

Charitable Remainder Trusts (CRTs) and Charitable Lead Trusts (CLTs): Split-interest Trusts Can Sweeten Charitable Giving Benefits

If you're philanthropically inclined, a charitable split-interest trust is one way to support the causes you care about while enjoying significant tax and estate planning benefits. These benefits are divided between a charitable beneficiary and one or more noncharitable beneficiaries. The two most common examples are charitable remainder trusts (CRTs) and charitable lead trusts (CLTs).

A CRT provides you and your family with lifetime income, with the remainder passing to a charity at the end of the trust's term. A CLT is the reverse: It makes payments to a charitable organization for a specified period and then distributes the remainder to your loved ones. Let's take a closer look at both trust types.

CRTs

A CRT is an irrevocable trust to which you contribute cash, stock or other assets. The trust provides you or other family members with an income stream for life or for a term of up to 20 years, after which the remaining assets are transferred to a qualified charity.

Annual payouts from the trust may be determined in one of two ways:

1. A charitable remainder annuity trust (CRAT) pays out a fixed dollar amount ranging from 5% to 50% of the trust's initial value.
2. A charitable remainder unitrust (CRUT) pays out a fixed percentage of the trust's value, ranging from 5% to 50%, recalculated annually. Note: When the trust is established, the present value of the charity's remainder interest must be at least 10% of the trust assets' initial value.

Although payouts can be unpredictable, CRUTs are usually preferable to CRATs. Because the assets are revalued annually, payouts increase with inflation. Also, CRUTs allow additional contributions after the initial contribution; CRATs do not.

CRTs offer several tax advantages, including:

- The donor is entitled to claim a charitable deduction equal to the present value of the charity's remainder interest (subject to otherwise applicable limits on charitable deductions).
- As a tax-exempt entity, a CRT can be an effective vehicle for selling and diversifying appreciated assets while deferring capital gains taxes.
- Assets transferred to the trust are removed from the donor's estate, reducing potential estate tax liability. Note, however, that a CRT may have gift tax implications if payouts are made to beneficiaries other than the donor.

CLTs

A CLT is like a CRT in reverse: It makes payments to the charitable organization during the trust term, with the remaining assets preserved for your heirs. And like CRTs, CLTs can be structured as charitable lead annuity trusts (CLATs) or charitable lead unitrusts

(CLUTs), which pay out a fixed dollar amount or a fixed percentage of the trust's value, recalculated annually, respectively. CLATs are usually preferable because they tend to maximize the amount left for the noncharitable beneficiaries.

CLTs also offer several tax advantages, including:

- The value of the gift received by your beneficiaries for gift and estate tax purposes is reduced by the present value of the trust's payments to charity.
- The present value of the charitable payments is calculated using a conservative IRS-prescribed interest rate. So, to the extent the trust's investments outperform that rate, the excess received by your beneficiaries is essentially a tax-free gift.
- The donor or the trust may claim charitable deductions, depending on whether the trust is set up as a grantor or nongrantor trust.

Unlike CRTs, CLTs aren't tax-exempt entities. Their tax treatment depends on whether they're structured as grantor or nongrantor trusts. If a CLT is a grantor trust, the donor enjoys an immediate charitable deduction based on the present value of the charitable payments. The tradeoff is the donor must report the trust's income each year on his or her tax return. This can be an advantage, however, because it allows the trust assets to grow tax-free, leaving more for the noncharitable beneficiaries.

If the CLT is a nongrantor trust, the donor can't claim an immediate deduction. Instead, the trust deducts the annual charitable payments from its income and pays tax on any retained income. Given current limitations on charitable deductions by individuals (including higher standard deductions and a 0.5%-of-adjusted-gross-income floor on itemized charitable deductions), it may be advantageous to structure a CLT as a nongrantor trust, which isn't subject to those limitations.

Which is right for you?

The answer depends on your circumstances and your financial goals. If you're looking to receive current income, tap appreciated assets and generate an immediate tax deduction, a CRT may be for you. If you're interested in preserving assets for your loved ones down the road while minimizing gift and estate taxes, a CLT may be your best choice. Contact your estate planning advisor to help you make the right choice for you and your family.

SIDEBAR: Best of both worlds: Using a qualified charitable distribution to fund a CRT

If you're age 70½ or older, a qualified charitable distribution (QCD) can be a highly tax-efficient tool for satisfying your charitable goals. By enabling you to transfer up to \$111,000 tax-free from an IRA directly to a qualified charity, a QCD essentially provides you with a charitable deduction regardless of whether you itemize and is free from any income-based limits. And QCDs count toward your required minimum distributions for the year, providing even more tax savings.

In addition, you're entitled to make a once-per-lifetime QCD of up to \$55,000 to a CRT. This allows you to combine the tax benefits of a QCD with the income and tax advantages of a CRT.