



Charitable Remainder Trust Handbook

Gregory W. Baker, J.D., ChFC®, CFP®, CAP
Executive Vice President

About Renaissance Philanthropic Solutions Group

Headquartered and operated in Indianapolis, Ind., Renaissance Philanthropic Solutions Group (RenPSG) is the largest independent charitable gift solutions provider in North America. With over 30 years of industry knowledge, RenPSG delivers custom solutions that include tax expertise, accounting support and impeccable client service, all through our proprietary cloud computing technology. We count financial services firms, elite nonprofit organizations and leading community foundations as our partners, and currently service more than \$22 Billion of assets including more than 3,000 charitable trusts as well as more than 60,000 donor-advised funds, pooled income funds, endowments and private foundations.

DISCLAIMER

This publication is designed to provide accurate and authoritative information concerning the subject matter covered. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting or other tax consulting services. If legal or other expert assistance is required, the services of a competent professional person should be sought. The information contained herein is merely an overview of an extremely complex area of tax and estate planning law and must not be construed as providing legal, tax or accounting advice. This material should not be relied upon for any particular situation without first consulting with an appropriate professional advisor.

Renaissance and the author hereby disclaim any and all responsibility or liability, which may be asserted or claimed arising from or claimed to have arisen from reliance upon the procedures and information or utilization by anyone of the forms, ideas or concepts set forth in this material.

Copyright © 2003 - 2020
Renaissance Administration LLC
8910 Purdue Road, Suite 500, Indianapolis, IN 46268
800-843-0050
info@reninc.com
www.reninc.com

Charitable Remainder Trust Handbook

Table of Contents

Parties to a Charitable Remainder Trust	1
Charitable Remainder Trust Formats	3
When Should Donors Consider a CRT	4
Thoughts on Unusual Funding Assets	5
Designing the CRT	7
Drafting the CRT Document	9
Computing and Claiming the Income Tax Deduction	11
Income Taxation of CRTs	12
Operation and Administration	13
Investments	17
Gift, Estate, and GST Tax Considerations	18
Post-Mortem Planning with CRTs	21
Disclaimer Planning with CRTs	21
Benefits to Donors	21
Benefits to Charities	22

Charitable Remainder Trust Handbook

By
Gregory W. Baker, J.D., ChFC®, CFP®, CAP

Introduction

A Charitable Remainder Trust (CRT) is an irrevocable agreement in which a donor transfers assets to a trust in exchange for the right to receive income (known as an income interest).¹ A qualified CRT is exempt from income tax, allows the donor to claim an income tax charitable deduction, permits the

tax-free sale of appreciated assets, and irrevocably designates the remainder for the benefit of one or more charitable beneficiaries, which may include public charities, donor-advised funds and private foundations.

Parties to a Charitable Remainder Trust

In its most basic form, a charitable remainder trust consists of an arrangement between four parties: 1) a donor; 2) a trustee; 3) an income beneficiary; and 4) a charitable remainder beneficiary. As discussed below, it is possible for the donor, trustee, and income beneficiary to be the same person. The donor enters into an agreement with the trustee to transfer certain assets to be managed and maintained by the trustee. The agreement is documented by a written instrument called a trust instrument, trust agreement or declaration of trust. In accepting the assets, the trustee agrees to pay an

About the Author

Greg has helped nonprofit and for profit advisors help their donors and clients commit over \$6 Billion to charity through a variety of giving tools. Greg is recognized as a subject matter expert and speaks regularly at industry conferences.

Gregory W. Baker, J.D., ChFC®, CFP®, CAP
Executive Vice President, Legal Services
RenPSG

If you are interested in securing Greg to speak at your next meeting, contact SpeakerRequest@reninc.com.

