Charitable Remainder Unitrust

CRUT

A Charitable Remainder Unitrust (CRUT) is an irrevocable trust which pays a fixed percentage of the value of its holdings each year to a beneficiary such as the donor of the trust assets, his or her spouse, child, etc. Unlike the fixed dollar payment of a charitable remainder annuity trust, the unitrust payments will fluctuate with the changing asset balance in the trust, reflecting year-to-year investment performance.[1]

After the death of the income beneficiaries or at the end of a set number of years (no more than 20), whatever assets remain in the trust are distributed to the charities named in the trust. Additional contributions can be made to the trust in later years if desired.

CRUT Variations

The standard form of CRUT requires payment of the full stated percentage throughout the life of the trust, even if assets must be liquidated. Other CRUT variations include:

- **Net-Income CRUT:** A CRUT may be drafted to pay out less than the established percentage if the trust income during the year is less than the required payout percentage. This shortage can be made up in later years when the trust earns more than the required payout percentage.
- **"Flip" CRUT:** Under IRS regulations, a CRUT may begin life as a net-income trust, and, at some pre-determined future date or triggering event, permanently convert ("flip") to a standard unitrust. A "flip" CRUT is an option for an individual seeking a current income tax deduction, tax-deferred buildup and increased income at a later date.

Income Tax Considerations

The charitable income tax deduction is based on the current value of the charity's right to receive the trust assets at some time in the future. Three factors are involved:

- The estimated length of time, which the charity must wait; for example, a term of years (like 10, 15, 20, etc.) or for the donor's or other person's lifetime.
- The percentage rate payable to the income beneficiaries each year and how frequently it is paid, e.g., annually, monthly, etc. The higher the rate of payout, the less there will be for the charity; and, therefore, the smaller the charitable deduction.
- The current investment return, as determined by the IRS. These are called the IRC 7520 mid-term rates.[2]

These factors are applied to government tables to determine the current value of the charitable deduction. If the charitable deduction exceeds a certain percentage of the donor's adjusted gross income in the year of the gift, the excess must be carried over to future years.

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[1] Assets must be revalued each year to determine the payout amount.
[2] This rate changes monthly.

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Gift Tax Considerations

If the income from the CRUT is payable to someone other than the donor, it may be subject to federal gift taxation. If certain requirements are met, the income gift can be made to qualify for the annual gift tax exclusion of $13,000[1] per beneficiary. Also, the marital deduction will usually eliminate any tax on payments to the donor's spouse.

Estate Tax Considerations

The value of the interest passing to the charity is deductible from the gross estate. If there are income beneficiaries other than the donor and his or her spouse, there may be an estate tax on the value of this income interest.

Some states allow a surviving spouse to "elect" to receive a portion of the deceased spouse's estate. Such laws are designed to prevent the surviving spouse from being completely disinherited. If state law allows assets in a CRUT to be used to satisfy the surviving spouse's election, the CRUT could cease to qualify as a charitable trust under federal law. As a result, previous income tax deductions can be lost and the assets in the trust could be added back to the deceased spouse's estate.[2]

Almost Everyone Benefits

A taxpayer can contribute an asset (usually highly appreciated and low income producing) to a CRUT and receive a current income tax deduction. The trustee can sell the appreciated asset without paying any capital gain tax and can then reinvest the entire proceeds at a higher rate of return. The trust will often pay out a higher return than the donor previously received. This, coupled with the federal income tax deduction, can create a substantial increase in cash flow.

Thus far, the only ones to lose are the donor's heirs. To solve this problem, many taxpayers use a portion of the increased cash flow to purchase a life insurance policy (outside of the estate) to replace the value of the asset placed in the trust. This arrangement lets almost everyone benefit.

Party	Benefit
Donor (and spouse)	Increased cash flow during retirement years
Children/heirs	Same size or larger inheritance (with insurance)
Favorite charity	Receives remaining assets after donor's death
Internal Revenue Service	Receives less income and estate tax

[1] The annual gift tax exclusion ($13,000 in 2012) is indexed for inflation in increments of $1,000.
[2] The IRS originally provided a "safe harbor" for this situation in Revenue Procedure 2005-24, with a grandfather date of June 28, 2005. In Notice 2006-15, however, the federal government extended the June 28, 2005 date until "further guidance is issued by the Internal Revenue Service."

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