

## Charitable Trusts

What is a charitable trust? A charitable trust is a gift plan defined by federal tax law that enables a donor to derive income or tax benefits from a gift that is ultimately intended to benefit a qualified non-profit organization, e.g., a church. There are many variations of charitable trusts and some are used much more often in gift planning than others.

Some charitable trusts, like Remainder Trusts, actually sound and operate a lot like a charitable gift annuity. Donors who create a Charitable Remainder Unitrust receive a lifetime income, and after their deaths, their church receives the remainder of what is left in the Charitable Remainder Trust account.

Charitable trusts are simple in concept, but federal tax law requires the donor to be very specific with his / her intentions when it comes to these types of gifts. The donor must specify the length of time that income distributions should occur. Donors have the option of specifying a certain term of years (not to exceed 20 years) or specifying the donor's lifetime. The donor may also specify that distributions should go to other beneficiaries, again for a period of years or for the lifetimes of the other beneficiaries.

According to federal tax law, the donor's annual distributions from a CRT must be a minimum of 5% of the total fund. The donor's income tax deduction for creating the charitable trust depends on: 1) how the trust is funded in terms of whether it is funded with cash or securities, or other property, 2) the value of the trust fund when it is created, 3) the date of the gift, and 4) the age of the donor and other beneficiaries (if any).

When the trust ends, the amount remaining in the trust fund account is called the "remainder" and it passes directly to the charity. In the case of CRTs, federal tax law also requires that a minimum of 10% of the trust's initial funding must pass to the charity upon the trust's termination. Federal tax law also provides the formula used to determine if the trust qualifies under the "10% rule" prior to creating the trust.

There are several types of Remainder Trusts. There are also several types of Lead trusts. What makes all the various types of trusts different from each other is a combination of 1) the type of accounting used to track the trust fund's growth over time, and 2) the type of distribution expected by the donor.

Using the correct type of charitable trust is a great way for a donor to receive lifetime income from assets that will ultimately be given to a charity. Charitable trusts are not for everyone. Professional advice from financial planners and tax advisors should be solicited by the donor prior to the creation of a charitable trust. Charitable trusts are legal documents that can vary greatly in costs.

Following is more detail about different types of trusts:

**1. The Charitable Remainder Unitrust (CRT or CRUT)**, defined in Internal Revenue Code Section 664(d) (2), provides a fluctuating income for one or more income beneficiaries during their lifetimes. The CRUT could also be created to provide income for different periods of time:

A. a term of twenty years or fewer,

- B. a term of a lifetime(s) plus a term of years, or
- C. a term of the longer of the two periods.

At the end of that time, which is the end of the life of the trust, income to the beneficiaries stops and the assets remaining in the trust are transferred to the Church.

One of the distinguishing characteristics of a CRUT involves the ability of the donor to contribute additional gifts to the trust once it is established.

Subject to donation ceilings, as defined in Internal Revenue Code Section 170(b)(1)(A) and described in Federal Tax Regulations Section 1.170A-8, the donor receives a charitable income tax deduction for the calculated remainder value in the year the gift is made. Donation ceilings allow a donor to deduct no more than 50% of Adjusted Gross Income for Cash Gifts and no more than 30% of Adjusted Gross Income for Property Gifts held long term. Cash or property gifts to a Charitable Remainder Unitrust that exceed a donor's ability to deduct the full amount in the year of the gift, however, qualify for a carryover for up to five additional years to enable the donor the ability to deduct the full amount for which they qualify over time.

The remainder value, which is the amount that is transferred to the Church at the end of the life of the trust, takes into account the number of income beneficiaries, their ages, the gift value, the life of the trust and the annual payment made to the beneficiaries. According to Code Section 664(d)(1)(A), a unitrust is a trust "from which a sum certain (which is not less than 5 percent of the initial net fair market value of all property placed in trust) is to be paid..." Another factor affecting the remainder value is the interest rate (Applicable Federal Rate), which is set by the federal government monthly.

Payments are made to income beneficiaries annually, semi-annually, quarterly or monthly, and are taxed subject to the four-tier provision as defined in Code Section 664(b) and described in Regulation Section 1.664-1(d)(1)(i). Because the payments equal a fixed percentage of the unitrust and the value of the trust may change annually, payments may vary each year.

There are three types of Unitrusts:

- A. Standard,
- B. Net Income with Makeup, and
- C. Net Income without Makeup.

Code Section 664(d) (3) outlines the exception to the Standard Unitrust, which pays the pre-determined, fixed, payout amount regardless of the trust's actual yield.

Per the Taxpayer Relief Act of 1997, all newly established or additions to existing Charitable Remainder Unitrusts must meet a minimum 10% Remainder Value Requirement as calculated when the transfer to trust is made. In plain language, this means that after completing all the calculations involving the life of the trust, the ages of the beneficiaries, the amount of the gift, the amount of the payout, etc., the amount calculated to be transferred to The Church at the end of the trust must be an amount that is equal to or greater than 10% of the original gift. If such calculations determine that the trust will transfer less than 10% of the original gift to The Church at the end of the trust, then the trust is declared "unqualified," and would not be permitted to exist. This is called the "Ten Percent Rule."

