DONALDSON
CAPITAL MANAGEMENT

Your Guide to Understanding

Charitable Remainder Trust

A Charitable Remainder Trust (CRT) is a powerful estate planning tool, especially for those who prioritize tax efficiency in their financial planning. It allows you to support your favorite charities while providing potential financial benefits for you and your heirs. Let's explore the mechanics, benefits, and tax implications of CRTs.

What Is a Charitable Remainder Trust?

A Charitable Remainder Trust is an agreement between you and a trustee, typically your spouse, who holds assets for a specified term. The term can last for your lifetime, your spouse's lifetime, and/or other beneficiaries' lifetimes, or for a period not exceeding 20 years. During the term of the CRT, the trustee distributes a portion of the trust assets, as you determine, to a non-charitable beneficiary, known as the income recipient, typically you and/or your spouse. At the end of the term, the charity or charities you selected receive the remaining assets in the CRT. There are two types of CRTs: Charitable Remainder Annuity Trust (CRAT) and Charitable Remainder Unitrust (CRUT).

Charitable Remainder Annuity Trust (CRAT)

A CRAT pays out a fixed annuity amount each year, providing stable income for the donor or beneficiaries. This can be appealing to individuals seeking predictable income. However, the annuity amount cannot be altered, even if the trust's investments perform poorly. Once a CRAT is established, no further contributions can be made to the trust.

Charitable Remainder Unitrust (CRUT)

The CRUT pays out a fixed percentage of the trust's assets each year, allowing the income to grow if the trust's investments perform well. This can be appealing for individuals looking for income that might grow. However, if the trust's investments perform poorly, the income from the CRUT can decrease. **Unlike a CRAT,** additional contributions can be made to a CRUT after it's established.

What Are The Benefits?

- ### Reduction in Estate Size

  The gift to a CRT is immediately removed from your estate, creating estate tax savings. No gift taxes are due if you and/or your spouse are the income recipients.

- ### Income Tax Deduction

  You receive a charitable income tax deduction based on the value of the assets expected to remain in the trust at the end of the term. The deduction amount depends on:

  1. The income amount, with higher income or longer periods resulting in less for the charity and a smaller deduction.

  2. The age of the income recipient, with older recipients getting larger deductions.

  3. The Internal Revenue Service **interest rates** at the time of the gift.

  Additionally, at least 10% of the property's initial value must go to the charity to qualify as a CRT.

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What Are The Benefits? *(continued)*

- **Potential Capital Gains Tax Savings & Higher Living Income**

  Your cash flow may increase due to the income tax deduction and the interest from the CRT. Many grantors donate highly appreciated, non-income-producing property to a CRT. Since it's a charitable trust, the CRT can sell the asset without incurring capital gains tax. The proceeds are reinvested into income-producing property to pay the income interest. This allows a CRT to unlock income from a non-income-producing asset without losing value due to capital gains.

- **Significant Gift to Charities**

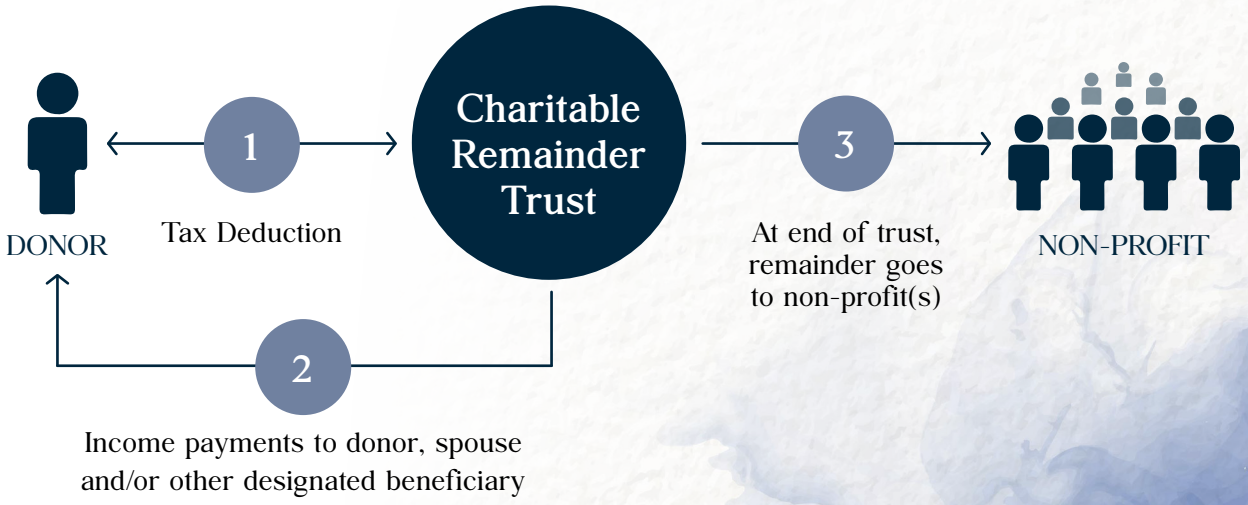
  Any assets remaining in the CRT at the end of the term go to the specified charities. If the CRT earns a growth rate higher than the amount paid to the income recipient, the trust assets will grow over time. The potential benefit to charities may be tremendous. In fact, many large charities have special departments to help donors create a CRT.

Charitable Remainder Unitrust (CRUT) Scenario

Phil has $1 million of highly appreciated growth stocks that he wants to convert into an income stream without generating a huge tax bill. Philanthropy is important to Phil, but he doesn't want to lose all the current benefits of the assets that will eventually go to charity. He donates $1 million of growth stocks to a CRUT.

The trust then sells the growth stocks and reallocates the proceeds to a portfolio of dividend stocks and fixed-income instruments. No capital gains taxes are due because the sale occurs in a charitable trust. The CRUT is set up for Phil to receive 6% of the trust's value annually for 20 years. Due to the charity's remainder interest, the IRS might recognize a charitable deduction equivalent to 40% of the gift ($400,000). This deduction can be applied to the current year's income and carried forward to additional years.

After 20 years, the charity receives a significant gift. Additionally, Phil expects his estate to be subject to federal estate taxes. The assets transferred to the CRUT and any future growth will not be included in Phil's estate, thus lowering his potential federal estate tax bill.



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