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Nitty-Gritty Details About Charitable Remainder Trust Participants

We previously provided an overview of Charitable Remainder Trusts (CRTs) and suggested that they might be a good strategy to employ to avoid immediate capital gains taxes on appreciated or concentrated marketable securities positions. That overview has sparked a number of specific questions about this strategy. In this article, we review details about **who can and should be involved in creating a CRT**. We will follow with a final installment in this series detailing flexibility in choosing ultimate charitable beneficiaries, how the charitable income tax deduction is calculated, and what types of trust assets should be contributed to a CRT and what types should be avoided.

Who Can Be the Trustmakers and Income Beneficiaries of a CRT

Any CRT can have one or more trustmakers. Sole trustmakers are generally either unmarried or a married person who chooses to fund the trust with his or her separate property. Married spouses who own property jointly often elect to create a joint CRT where they are both trustmakers.

The trustmakers of a CRT also can be its income beneficiaries. A trustmaker's spouse, children, grandchildren, or anyone else for that matter, can be an income beneficiary.

A CRT can have a sole income beneficiary, or it can have multiple beneficiaries. Multiple beneficiaries can receive their income concurrently or successively. "Concurrent" beneficiaries each receive payments. (For example, "I want the income of my trust paid equally to my spouse and me.") A CRT can also name a succession of income beneficiaries. ("I'll receive the income first; on my death my spouse will receive it, and after her death, my children will receive it equally.")

If there are income beneficiaries other than the trustmaker or the trustmaker's spouse, it is important to note that (as discussed in more detail below) a gift taxable transfer can occur. This, however, may be a good way to lock in high federal estate tax exemptions that will be halved in 2026. The IRS has already ruled that gifts made using the higher exemption will not be "clawed back" into a donor's estate.

How Much Income Should Be Taken?

A concern of almost all who are considering a CRT is what percentage of income they should take out of their CRT each year. By law, this income percentage can be no less than five percent and can go as high as 50 percent, as long as the predicted value of the assets ultimately passing to charity are at least 10 percent of the value of the contributed assets. (For CRATs only, there is an additional requirement that there exists at least a one in 20 probability that the charity will receive some of the trust property end of the period of distributions to noncharitable persons.)

At first blush, it is the tendency of most people to opt for a higher percentage as representative of a greater benefit. However, on reflection they often change their minds because of two very significant reasons:

1. The charitable income tax deduction is inversely proportionate to the income percentage: the higher the income percentage, the lower the immediate charitable tax deduction will be, and vice versa.

2. By selecting a lower income percentage, the trust principal will appreciate faster and generate more income to the income beneficiaries over time. There is power in tax-free compounding of income and appreciation inside the CRT. A lower percentage taken as against a larger principal will often yield a greater overall income return than a higher income percentage over the same period. Taking out a great deal of income does not allow the principal to grow.

Be sure to look at a number of projections about the ultimate return before deciding on a particular CRAT annuity percentage or CRUT unitrust amount. If your income is likely to decrease in the future, you may want to vary the income amounts received at different times using a NIMCRUT.

Multiple Income Beneficiaries

Sometimes, a CRT names multiple income beneficiaries. Naming more than one income beneficiary creates some planning complexities. These can be positive or negative based on each individual's personal situation.

A trustmaker's spouse can be named as either a current or successor income beneficiary without any adverse tax consequences because of the unlimited marital deduction law. Most trustmakers routinely name their spouses as income beneficiaries.

If a parent names children as immediate income beneficiaries ("I want the current income beneficiaries of my CRT to be my children") or concurrent income beneficiaries ("I want the income from my CRT split equally between me, my spouse, and my children"), then the trustmaker has made a gift to his or her children. The amount of the gift is the present value of their income interest based on their life expectancies. While this may seem like a very complex computation, the Internal Revenue Service has tables that can be used to readily ascertain the amount of the gift.

If a parent names children as successor beneficiaries ("I want my trust income paid to me and my spouse for our lives, and then equally to our children for their lives"), the gift to the children will either be subject to immediate gift taxation or to estate tax on the death of the survivor of their parents. The timing of the gift depends on how the CRT is drafted. While a federal gift tax return will be required for a lifetime gift to children, the practical effect of today's $11,400,000 estate and gift tax exemption is that actual current taxation of this gift is unlikely to occur. The gift will, however, reduce the amount of this exemption available in the future.

When children or grandchildren are named as concurrent or successor beneficiaries, the present value of the amount that is ultimately going to pass to charity is going to be very low or nonexistent. As a result, the charitable income tax deduction is going to be very small or nonexistent. The CRT will not qualify for beneficial tax treatment if this amount predicted to go to charity is less than 10% of the amount initially contributed to the CRT. Therefore, this is not a good strategy to use when current income taxation is important to the overall planning.

Selecting Who Can or Should Be Trustee

You can be your own trustee. As trustee, you can, in effect, retain total control of your trust assets during your lifetime. If you choose to act as your own trustee, you must name a special independent trustee in your CRT–someone who is not related or subordinate to you. Having a special independent trustee is important when a CRT acquires hard-to-value assets such as business interests and real estate holdings. Because these types of assets can create conflicts of interest when the trustmakers are also the trustees, the special independent trustee acts to ensure that any conflicts are resolved. A special independent trustee is especially important if the trustmaker gives real estate or closely-held stock in a corporation to a CRT.

Almost all people who decide to create a CRT name themselves as trustee of their trusts. However, a few of them name corporate fiduciaries or children as their trustees. These decisions are based upon unique situations and are in the minority.

As you can gather from this discussion about CRT participants, there are a number of interrelated considerations to decide before obtaining the powerful benefits of a CRT. If you think that a CRT might be a valuable solution for your situation, I will be happy to assist you with this strategy.