**2. The Charitable Remainder Annuity Trust (CRAT)** is defined in Internal Revenue Code Section 664(d) (1). It provides a fixed income for one or more beneficiaries during their lifetimes or for the same periods of time as described above for the Unitrusts. At the end of the life of the trust, the

income stream distributed to beneficiaries stops and the assets in the trust are transferred to The Church or other non–profit entities known as charitable remaindermen.

Among several characteristics that distinguish a CRAT from a CRUT is the restriction against allowing the donor to contribute additional gifts to the trust once it is established. With the CRUT, additional gifts to the trust are permitted. Additional gifts to a CRAT are not permitted.

The CRAT is subject to the same Donation Ceilings, as defined in Internal Revenue Code Section 170(b)(1)(A) and described in Federal Tax Regulations Section 1.170A–8. The donor qualifies for a charitable income tax deduction, which is calculated and can be used in the same fashion as the deduction for the CRUT.

Payments are made to income beneficiaries in the same way. Per the Taxpayer Relief Act of 1997, all newly established Charitable Remainder Annuity Trusts must meet a minimum 10% Remainder Value requirement as calculated when the trust is created. All CRATS must comply with the “Ten Percent Rule.”

**3. Charitable Lead Trusts.** Charitable Lead Trusts come in both the “Annuity” and “Unitrust” styles mentioned above. These trusts work in the opposite way that remainder trusts work. Remainder trusts provide gifts to the Church and/or other charities based on the amount remaining in the trust account after the trust terminates.

**3A. The Charitable Lead Annuity Trust (CLAT)** is a trust that provides a fixed income to The Church and/or other charities now – during the life of the trust – not after the life of the trust. The Church receives income from the trust now, hence the word “Lead.” Payments to the Church and/or other charities can be made for different time periods:

1. a specific number of years and days,
2. by the life or lives of people who are alive at the time the trust is created, or
3. a combination of both measures.

Upon the expiration of the trust (when income payments to the Church stop), the property reverts to the donor or the non–charitable beneficiary designated by the donor.

In the Lead Annuity Trust, the annual amount paid to the Church is a fixed dollar amount based on a percentage of the value of the original trust assets, which is determined when the gift is established. Once the payment amount is determined, it is fixed and cannot be changed. (When you hear or see the word “annuity” with regard to trusts, think “fixed payout!”)

For Charitable Lead Annuity Trusts whose assets revert back to the donor, the donor is entitled to an immediate charitable income tax deduction based (within the limits of the law) on the present value of the charitable income. However, the donor must also include the annual income paid to charity in his or her personal income for tax consideration. This type of Lead Trust, in which the trust assets revert back to the donor, is known as a Grantor Lead Trust.

For Charitable Lead Annuity Trusts whose assets do not revert back to the donor, the donor may not claim an income tax deduction for the present value of the charity's income interest. Also, the donor does not include the charitable income in his or her personal income. The value of this type of Lead Trust, a Non–Grantor Lead Trust, is the donor's ability to transfer assets at the end of the life of the trust to others with a potentially reduced gift or estate tax.

The donor must pay a gift tax in the year the Non–Grantor Lead Trust is established based on the amount of the remainder interest in the trust. This tax may be offset by the donor's unified credit, but the annual gift exclusion is not available. Still, many donors find a Non–Grantor Lead Trust attractive because the remainder interest can be quite low compared to what the asset's value may be at the time the donor would otherwise transfer the asset. In addition, once the asset is in a properly drafted Non–Grantor Lead Trust, it is no longer a part of the donor's estate; therefore it cannot be included in the estate for federal estate tax purposes.

A Charitable Lead Annuity Trust provides an advantageous method to give charitably for the donor who has a larger income than s/he currently needs. The gift also enables a high–income donor to pass the same property used to fund the trust back to his or her family with reduced gift or estate taxes upon said transfer.

**3B. The Charitable Lead Unitrust (CLUT)** is a trust, which provides a fluctuating income to the Church for a period of time. The time periods during which payments are made to The Church are the same as those available with the Charitable Lead Annuity Trust (CLAT). As with the CLAT, when income payments to The Church stop, the property reverts to the donor or the non–charitable beneficiary designated by the donor.

The annual amount paid to The Church is a fluctuating dollar amount based on a percentage of the value of the trust assets, as determined each year. (When you hear or see the word “Unitrust” with regards to discussions involving trusts, think “variable payout!”)

Everything else about the CLUT is the same as the CLAT including: 1) The immediate charitable income tax deduction based (within the limits of the law) on the present value of the charitable income when assets revert back to the donor. 2) The donor must also include the annual income to charity in his or her personal income for tax consideration.

Except for the fluctuating income to The Church, the Non–Grantor Charitable Lead Unitrust works just like the Non–Grantor Charitable Lead Annuity Trust. A major difference between the two types of trusts is the difference between fixed and variable payouts.

Just like the Charitable Lead Annuity Trust, A Charitable Lead Unitrust provides an advantageous method to give charitably for the donor who has a larger income than s/he currently needs. The gift also enables high–income donors to pass property to their family with reduced gift or estate taxes upon the transfer of the trust assets back to the family.