Deferred Charitable Gifts

Charitable Remainder Unitrust

A Charitable Remainder Unitrust ("CRUT") is an irrevocable trust that provides payments to a beneficiary or beneficiaries for life or a term of years. At the termination of the trust, the remaining trust assets are paid to a charity or charities selected by the donor. The donor receives an immediate income tax deduction upon donating assets to the trust, even though the charity may not receive the assets for years. The distributions to be paid from the trust to the beneficiary is normally determined by multiplying a fixed payout percentage of at least 5 percent by an annual valuation of the CRUT's assets. As the overall value of the CRUT increases or decreases in value each year, the beneficiary's income will change correspondingly.

Increase Income and Avoid Capital Gains Tax. Many individuals hold appreciated assets such as stock or land that, despite the high fair market value, produce a relatively low rate of return. Such highly appreciated, low-return property is ideal for transfer into a CRUT. The trustee can sell the property without paying any capital gains tax (because a CRUT is a tax-exempt entity) and reinvest the proceeds in higher-yielding assets. This often means that a donor will achieve a higher level of income from the assets after donating them to the trust.

Charitable Deduction. The donor receives an immediate tax deduction when establishing the CRUT. This deduction is generally based on the gift amount, payout percentage, and age of the income beneficiary. The benefit of the deduction is that it reduces the "cost" of the gift. For example, a 59-year-old donor transfers $250,000 cash into a CRUT that will distribute 5 percent income to her for her life. Such a gift generates a deduction of approximately $101,700 for the donor, who, generally, if in a 33 percent income tax bracket, will save approximately $33,560 on income taxes. Therefore, her "cost" of funding the CRUT is reduced to $216,440 ($250,000 minus $33,560).

Deduction Limitations. Gifts of cash to a charitable remainder trust are subject to a deduction limitation of 50 percent of the donor's adjusted gross income ("AGI"). Gifts of capital gains property, such as real estate or stock, are subject to a deduction limitation of 30 percent of AGI. Deductions are claimed the year the gift is made; however, any unused deduction amount can be carried forward for up to five additional years if necessary. It is important to note that if a CRUT names a private foundation as its ultimate charitable beneficiary, a donor's deduction for contribution to the CRUT will be more limited (30 percent of AGI for gifts of cash and 20 percent of AGI for gifts of capital gains property).

Reduce the Size of the Taxable Estate. A CRUT can be an excellent way to save on federal estate tax by removing the value of assets contributed from a donor's estate. In some cases the value of a CRUT is included in the gross estate, but because of the estate tax charitable deduction, the net effect is little or no estate tax liability.

Distributions to Beneficiary. Distributions to the beneficiary of a CRUT may be structured one of three ways: (1) a distribution equal to a fixed percentage of the net fair-market value of the trust assets as valued annually (commonly known as a "standard unitrust"), (2) a distribution of the lesser of the fixed percentage of the net fair-market value of the assets valued annually or the trust net income (commonly known as a "net income unitrust"), or (3) a distribution of the lesser of the fixed percentage of the net fair-market value of the assets valued annually or the trust net income; provided, however, in any year in which the income exceeds the fixed percentage that is to be paid out, the excess will be paid out to the extent the trust's income is less than the fixed percentage in earlier years (commonly known as a "net income with makeup" or "NIMCRUT"). Distributions to a beneficiary are taxable – typically part ordinary income and part capital gain. A portion of the distributions may be nontaxable depending on the nature of the trust investments over time.

Illiquid Assets. If a donor contributes illiquid assets to a CRUT, two options are available that allow for distribution of the income interest. The first option is that the CRUT may contain a "makeup" provision as described above, so that any income that is not distributed in the initial years of the trust is "made up" and distributed after the sale of the illiquid assets. The second option is that the CRUT can "flip" from an "income only" or a NIMCRUT to a standard unitrust following the sale of the assets. An example of this is as follows:

> A CRUT is created with a 6 percent payout percentage and a net income with makeup provision. The Trust is initially funded with land, and no income is generated to meet the payout requirement. Until the land is sold, the trustee will make no distributions to the donor. When the land is sold, the trust will "flip" to a standard unitrust and the donor will receive annual payments of 6 percent of the net fair-market value of the trust assets going forward.

