Charitable Giving, Part III: *Charitable Trusts*

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For families with significant assets, charitable planning can accomplish more than simply directing assets to a favored organization. With the right structure, it can also provide income and help determine how wealth ultimately passes to the family and charity of choice.

If you have been around for Part I and Part II of this series, thank you for your persistence. We are now graduating up to Charitable Planning 301, talking about Charitable Trusts.

Charitable Trusts introduce more complexity, but for the right family, they can offer a powerful way to marry charitable giving with income and legacy goals. To execute effectively, these decisions should be made in coordination with an attorney, tax professional, and wealth advisor.

Before considering which type of trust to utilize, start with two questions:

1. **Do you need income from these assets?**
2. **Where do you want the assets to ultimately land – with a charity, or with your heirs?**

If income is desired first and charity is the ultimate beneficiary, a **Charitable Remainder Trust (CRT)** is best. If you prefer the converse and would like charity to receive the income first and you or your beneficiaries receive the remainder, a **Charitable Lead Trust (CLT)** may make more sense. Let's review both options.

Charitable Remainder Trusts (CRTs)

A Charitable Remainder Trust is an irrevocable arrangement in which property or money is donated to a charity. The donor and/or a designated beneficiary continue to use the property and/or receive income from it for a term of years or lifetime. At the end of the term or at death, the remainder of the trust passes to the designated charity or charities in the trust document.

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CRTs are ideal for charitably inclined clients with appreciated assets who would like to generate an income stream and ultimately make a meaningful gift to charity, all while enjoying immediate tax deduction benefits.

There are three variations of a CRT:

- **Charitable Remainder Annuity Trust (CRAT):** gives the beneficiary of the trust a fixed dollar amount each year.
- **Charitable Remainder Unitrust (CRUT):** gives the beneficiary a percentage of the trust assets on an annual basis, commonly based on the account value as of the first of the year.
- **Net Income Make-Up Trust (NIMCRUT):** gives greater flexibility over the timing of the distributions. A NIMCRUT may make the most sense for a client that doesn't need a lot of income in the early years of the term of the trust, but wants more income later in the term. The investments can be adjusted to allow for more income later, which will allow for the make-up distributions of income.

Advantages of a CRT	Disadvantages of a CRT
Income is received (over a term of years, for life, or for life of two individuals – donor and their spouse, for example)	It is irrevocable
Income, Gift, and Estate Tax deduction	Income taxes still apply to distributions from the trust, keeping the same character of the activity contributing to the amount distributed. For example, ordinary income gains distributed out are taxed as ordinary income, capital gains distributed out are taxed as capital gain, municipal bond interest distributed out is not taxed, etc.
Potential reduced estate taxes	
Avoid capital gain tax on sale of appreciated assets	
Asset protection	
Assets pass to charities and avoid probate	
Opportunity for diversification and income without a large tax bill	Potential excise tax on any Unrelated Business Taxable Income (UBTI)*
Good option for appreciated assets that provide little income	
Additional contributions are allowed if a Unitrust	

* Very quick note on UBTI – this is income earned by a tax-exempt entity from a trade or business that is regularly carried on and not substantially related to its tax-exempt purpose (e.g. LPs, LLCs, Master LPs). Those would not be great assets to hold in a charitable trust.

Charitable Lead Trusts (CLTs)

Compared to a Charitable Remainder Trust where the beneficiary receives the income and the charity receives the remainder; a Charitable Lead Trust is just the reverse.

A Charitable Lead Trust (sometimes called a "Jackie O Trust") is an irrevocable vehicle which pays an income stream to a charity for a specified period, and after the term has ended, the remainder of the assets are then distributed to the donor or other designated beneficiaries.

Charitable Lead Trusts, like their Remainder Trust cousin, also have Annuity (CLAT) and Unitrust (CLUT) variations.

- **Charitable Lead Annuity Trust (CLAT):** the charity receives a fixed dollar amount.
- **Charitable Lead Unitrust (CLUT):** the charity receives a percentage of the trust assets based on the annual account value.

A Famous CLAT That Never Was

In one of the most famous examples of this type of planning, Jacqueline Kennedy Onassis set up a testamentary CLAT in her estate plan that would have paid an 8% annuity to charity for 24 years, with the remainder passing to her family tax-free. Assuming $100 million in funding, the trust was projected to distribute approximately $192 million to charity and ultimately $98 million to her family. This shows the immense impact this type of trust can have on wealth transfer.

Unfortunately, and perhaps infamously, the family decided against funding the CLAT, and instead they paid $23 million in estate tax. What a bummer!

Advantages of a CLT	Disadvantages of a CLT
Appreciation of assets is not subject to gift and estate taxes	It is irrevocable
Potential income tax deduction (up front, or over the term)	Assets may not avoid capital gains tax
Best for cash and high-basis marketable securities that are expected to appreciate	The charitable beneficiary (or beneficiaries) is unchangeable
Assets avoid probate	If the asset value in the trust decreases, heirs could receive less than anticipated
Allows for funding charitable obligations with potential for leveraging gift and estate tax exemption	

Comparing CRTs and CLTs

If a charitable trust is within the consideration set, it's important to understand the key differences between CRTs and CLTs and determine where you would like the assets to ultimately remain.

	Charitable Remainder Trust	Charitable Lead Trust
Who receives income first?	Donor/beneficiary	Charity
Who receives the remainder?	Charity	Donor/heirs
Typical objective	Income is important	Wealth transfer is important
Common Structures	CRAT, CRUT	CLAT, CLUT

Aligning Charitable Giving With Your Wealth Goals

Throughout this series, we have looked at charitable strategies ranging from relatively straightforward gifts to donor advised funds, private foundations and, finally, charitable trusts. The structures may become increasingly sophisticated, but the starting point remains surprisingly simple: **What do you want your wealth to accomplish?**

Once that answer is clear, your Truxton advisor can work alongside your tax and legal professionals to help evaluate which strategies best align with your charitable, financial and legacy goals.

If charitable giving is part of your financial or estate-planning goals, please consult with your Truxton advisor or give us a call. We are delighted to help you evaluate which strategies best align with your charitable, financial and legacy goals. ▪