For assistance with design and implementation of a CRT, contact consulting@reninc.com.

www.reninc.com

¹ In some cases, the income interest may be designated to a person or persons other than the donor and the donor's spouse. See the section below titled "Gift, Estate, and GST Tax Considerations" for an overview of the transfer tax implications of this choice.

income stream to one or more designated income beneficiaries for the rest of their lives or a designated period of time. At the expiration of the trust term, the trustee delivers the remaining trust assets to the charitable remainder beneficiary. A unique feature of the CRT is that it is generally exempt from income tax.²

The Donor. Any individual, corporation, partnership, limited liability company (LLC), or trust can be a donor.³ An individual donor can create a CRT during life or at death. Transfers to a qualified CRT allow a donor to claim a charitable deduction for income, estate, gift and/or generation-skipping transfer (GST) taxes.

The Trustee. The CRT trustee may be an individual, including the donor,⁴ or an institution such as a trust company or charity. When the donor serves as trustee, the donor can hire best-in-class service providers for investment management, and CRT administration. This arrangement unbundles the traditional trustee services of investment management, fiduciary decision-making, and CRT administration. Charities and trust companies can utilize this same

outsourcing approach for investment management and CRT administration.

The Income Beneficiary. In most CRTs, the donor and the donor's spouse will be named for their joint lifetimes as the only income beneficiaries of a CRT. Nevertheless, the Internal Revenue Code ("IRC") and regulations permit any person⁵ to be named as a CRT's income beneficiary so long as at least one income beneficiary is not a charitable organization.⁶ For example, the income beneficiary could be an individual, corporation, partnership, LLC or trust. However, if any non-natural person (other than a charity) *could be* an income beneficiary, the payout length of that person's CRT interest generally may not exceed 20 years.⁷

In addition, the donor may elect to include one or more charities as co-income beneficiaries.^{8,9} This may be desirable when the donor wishes to currently benefit the charity and/or purposefully reduce the amount paid to the non-charitable beneficiary.

Occasionally, CRTs name an income beneficiary other than the donor and/or the donor's spouse. Designing such a CRT creates an array of complications in the design, drafting, investing, and

² For an exception to the CRT's tax-exempt status, see IRC §664(c)(2) and the discussion below on unrelated business taxable income.

³ A sampling of PLRs that permit non-natural person entities to be a CRT donor and income beneficiary includes: C-Corporation – 9205031 and 8102093; S-Corporation – 200644013 and 9340043; LLC – 199952071; Partnership – 9410021; and Trust – 9821029.

⁴ See Revenue Ruling 77-285.

⁵ See IRC §7701(a)(1), which defines a "person" as an individual, trust, estate, association, company, corporation or partnership.

⁶ See IRC §664(d)(1)(A) and Treas. Reg. §1.664-2(a)(3)(1) for annuity trusts. See IRC §664(d)(2)(A) and Treas. Reg. §1.664-3(a)(3)(1) for unitrusts.

⁷ One notable exception is that a CRT may treat a specially-drafted, separate trust as a lifetime beneficiary when that separate trust is for the life of a disabled beneficiary. See Rev. Rul. 2002-20.

⁸ See PLRs 9323039 and 200108035 for a discussion of some of the issues involved with naming a charity as a CRT income beneficiary.

⁹ If a charity is named as an income beneficiary, then the application of IRC §§4943 (excess business holdings) and 4944 (jeopardizing investments) must be required by the trust's governing instrument. IRC §4947(b)(3).

administration of a CRT. These complications are discussed more fully below.

The Charitable Remainder Beneficiary. The charitable remainder interest in a CRT may benefit a public charity (e.g., a donor advised fund, the donor's alma mater, a religious institution, etc.) or a private foundation. A third possibility is to split the remainder interest among several charities such as "2/3 to my alma mater and 1/3 to my private foundation."

In many CRTs, donors retain the power to change the charitable remainder beneficiaries.¹⁰ The donor may choose to name a specific charitable remainder beneficiary immediately, defer the decision until later, name the charitable remainder beneficiary in their will, or grant that power to a child or friend. The donor's charitable goals should govern the selection and timing of naming the charitable remainder beneficiaries. Regardless of the donor's choice in describing the charitable remainder beneficiaries, the CRT document must contain a provision mandating that the CRT may make remainder distributions only to one or more charities.

