

Charitable Remainder Trusts Revisited

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Outline

1. Where Do CRUT's Fit In?
2. The Basics of a CRUT...
3. ...Illustrated With an Example
4. The Ideal CRUT Gift and The Nightmare CRUT Gift
5. The CRUT Variants (Standard vs. NICRUT vs. NIMCRUT vs. Flip CRUT)
6. Operational Decisions for a CRT Program:
7. The Abusive CRAT: i.e., Don't Do Scams
8. Case Studies

Where Do CRUT's Fit In?

Situation: Donor has Charitable Intent, Not in a Rush to Make the Gift

<u>Approach</u>	<u>Benefits</u>	
Wait, Die, Leave \$\$ or Stuff to Charity In Your Will	Estate Tax Deduction	
Give Some \$\$ to Charity Now	Gift Tax Deduction + Income Tax Deduction	
Give Some Appreciated Property to Charity Now	Gift Tax Deduction + Income Tax Deduction + Avoiding Capitals Gain Tax on the Property	

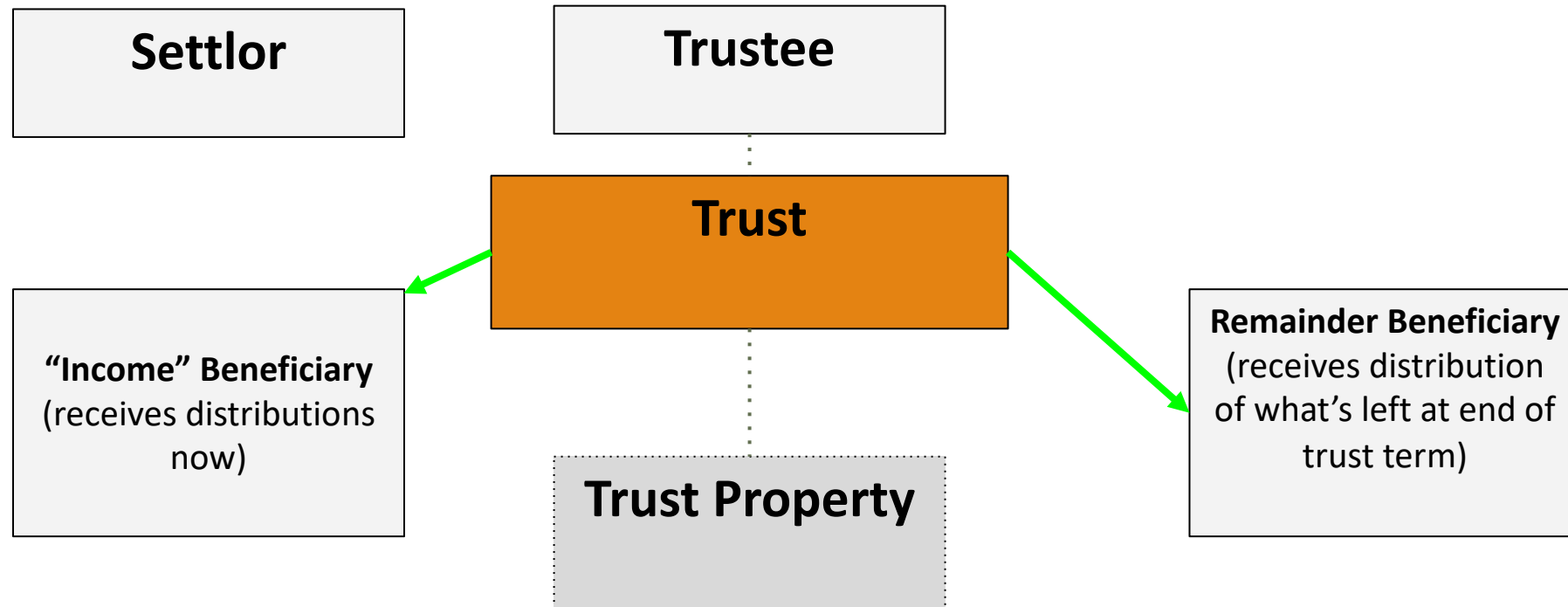
Where Do CRUT's Fit In?

