Charitable remainder trusts can provide you with a lifetime income stream while helping fulfill legacy goals of supporting charitable organizations that are important to you. There are two kinds which are minor variations of each other: the Charitable Remainder Annuity Trust (CRAT) and the Charitable Remainder Unitrust (CRUT).

A CRAT can be set up so that you receive income from it for a term of years (20 or fewer), or for your lifetime. When you pass away, or at the end of the chosen term, any remaining assets in the trust are distributed to the qualified charitable organizations you named as the beneficiaries of the trust. One important caveat to a CRAT is that it is an irrevocable trust. This means you cannot reclaim the value of the assets you place in the trust. However, even though the terms of the trust are irrevocable, it is possible for you to retain the right to change the charitable beneficiaries during the term of the trust.

**Potential Tax Benefits**

The tax rules that can make CRATs work to your advantage have been in place since 1969. A main feature of a CRAT is you may be able to receive an income tax deduction in the current tax year for the assets that will pass in the future to the charities you named as beneficiaries. Another attractive feature of a CRAT is that you will not immediately realize capital gains on assets sold inside the CRAT—and the associated taxes you would otherwise have had to pay could potentially be deferred.

The CRAT receives a gift of assets from the person who creates it, known as the grantor. The grantor chooses the annuity rate he or she will receive subject to certain Internal Revenue Service rules and limitations. That rate is based on the total value of the gift at the time the trust is created. Choosing the annuity rate is almost always done with the help of advisors because it has such a big impact on any possible current income tax deduction. Generally, the larger the annuity payment you choose, the smaller your potential deduction.

You work with your trustee to decide how the distribution(s) will be made to you once the annuity amount is determined. You can ask your trustee to send you a quarterly or monthly pro-rata distribution so long as the full annuity value is delivered to you within the current tax year.
If you have highly appreciated assets, you would typically have to sell them if you wanted a higher income stream. Doing this would cause you to recognize capital gains and incur an immediate tax liability on the entire gain. However, if you use those highly appreciated assets, also known as low basis assets, to fund the creation of a CRAT, they can be sold by the CRAT without incurring capital gains that are immediately attributable to you. This is another reason why so many charitably inclined people have created CRATs as part of their financial plan.

Finally on the fundamentals, be aware that it is possible for a married couple to create a CRAT that will run for both lifetimes, terminating at the death of the second spouse. This choice may mean a longer life expectancy for the charitable deduction calculation, making it likely that any possible deduction for the remainder interest will be diminished. But, the diminished interest may be far outweighed by the CRAT’s ability to provide lifetime income for both spouses.

The CRUT

The Charitable Remainder Unitrust, or CRUT, is an intriguing variation on a CRAT. Instead of paying you a fixed annuity amount for the rest of your life, the CRUT pays you a fixed percentage of the market value of the trust as of a specific date each year. A CRUT could be a good choice for those who can tolerate variations in annual payments because it allows for some possible inflation protection. If the value of the trust increases over time, so too will your annual payments. However, if the trust decreases, your annual payment will decrease as well.

There is an interesting twist on these charitable remainder trusts (CRTs) for some families. Many families have one or more longtime household employees who have been valuable and loyal resources to the family before leaving their employ. A CRT can be an efficient way to provide some support to them in their retirement years. We have seen people create a CRT naming the valued, retired employee as the lifetime beneficiary, and one or more favorite philanthropies as the charitable beneficiary. Even though the grantor has not retained the income interest for themselves, they may still be able to take advantage of the charitable deduction and capital gains reduction opportunities described in this fact sheet.
Opportunities

- The trust provides a stable lifetime stream of income.
- The trust allows for deferral of capital gains that would otherwise occur when liquidating low-basis assets for consumption.
- The trust provides a potential to obtain an income deduction for a charitable gift.

Challenges

- Creation of a CRT is an irrevocable transaction; may not retrieve assets gifted to the trust if needed.
- Inflation may diminish the value of the lifetime income stream.

For more information, please contact your Hawthorn advisor.