claim a charitable income tax deduction equal to the present value of the remainder interest (subject to applicable limits on charitable deductions). Your annual payouts from the trust can be based on a fixed percentage of the trust's initial value — known as a charitable remainder *annuity* trust (CRAT). Or they can be based on a fixed percentage of the trust's value recalculated annually — known as a charitable remainder *unitrust* (CRUT).

Generally, CRUTs are preferable for two reasons. First, the annual revaluation of the trust assets allows payouts to increase if the trust assets grow, which can allow your income stream to keep up with inflation. Second, you can make additional contributions to CRUTs, but not to CRATs.

The fixed percentage — called the unitrust amount — can range from 5% to 50%. A higher rate increases the income stream, but it also reduces the value of the remainder interest and, therefore, the charitable deduction. Also, to pass muster with the IRS, the present value of the remainder interest must be at least 10% of the initial value of the trust assets.

The determination of whether the remainder interest meets the 10% requirement is made at the time the assets are transferred — it's an actuarial calculation based on the terms of the trust. If the ultimate distribution to charity is less than 10% of the amount transferred, there's no adverse tax impact related to the contribution.

What are the investment advantages?

CRTs facilitate tax-efficient investment strategies. To manage investment risk, diversification is critical. Ordinarily, to diversify your portfolio, you liquidate more-concentrated holdings and reallocate the proceeds to a broader range of investments. But portfolio rebalancing typically generates taxable income. By contributing assets to a tax-exempt CRT, however, you're essentially free to reallocate the assets to achieve your investment objectives without concern about immediate tax consequences.

A CRT is particularly effective for highly appreciated assets that would otherwise generate substantial immediate capital gains. Instead of selling those assets outright, you contribute them to a CRT. The trustee then sells them, unburdened by capital gains taxes, and reinvests the proceeds in more diversified assets that hopefully provide greater returns.

Annual payouts from a CRT are taxable — generally as a combination of ordinary income, capital gains and tax-exempt income (if any), and tax-free return of principal. But because you pay tax only as you receive the annual payouts, you can defer much of the tax on a large capital gain for a potentially significant period of time (depending on the trust's term).

Seek advice before taking action

After listening to his advisor, Joe decides a CRT can help him to continue making substantial contributions to his favorite charity while alleviating his concerns about his future cash flow. Before taking action yourself, it's important to know that a CRT requires careful planning and solid investment guidance. Your attorney can help you determine if a CRT is right for you.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com