Situation: Donor has Charitable Intent, Not in a Rush to Make the Gift

<u>Approach</u>	<u>Donor Benefits</u>	<u>Charity Pros</u>	<u>Charity Cons</u>
Wait, Die, Leave \$\$ or Stuff to Charity In Your Will	Estate Tax Deduction	??? Easy, I guess?	-You Might Not Get It -Donor paying tax on assets going to you in meantime
Give Some \$\$ to Charity Now	Gift Tax Deduction + Income Tax Deduction	You get it now, can start investing tax-free	??? This is Pretty Great
Give Some Appreciated Property to Charity Now	Gift Tax Deduction + Income Tax Deduction + Avoiding Capitals Gain Tax on the Property	You get it now, can start investing tax-free	-You have to deal with selling it -Direct liability for property
Give Some Appreciated Property to a CRUT Now	Gift Tax Deduction + Income Tax Deduction + <i>Deferring</i> Capitals Gain Tax on the Property + Tax-Law-Enhanced Income Stream for Life	-Can "lock in" the long-term gift -Tax-free growth in interim -No direct liability for property	-Gift reduced by payout -Got to wait -Either need to trustee or believe donor can do it- CRUTS take work

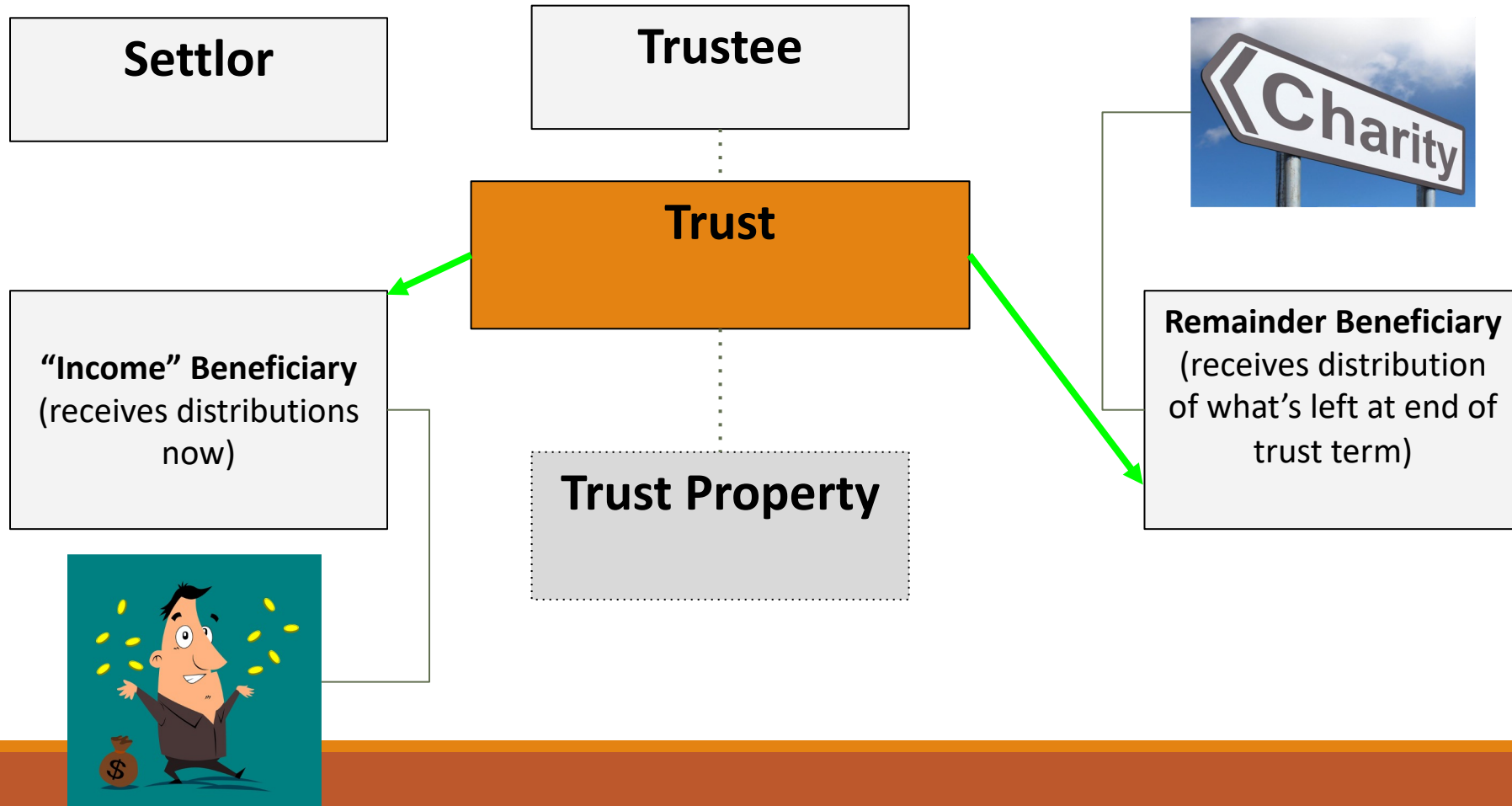
Basics – What is a Charitable Remainder Trust?