The Heirs. Often, the seemingly neglected fifth party to a CRT is the donor's heirs. Because most CRTs are created for the benefit of the donor and the donor's spouse, the heirs are left out of the equation without additional planning. This omission is easily remedied by using life insurance held in an irrevocable life insurance trust ("ILIT"),

sometimes called a wealth replacement trust, to replace the assets transferred to the CRT.

Another option is to name the children as additional income beneficiaries of the CRT. This creates additional complications as noted above.

Charitable Remainder Trust Formats

There are a number of qualified CRT formats. The principal distinction among these formats is how the trust agreement defines the income interest. The trust must specify that the income interest will be paid as: (a) a fixed amount (a Charitable Remainder Annuity Trust, or CRAT)¹¹ or (b) a fixed percentage of the trust's assets revalued annually (a Charitable Remainder Unitrust, or CRUT).¹² The IRC requires that one of these defined formats be used in order to receive the benefits of a qualified CRT.

Within the CRUT format there are three varieties:

- **Standard Charitable Remainder Unitrust (SCRUT).** A SCRUT must pay a *fixed percentage* of the trust's assets revalued annually.¹³ Therefore, as the value of the trust's assets rises or falls (based on the annual revaluation methodology), payments to the trust beneficiaries will correspondingly rise or fall.
- **Net-Income with Make-up Charitable Remainder Unitrust (NIMCRUT).**¹⁴ A NIMCRUT differs from a SCRUT in two key aspects. First, in determining

¹⁰ See Revenue Rulings 76-7 and 76-8.

¹¹ IRC §664(d)(1)(A).

¹² IRC §664(d)(2)(A).

¹³ *Id.*

¹⁴ Technically another variation is the **Net-Income Charitable Remainder Unitrust (NICRUT)**. Note that this version is identical to a NIMCRUT but has no make-up provision and is infrequently used.

the amount of the payments to the income beneficiaries, the trustee must compare the fixed percentage unitrust amount calculated for the year to the trust's accounting income for the year¹⁵ and pay the *lesser* of these two amounts to the income beneficiaries.¹⁶ Second, for each year that the trust's accounting income is less than the unitrust amount, the difference (or deficiency) is accumulated as an amount that could possibly be "made up" in the future¹⁷ (i.e., the "make-up amount"). Payments of the make-up amount *must* be made to the extent that the trust's accounting income in a future year exceeds the fixed percentage unitrust amount for that future year.

- **Flip Charitable Remainder Unitrust (Flip-CRUT).** The life cycle of a Flip-CRUT is generally characterized by two phases. For each year of the initial phase, a Flip-CRUT acts like a NIMCRUT or NICRUT and only distributes the lesser of the trust's accounting income or the fixed percentage unitrust amount to the income beneficiaries. In the second phase, beginning with the first day of the year following the occurrence of a predetermined triggering event, the trust switches, or "flips," to a SCRUT¹⁸ and pays out a fixed percentage of the trust's annual fair market value. The trustee has only until the end of the tax year in which the triggering event occurs to make

any payments pursuant to the make-up provision, if any.¹⁹ The change in the payout method commences on January 1st of the year following the triggering event.

Permissible triggering events²⁰ include:

1. The *sale of an unmarketable asset*;
2. A *date certain*;
3. The *birth* of any person;
4. The *death* of any person;
5. The marriage of any person;
6. The divorce of any person; or
7. An event outside the control of a trustee or certain other persons.

When Should Donors Consider a CRT

There are three principal situations where a CRT may be appropriate:

1. A donor is contemplating a transaction which will generate a significant tax liability;
2. A donor needs income now or in the future; or
3. A donor has charitable goals and interests to support.

These factors are not mutually exclusive and the greater degree to which each describes a donor, the more likely a CRT will be a satisfying solution.