Charitable Remainder Annuity Trust

An alternative to a CRUT is a Charitable Remainder Annuity Trust, or "CRAT." A CRAT pays a donor, or another designated noncharitable lifetime beneficiary, the same sum every year, which must be equal to at least 5 percent of the fair market value of the trust assets valued as of the date the assets are transferred to the trust. In determining whether a CRAT or CRUT should be used, consideration must be given to several factors, including the composition of the corpus of the trust, the trust terms, and the beneficiary's financial situation. The following points provide some guidelines:

- The principal advantage of a CRAT is that the lifetime beneficiary can be sure the annual payments will remain constant. In a CRUT the annual payments will fluctuate.

- Additional contributions may be made to a CRUT, but not to a CRAT.

- If a trust is funded with illiquid assets such as land, a flip unitrust or a CRUT with net income and makeup provisions should be used, as a CRAT requires distributions to pay the annuity amount. If a CRUT is used, the trustee may delay distributions until the asset is sold.

Charitable Gift Annuity

A Charitable Gift Annuity ("gift annuity") will feel like a CRAT to the donor, but it is not a trust at all. It is, instead, a bargain sale. The donor transfers cash or other property to a charity in exchange for the charity's promise to make annuity payments to the donor, to another person, or to both. The annuity payments the donor receives are not worth as much as the cash or other property that the donor contributed. The difference in value is the gift. The annuity amount can be paid monthly, quarterly, semiannually, or annually and is a fixed amount. The amount paid to the donor each year will not be adjusted as the value of the assets increases or decreases.

Difference Between Gift Annuities and CRATs. A gift annuity is backed by all of the assets of the charity. The charity has signed a promise to pay and must fulfill that promise. With a CRAT, the payments to the donor would end if the CRAT assets were fully depleted. To issue a gift annuity, the charity must comply with state laws governing the sale of insurance. For example, the charity must invest the reserve to ensure sufficient funds to pay the annuity.

Taxation of Gift Annuity Payouts. A percentage of each payment is tax-free. The percentage represents the portion of the payment that is actuarially computed to consist of assets the donor gifted to the charity. Depending on the assets used to purchase the annuity, a portion of each payment may also be considered to be capital gain. That portion is computed actuarially in a manner calculated to cause the donor to report the capital gain over the life of the annuity. The capital gain occurs because the donor is deemed to have sold a portion of the transferred property in exchange for the annuity.

Charitable Lead Trust

A charitable lead trust makes payments to charity as long as a person lives or for another specified period. At the end of that period, the property remaining in the trust is transferred to a noncharitable beneficiary.

Benefits of Charitable Lead Trusts. Generally, charitable lead trusts are used by wealthy individuals as a way to leave an inheritance to children that the children cannot use for a specified number of years. Because payments are made to charity during those years, the donor is allowed to pass a portion of the inheritance to the children with a reduced estate tax. Charitable lead trusts can make effective gifts in years that the donor is in a much higher income tax bracket than the donor is expected to be in the following year. Charitable lead trusts work particularly well in periods of low interest rates.

Gift of Remainder Interest in Personal Residence or Farm. A donor can transfer title to a residence or farm, retain the right to occupy or use it, and still obtain a charitable deduction. The right to occupy or use the residence or farm may belong to the donor, to another person, or to both. It can last either for a lifetime or for a specified number of years. The gift is accomplished by recording a deed.

The tax benefits of a gift of a remainder interest in a personal residence or farm include an income tax deduction for the actuarial value of the remainder interest, which is determined taking into account straight-line depreciation. At the death of the donor, the property is owned by the charity. Although the tax rules require that the full value of the residence or farm be included in the donor's estate, the estate receives an offsetting charitable deduction for the full value of the residence or farm.