Obvious Point #1: It's a TRUST



Basics – What is a Charitable Remainder Trust?

Obvious Point #2: The remainder beneficiary is charitable



Basics – What is a Charitable Remainder Trust?

Less obvious point #3: Meets all of the requirements of Internal Revenue Code Section 664, including:

- Payout to income beneficiary meets requirements (e.g., 5 to 50% and either annuity or unitrust, with some variants we'll talk about)
- Value of remainder beneficiary's interest is at least 10% (if it's a CRAT, satisfy 5% risk of exhaustion test – easy now, hard when rates are low)
- Lasts for a term based on lives in being or a term of years (no more than 20)

Basics – Tax Characteristics of a Charitable Remainder Trust

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1. Gift to CRT = Gift, Estate, and Income-Tax Deductible to Extent of Remainder Interest
 2. CRTs do not *pay* income taxes....
 3. BUT, distributions from CRTs are taxable to the recipient to the extent CRT has accumulated taxable income (4-tier accounting)
 4. CRTs are subject to some, but not all of the private foundation rules -- most importantly, they are subject to self-dealing.
 5. Pays a 100% Tax (up to 113% in CA) on any Unrelated Business Income

UBIT Cheat Sheet

NOT RELEVANT TO A CRUT...

	UNRELATED INCOME GENERATING ACTIVITY	RELATED INCOME GENERATING ACTIVITY
PASSIVELY-GENERATED INCOME <i>Rent, royalties, interest, gain, dividends, annuities</i>	USUALLY NOT TAXABLE , unless exception applies, such as: <ul style="list-style-type: none"> • Debt-financed income • S-corporation income • Payments from controlled sub (except dividends) 	NOT TAXABLE
ACTIVELY-GENERATED INCOME <i>Sale of inventory, fees for services, etc.; includes pass-through income from partnership actively conducting business</i>	USUALLY TAXABLE , some exceptions, including: <ul style="list-style-type: none"> • Activities not regularly carried on • Volunteer exception • Sale of donated merchandise • Convenience exception 	NOT TAXABLE



Basics – Why Would a Donor Give to a CRT?

EXAMPLE: Donor (50 years old) gives publicly traded stock worth \$1M to CRT; basis is \$100k; unitrust payout of 5% per year to Donor for life; remainder interest is projected at about 25% based on AFR and age. Let's say their federal and state combined tax rate is 45% (this is made up).

- If donor sold the stock personally instead of contribute to a CRUT, \$900k in gain, \$405k in tax.
- By giving to CRUT, no gain recognition or capital gains tax on the transfer.
- Plus, donor walks away with \$250k deduction (usable against other income) and no capital gains tax on the sale.
- Will pay tax as income goes out for rest of life. *Tax deferred = Tax reduced*. Also, if it never comes out of the CRT, it's never taxed
- The 5% payouts (\$50k in year one) are likely to grow over time if tax-free CRUT grows at rate > 5%.

How Can Charities Guide Towards a Desirable Payout?