¹⁵ To determine a trust's accounting income, IRC §643(b) specifies that the trustee look to state trust law. Most states have a "Principal and Income" statute that provides a set of default rules for determining whether a cash receipt or cash disbursement is allocated to trust income or trust principal. These rules often differ significantly from definitions of taxable income.

¹⁶ See IRC §664(d)(3) and Treas. Reg. §1.664-3(a)(1)(i)(b).

¹⁷ See IRC §664(d)(3) and Treas. Reg. §1.664-3(a)(1)(i)(b)(2).

¹⁸ See Treas. Reg. §1.664-3(a)(1)(i)(c).

¹⁹ See Treas. Reg. §1.664-3(a)(1)(i)(c)(3).

²⁰ See Treas. Reg. §1.664-3(a)(1)(i)(d).

Much of the power behind the CRT is based on its tax-exempt status and irrevocable nature. CRTs can be funded with a variety of assets including stocks, bonds, mutual funds, restricted securities, exchange traded funds, real estate in various forms, partnership interests, LLCs, C-corporations, art, and other tangible personal property. When combined with an ILIT, the CRT can solve many of a donors' noncharitable goals within a charitable context.

A CRT can enable donors to realize charitable goals that seem beyond their reach. For example, making a current gift to endow a chair in the donors' name at their *alma mater* may be infeasible, but by utilizing a CRT, this goal can be achieved while also maintaining or potentially increasing the donor's lifetime cash flow.

Thoughts on Unusual Funding Assets

Obviously, some assets work more compatibly in a CRT than others. For example, cash and publicly traded securities (that can be freely traded) work extremely well both as a gift to a CRT and as an investment by a CRT. On the other hand, gifts of real estate, partnership interests, LLCs, and C-corporations require much greater analysis and may ultimately be a poor choice of asset as either a gift to or investment by a CRT. Thoughtful analysis should always include a review of whether the asset is encumbered by debt. In the case of partnerships and LLCs, their pass-through nature requires the planner to review the debt characteristics inside the business as well as the actual business operations. Any debt on the contributed asset will reduce the client's income tax deduction, cause recognition of income

due to the transfer, potentially make the CRT owe unexpected taxes, may make the CRT and donor subject to self-dealing excise taxes, and possibly turn the trust into a grantor trust. Some of the same concerns also apply for debt or certain business operations that occur within a partnership or LLC owned by a CRT.

The gift of an interest in real estate to a CRT has important tax and other legal ramifications. Such gifts require special handling. To assist with the unique aspects of real estate gifts, prospective donors and their professional advisors must do their best to uncover and resolve all "special handling" issues before they become major problems. Consistently using a thorough checklist can help gift planners uncover many of these issues **before** the property is contributed.

Real estate gift special handling issues come in many varieties. For example, a given parcel of realty can possess attributes that make it unfit for contribution to a charitable remainder trust in its present state. A very partial list of examples includes: questionable or defective title; mortgages, the payment of which by the trustee could ruin the trust's tax-exempt status; leases or uses of the property that will generate unrelated business taxable income; a poor location, shape, or other physical characteristics that render the property virtually unmarketable; a post-gift use or co-tenancy arrangement that would constitute prohibited "self-dealing"; the existence of legal restrictions that would impede or prevent future development; environmental defects/contamination; an existing sales agreement, sales contract, or option to purchase; the existence of co-tenants whose intentions with respect to the property will run counter to those of the trust; and existing improvements to

the land (or nuisances) that (i) require excessive management services and/or maintenance, and/or (ii) present an undesirable degree of premises liability. For these reasons, among others, contributions of real estate to a CRT should never be made without the thorough analysis and recommendation of independent legal counsel.

