

Charitable Remainder Unitrusts

Charitable Remainder Unitrusts (often referred to as a "CRUTs") are commonly used to receive property that will return an income stream to the donor throughout his or lifetime (or for a specified period of time), and then distribute the property to the donor's selected charity(ies). One of the benefits of a CRUT is that it provides the donor with a current income tax deduction for the present value of the amount that will ultimately pass to the charity(ies). For example, if a 50-year old establishes a CRUT to which he or she contributes property valued at \$500,000, from which he or she will receive an annual payment valued at 10% of the CRUT's assets, he or she will be entitled to a charitable deduction of approximately \$55,025 (assuming the interest rate required by the government, used to determine such values, is 6.4%).

Another benefit of a CRUT is that the trust is a tax-free entity – thus, if assets contributed to the trust have a low income tax basis, a sale by the trust will not generate taxable gain. As such, the income stream retained by the donor, which is based upon the value of the trust assets, will generally be larger than that the donor could receive from investing the after-tax proceeds from the sale of the property.

The most common use of a CRUT is to receive property that has a low income tax basis and that a donor is reluctant to sell because of the potential capital gain tax. As noted above, by placing such property into a CRUT, the

property can be sold without gain being taxed to the donor, thus providing a larger base of assets to generate income for the donor's benefit and the ultimate benefit of the donor's designated charity(ies).

The principal disadvantage of a CRUT is the loss of the value of the trust assets to the donor's family upon the donor's death. Namely, while the assets produce a stream of income to the donor during the donor's lifetime (or for a specified term of years, whichever is chosen) upon the donor's death the assets pass to charity, rather than to family members. In order to replace the value of the assets donated, many donors create an irrevocable life insurance trust that holds insurance on the life of the donor. The insurance premiums are funded using the income resulting from the income tax deduction generated by the contribution of property to the CRUT and the excess of the income received from the CRUT over that which would have been produced if the property had been sold by the donor and taxes paid.

Since the insurance policy is held in a trust that is not owned (or controlled) by the donor, the proceeds paid at his or her death will not be included in his or her estate for estate tax purposes. If the donor's family is named as the beneficiary of this trust, they are compensated for the loss of the asset contributed to the CRUT.

There are certain rules that the IRS requires that CRUTs follow. For

example, a CRUT is required to distribute each year a certain percentage of the trust's annual value (a minimum of 5% per year). CRUTs can be drafted, however, so that the annual unitrust payment is the lower of a stated percentage or the actual income of the trust. In addition, the CRUT may provide for the CRUT to make up any payment deficit in a later year when the income of the CRUT permits. This is often an ideal option when the assets to be initially contributed do not produce sufficient income. There are also other alternatives to this method of payment that should be explored.

In addition, the donor must choose the charity(ies) to receive the remainder benefit before the document is drafted. The donor can, however, retain a right to change the beneficiary(ies) in the future if desired.

If there are beneficiaries other than the donor, a spouse, and the charity(ies) (e.g. assume the donor retains an income stream throughout his life and thereafter the unitrust amount is to be paid to his children), there will be a taxable gift when the property is contributed to the trust. The gift will reduce the Applicable Credit available to reduce taxes on other lifetime gifts or on the donor's estate at death. If the donor has already used up his credit, or if the remainder going to the other non-charitable beneficiaries is large

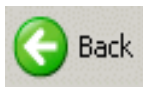
enough, there may even be a gift tax and estate tax to pay.

A taxable gift in this situation can be postponed by reserving the power to take away the benefits given to the noncharitable beneficiaries. Whether such a power is retained or not, the interest passing to the non-charitable beneficiaries will be taxable at the donor's death.

Anyone considering establishing a CRUT should keep in mind that, except for the powers to change the remainder charitable beneficiaries, and to take away any benefits granted to non-charitable beneficiaries, the CRUT is not revocable or amendable after the trust is signed.

CRUTs are the most common type of charitable trust because they can protect the beneficiary against inflation where the trust funds are invested in growth assets (since the unitrust payment is based upon the annual value of the trust assets). Donors should keep in mind, however, that the unitrust payment received may also decline if the value of the trust assets is reduced (e.g., if there is a downturn in the economy).

Also, unlike some other types of charitable trusts, additional contributions may be made to the CRUT after the initial contribution.



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