Remember that remainder interest can be as low as 10%, that means payout rates can be really high. (e.g. a 70 yr old can have a 1-life 22% pay-out). How should a charity respond to a donor who wants to max out?

1. **Don't You Want to Support Our Charitable Work...?**
2. **We Have a Policy – We Only Trustee Trusts if the Payout is No More Than X% (or the remainder value is at least Y%)**
3. **What about the deduction? The higher the payout, the lower the charitable contribution deduction**

4. The Red Line is a Better Retirement Plan Than the Blue Line

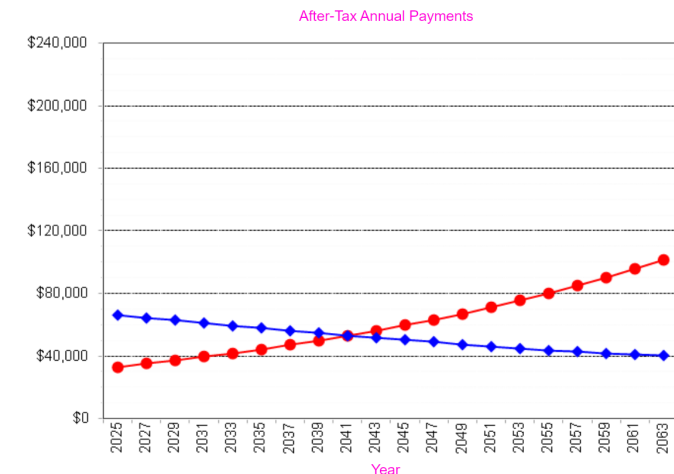
Income Projection

ASSUMPTIONS:

Projection runs for 40 years.
Measuring life age is 50.

Donor income tax bracket is 40.8%, 37% for tax savings, and 23.8% for capital gains.
Income is 3%. Appreciation is 5%.

- (1) 5% Charitable Remainder Unitrust for \$1,000,000 with 10% Basis
- ◆ (2) 9.3815% Charitable Remainder Unitrust for \$1,000,000 with 10% Basis



The Ideal CRUT Gift + The Nightmare CRUT Gift

What do we think are some characteristics of an ideal CRUT gift?

Donor that wants *some* deduction

Appreciated assets of all kinds (publicly traded stock, private c-corp stock, cryptocurrency, real estate)

Whoever is going to trustee (charity or donor) has access to quality investment management + CPA support

Donor who is interested in a retirement-income stream

The type of donor who wants to max out the tax deferral benefits

Donors who know they want to make an at-death gift



What are the characteristics of a nightmare CRUT gift?

Donor that *only* cares about maximizing deduction

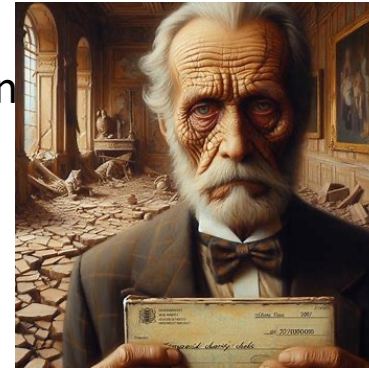
Encumbered real property

S-corporations

Cash-funded (not bad, but a waste)