It is important to recognize that a gift of S-corporation stock will immediately terminate the subchapter S status of the S-corporation because a CRT is not an eligible shareholder under IRC §1361(c). Nevertheless, some clients who own S-corporations do create CRTs. Most commonly, the S-corporation will create the CRT and fund it with assets which the corporation is ready to sell for a capital gain. In such a situation, the S-corporation is typically named as the CRT's income beneficiary, which means the noncharitable term is limited to a term that cannot exceed 20 years. Another rare possibility is for shareholder clients to transfer stock in the S-corporation to a CRT. For situations when this makes sense, the author recommends that the S-corporation's board vote affirmatively to terminate the S status *before transferring* stock to the CRT. At the very least, by following this recommendation the board will be forced to consider the ramifications of terminating the S-election as opposed to being subjected to an automatic, inadvertent termination that would occur if a shareholder simply transferred stock of an S-corporation to an ineligible shareholder. As a final note on this topic, CRTs cannot qualify as either a Qualified Subchapter S Trust (QSST) under IRC §1361(d) or an

Electing Small Business Trust (ESBT) under IRC §1361(e).²¹

Gifts of restricted securities create another set of concerns. While securities can be subject to a myriad of restrictions, the typical restriction limits the transfer of title to the securities. In some cases, the restriction will expire a certain number of months after an initial public offering. In other cases, the restriction simply requires the shareholder to disclose any transfer. In other cases, the restriction does not limit a transfer but does limit the overall number of shares that can be traded within a specified short timeframe. As a result, the type of restriction must be reviewed carefully before contributing (or considering a contribution of) these assets. Usually, the securities counsel for the company will need to review the proposed transfer. Often, the securities counsel will need to issue a formal opinion or instruction letter to the company's transfer agent before a transfer to a CRT will be permitted.

Gifts of art and other tangible property to a CRT involve additional considerations. Generally, the income tax charitable deduction for such gifts is limited to the smaller of the value or the client's cost basis in the property.²² If the donor or related parties will be an income beneficiary of the CRT, then the donor must also wait to claim the income tax charitable deduction until the CRT sells or otherwise disposes the property.²³ Additionally, each piece of art or tangible property may require special handling while the CRT owns it such as insurance, shipping costs, temperature controlled rooms, etc. The expenses associated with such special handling may outweigh

²¹ See Revenue Ruling 92-48.

²² See IRC §170(e)(1)(B)(1).

²³ See IRC §170(a)(3) and Treas. Reg. §1.170A-5(a)(1).

the benefits of contributing the art or tangible property to the CRT. Further, if the income tax charitable deduction claimed for the gift exceeds \$20,000 for a gift of art, the client must attach the entire Qualified Appraisal to the tax return on which the deduction is claimed.²⁴

Designing the CRT

Select the Appropriate Payout Rate.

When selecting the payout rate for a CRT, it is important to keep several key points in mind. First, the annual payout rate of all CRTs must be between 5% and 50%, inclusive.²⁵ Second, the payout rate is an integral part of the calculation of the actuarial present value of the remainder interest (APVRI), which is the amount of the charitable income tax deduction.²⁶ For CRTs funded after July 29, 1997, the APVRI for qualified transfers to a CRT must be at least 10% of the amount transferred.²⁷ This requirement also applies to additional contributions after this date to any unitrust.²⁸ Third, the payout rate selected should take into account the income beneficiary's current and future cash flow preferences. A payout rate greater than the actual investment return will cause most *unitrust* payments to decrease over time. Fourth, the higher the payout rate, the lower the income tax deduction. Note that for the same payout rate, the deduction allowed for a SCRUT is equal to the deduction allowed for a NIMCRUT or Flip-CRUT. This is true despite the fact that the actual payments to the charitable

remainder beneficiary of a SCRUT is likely to be less than the actual payments to the charitable remainder beneficiary of a NIMCRUT. This is discussed further below.

Match the CRT Format to the Income Beneficiary's Needs. The range of payout rates that satisfies all the requirements for qualification is only the starting point in designing the CRT. The CRT format selected has a significant impact on the amount and regularity of the income beneficiary payments. For example, if the SCRUT format is selected, the annual payments will vary in amount as the trust value fluctuates, but must be made regardless of trust's income. If the NIMCRUT format is selected, the annual payments will vary in amount and may cease altogether for one or more years if the trust does not recognize distributable income.

