Give and Take

The Many Benefits of Charitable Remainder Trusts & Charitable Lead Trusts

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Charitably inclined people take pride in knowing that their charitable gifts will help further the work of their favorite charities. When making donations through a charitable remainder trust (CRT) or a charitable lead trust (CLT), a person can enjoy many other benefits too, such as minimizing capital gains tax, diversifying his or her portfolio, receiving an income stream and making gifts to loved ones at reduced gift and estate tax cost.

DONATE TO CHARITY WITH A CRT OR CLT AND ENJOY MULTIPLE BENEFITS

You take pride in knowing that your charitable gifts will help further the work of your favorite charitable organizations and enjoy a feeling of goodwill. When you make donations through a charitable remainder trust (CRT) or a charitable lead trust (CLT), you can enjoy many other benefits too. In fact, using these trust types can allow you to achieve some combination of the following objectives while you give to charity: minimize capital gains tax, diversify your portfolio, receive an income stream, and make gifts to loved ones at a reduced gift and estate tax cost.

DOUBLE GIVING POWER

Both a CRT and a CLT — which you can fund with assets such as stock or real estate — have split interests, meaning they have charitable and non-charitable beneficiaries.

With a CRT, the income beneficiaries — you and your spouse, for example — receive payouts under a formula from the trust for a set period or for the rest of your lives. At the end of the trust term, the “remainder” interest (what’s left in the trust) passes to one or more charities. The CRT assets won’t be included in your taxable estate. (But there will be gift tax consequences if you name someone other than you and your spouse as income beneficiary.) Additionally, you’ll enjoy an immediate, though only partial, income tax deduction when you create the trust, calculated based on the present value of the charity’s remainder interest.

With a CLT, the charity receives the “lead” interest — periodic payouts throughout the trust’s term. At the end of the term, the remaining principal reverts to you (what’s known as a grantor trust) or goes to one or more of your no-ncharitable beneficiaries, such as your children. A grantor CLT works similarly to a CRT in that you receive an immediate income tax deduction when you create the trust (for the present value of the charity’s interest) — but you have to pay tax on the CLT’s income and the CLT assets remain in your estate. With a *nongrantor* CLT, there are gift tax consequences — but you also get an income tax deduction and don’t have to pay tax on the CLT’s income. The CLT assets won’t be included in your taxable estate.

CRT AT WORK

A CRT can be an ideal way to dispose of an asset that doesn't produce much income and would create a large capital gain if you sold it, such as a highly appreciated stock that pays no dividend. By funding a CRT with appreciated assets and naming yourself the non-charitable beneficiary, you can not only increase your cash flow (through the CRT payouts) but also defer (and possibly even eliminate some) capital gains taxes while diversifying your portfolio.

The CRT can sell the appreciated assets and use the proceeds to purchase diverse, income-producing assets. The trust won't incur capital gains tax because the charity is the remainder beneficiary. You'll pay capital gains tax only on payouts you receive from the trust that are attributable to the capital gain.

CLT at Work

A CLT can be useful if you're charitably inclined and hold assets that you expect to appreciate substantially in the future, such as stock in an early stage company. The trust can allow you to ultimately transfer the assets to, for example, your children, at a substantially reduced gift tax cost.

Only the present value of the non-charitable interest at the time you fund the trust is subject to gift tax. So if the CLT assets' growth rate is greater than the rate from the IRS tables used to determine the gift tax value, the excess growth will pass to the non-charitable beneficiary free of gift tax. (See "Benefiting charity now, a loved one later" for an example.)

Win-Win

A CRT or a CLT can help you meet your charitable goals as well as other financial goals, such as reducing estate taxes and eliminating capital gains tax. Which one you should choose depends on your particular circumstances.

Case Study: Benefiting Charity Now, a Loved One Later

Tom wants to give $50,000 per year to his favorite charity for the next 15 years. He transfers assets valued at $1 million into a CLT. The trust provides that 5%, or $50,000, will be payable to charity each year for the next 15 years, and at the end of the term the remaining trust assets will pass to Tom's daughter, Lily. If the trust earns 8% per year, Lily will receive $1.8 million. If the present value of Lily's interest for gift tax purposes, based on government tables, is only $500,000, that means $1.3 million passes to her tax-free in this example.

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