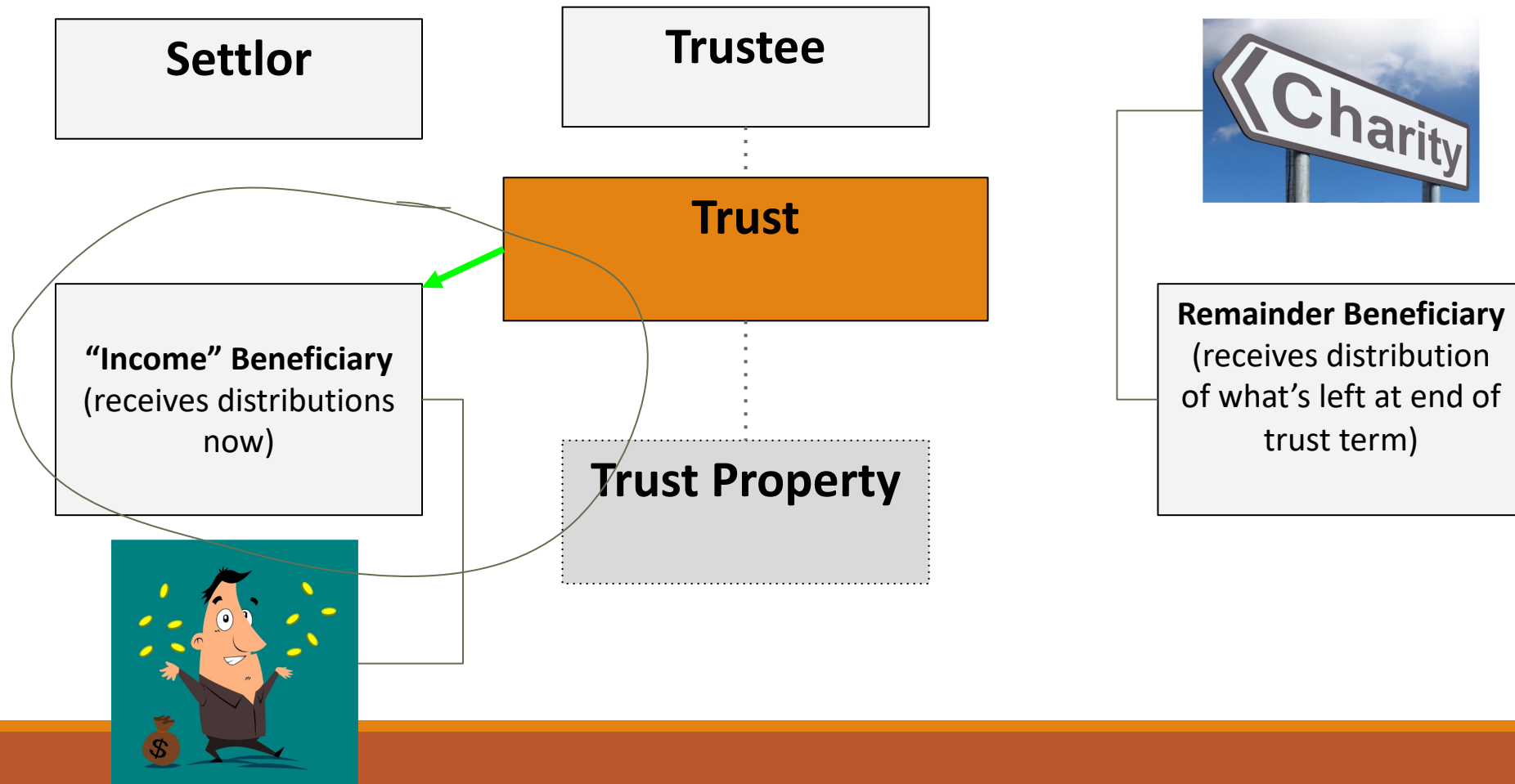
Neither donor nor charity has advisors with experience dealing with CRUTs

Donors that want to see an impact with their dollars now



Different Types of Charitable Remainder Trusts

It all depends on how the **income payment** is defined



Different Types of CRTs and When to Use Them:

Charitable Remainder Annuity Trust (CRAT): Payout = Fixed Dollar Amount
Based on Value at Time of Gift (e.g., \$1M gift, with 5% payout = \$50k per
year regardless of change in trust value, at least until it exhausts)

When is it The Best Option/Pros/Cons?

- RARE – at least if the CGA is an option; CGA does not require a separate entity AND the payments are guaranteed
- Currently, probably only with a donor/charity combination where the charity is not licensed to do CGAs (e.g. Oregon donor to a CA charity and CA charity not registered in Oregon)
- When rates are low, hard to satisfy the exhaustion test (not the case now)
- Does not take advantage of tax-free growth (from donor perspective)

Different Types of CRTs and When to Use Them:

Charitable Remainder Unitrust (CRUT): Payout = Variable Amount Based on Percentage of Value of Trust as computed *each year* (e.g., 5% of CRUT)

When is it The Best Option/Pros/Cons?

- In most situations, mutually beneficial for donors and charities
 - If it grows, charity gets larger distribution and donor gets larger payments
 - If it shrinks, damage mitigated to both because payments decrease (should never exhaust)
- Not as easy as a CRAT (need annual valuation/calculation of payment), but still simple to administer
- Challenging if only asset is illiquid and/or non-income-producing

Different Types of CRTs and When to Use Them:

Net Income Charitable Remainder Unitrust (NICRUT): Payout = The *lesser of* (A) actual income for trust accounting purposes and (B) the unitrust amount (see standard CRUT).

When is it The Best Option/Pros/Cons?

- VERY RARE – considering the NIMCRUT option, rare that a donor would choose this.
- Only likely to come up if there's a plan to hold non-liquid asset for duration of term (and even if so, the donor will probably prefer a NIMCRUT or FLIP CRUT, just in case).

Different Types of CRTs and When to Use Them:

Net Income (w/ Makeup) Charitable Remainder Unitrust (NIMCRUT):

Payout = Same as a NICRUT, but additional distributions of income in later years to make up for years in which income was below the unitrust amount

When is it The Best Option/Pros/Cons?

- If donor wants to hold onto illiquid asset for a long time, defer tax, then get a large distribution later on.
- Delicate balance of having a trustee that performs their function and avoids income recognition until desired – sometimes an LLC used
- Most complicated to administer – typically only see when CRT is being driven by donor tax-planning (charitable beneficiary might not even be set).

Different Types of CRTs and When to Use Them:

FLIP Charitable Remainder Unitrust (Flip CRUT): Payout starts as a NICRUT, but “flips” to a standard CRUT after some event (typically the sale of illiquid asset)

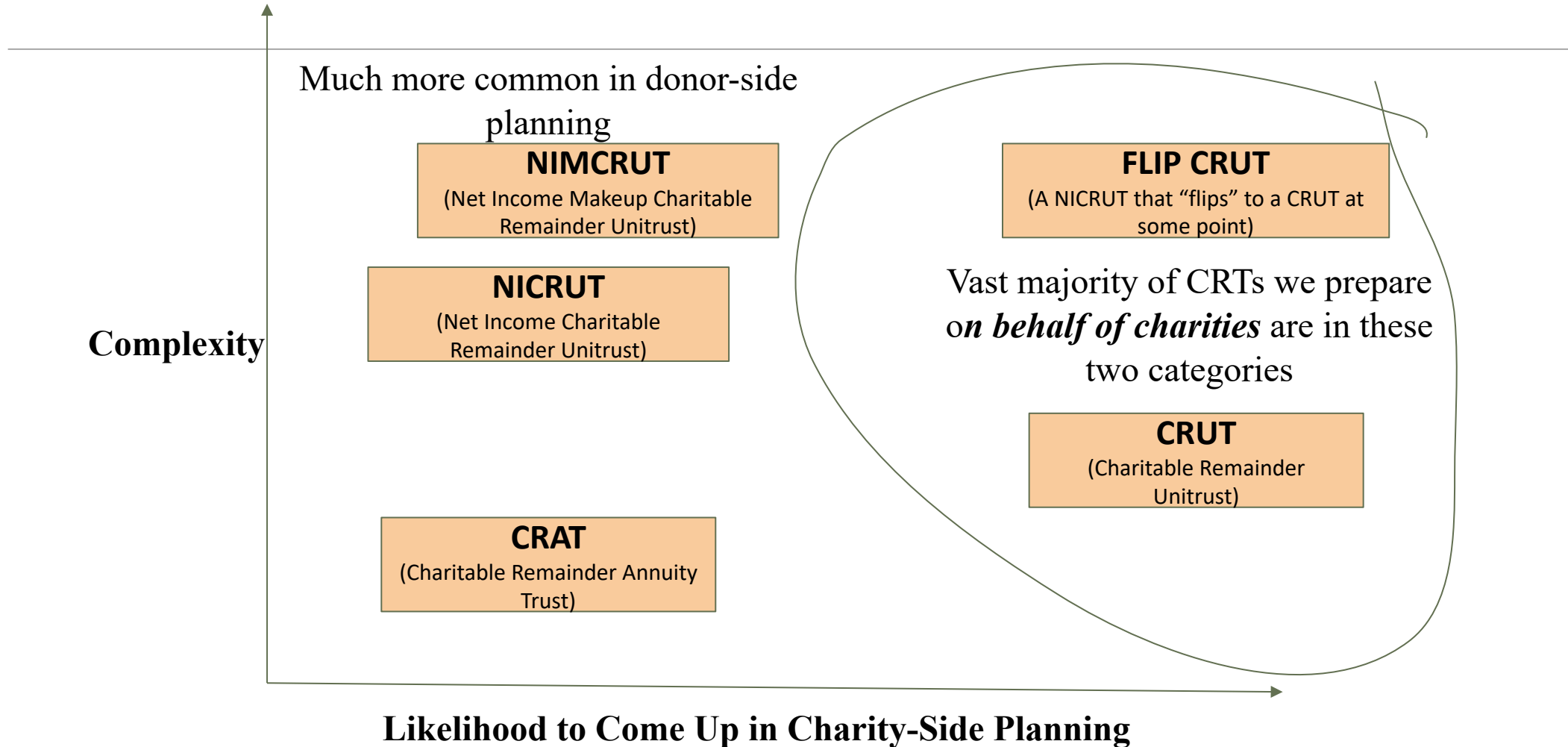
The triggering event can be a specific date, the sale of a particular asset, or some other event (marriage, divorce, death or birth of a child) not in the discretion or control of trustee or other persons

The “Flip” takes effect the NEXT YEAR.

When is it The Best Option/Pros/Cons?

- Very common when donor is giving an illiquid asset (real property or closely held business) that everyone wants to sell right away: best of NICRUT and CRUT.
- Slightly more complex than a standard CRUT to operate and explain

Different Types of Charitable Remainder Trusts – An Unscientific Chart



Operational Decision for a CRUT Program

Should Your Organization Be Willing to Trustee?

1. On the one hand, it's complicated (investment, payouts, annual Form 5227s)
2. On the other hand, would your donors do better on their own?





If Yes, Should Your Organization Charge a Trustee Fee? (Throughout? At End? Not at All?)

Post-Term (usually post-death) Administration – Registration?

12585(a): “(a) Every charitable corporation, unincorporated association, and trustee subject to this article shall file with the Attorney General an initial registration form, under oath, setting forth information and attaching documents prescribed in accordance with rules and regulations of the Attorney General, within 30 days after the corporation, unincorporated association, or trustee initially receives property. A trustee is not required to register as long as the charitable interest in a trust is a future interest, but shall do so within 30 days after any charitable interest in a trust becomes a present interest.”

Abusive CRATs

Remember what we said before?

<u>Approach</u>	<u>Benefits</u>	
Give Later	Estate Tax Deduction	
Give \$\$ Now	Gift Tax Deduction + Income Tax Deduction	
Give App. Prop. To Charity Now	Gift Tax Deduction + Income Tax Deduction + Avoiding Capitals Gain Tax on the Property	
Give App. Prop. To CRUT Now	Gift Tax Deduction + Income Tax Deduction + Deferring Capitals Gain Tax on the Property + Tax-Law-Enhanced Income Stream for Life	

Well, one promoter said:

Why not give appreciated to a CRAT, purchase an annuity product that generates non-taxable income, claim a FMV basis (not the donor's basis), and thereby *Eliminates* Capital Gains Tax, in addition to all other benefits?



IRS and Courts: Because it does not work!
This CRAT arrangement now on "Dirty Dozen" – promoters being punished

Case Study 1: Gift of Real Property

Unmarried Donor wants to give personal residence:

Basis is \$200k, FMV is \$2M, Mortgage is \$100k

Owned for 10 years (mortgage has not increased during that time)

Has already contacted a broker about listing the property for sale

Any issues?

What kind of CRT to use?

Case Study 2: Gift of Closely Held Business

Husband and Wife Own 50% of family business (a medical clinic)

Business in corporate form

FMV is \$10M, basis is \$1M

Third party planning to acquire the business - has submitted term sheet

Any issues? Questions that need to be asked?

What kind of CRT?

Random Questions and Anecdotes?

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