If the CRAT format is selected, payments of the same amount will occur like clockwork. For older income beneficiaries, this level payment stream is attractive, but the longer the trust term, the more the purchasing power of each payment is eroded by inflation. If the SCRUT format is selected, then it is possible for payments to increase each year—thereby keeping pace with inflation.²⁹ If the NIMCRUT or Flip-CRUT format is selected, then it is possible to create an accumulation phase followed by a distribution phase. This scenario might benefit a younger beneficiary who

²⁴ See Ann 90-25, 1990-8 IRB 25; Instructions to Form 8283.

²⁵ See IRC §§664(d)(1)(A) and 664(d)(2)(A).

²⁶ The payout rate is also a key factor in determining if a CRAT will pass the 5% probability test of Revenue Ruling 77-374 or the alternative to such test found in Revenue Procedure 2016-42.

²⁷ See IRC §§664(d)(1)(D) and 664(d)(2)(D).

²⁸ CRUTs may be drafted to permit additional contributions, but CRATS may not.

²⁹ For this to occur, the spread between the payout rate and the net investment return must exceed the inflation rate.

wishes to postpone cash flow until retirement.

Match the CRT Term to the Income Beneficiary's Needs. The trust term may be for a fixed period of time up to 20 years or, where the income beneficiaries are individuals, the term may continue for their lives so long as all are living at the time the CRT is funded. A trust for a fixed period of time is often selected for younger beneficiaries, when the donor wishes to benefit a class of beneficiaries (e.g., “my grandchildren”) all of whom may not be yet living, when the income stream is expected to be used by the beneficiary for a specific purpose (e.g., pay college expenses or underwrite a mortgage payment), or when an entity is the income beneficiary. A third (less common) variation is to combine a life interest with a term interest.³⁰

Match the CRT Format to the Contemplated Contribution Asset. The CRAT and SCRUT formats require sufficient liquidity to make immediate income beneficiary payments. Therefore, if the funding asset is an illiquid, unmarketable asset that produces insufficient cash flow to make the income beneficiary payments, then the NIMCRUT or Flip-CRUT format is generally preferable.

Match the CRT Format to the Charity's Needs. Because CRATs and SCRUTs must make their income beneficiary payments regardless of the amount of trust accounting income received, there is a greater probability that the charity's interest will be reduced to make those payments. CRAT payout rates that exceed the actual investment return will

not only result in a reduced remainder to the charity, but also create the potential that the trust will run out of money and make no distribution to the charitable remainder beneficiary. SCRUT payout rates that exceed the actual investment return will result in declining income payments to the income beneficiaries as well as a reduced remainder distribution to the charity. Extended bear markets combined with a high payout rate also reduce the future value to charity. In the author's experience, the highest donor and charity satisfaction seems to come from CRTs with payout rates between 5 and 7 percent.

Conversely, because NIMCRUT income beneficiary payments are limited to the lesser of the trust's accounting income or the fixed percentage unitrust amount, there is a greater probability that the charity's interest will be higher even with a higher payout rate. The same can be said for a Flip-CRUT before the triggering event occurs.

Consider the Prohibition on Self-Dealing. IRC §4947(a)(2) prohibits CRTs from engaging in self-dealing transactions with disqualified persons. In general, a disqualified person includes the donor, the donor's family, the trustee, the trustee's family, any business entities or trusts in which these individuals have a greater than 35% interest and an individual with a greater than 20% interest in any business entity or trust which is a substantial contributor.³¹ Further, self-dealing transactions include purchases, sales, leases, loans, excess compensation and use of trust income or property.³² Several exceptions apply.³³

³⁰ See Treas. Reg. §§1.664-2(a)(5) and 1.664-3(a)(5) for further discussion on combination terms.

³¹ IRC §4946(a)(1).

³² IRC §4941(d)(1).

³³ See IRC §4941(d)(2)(B)-(H).

Some common examples of prohibited activities include:

- A donor continues to reside in a home she has transferred to a CRT;
- A donor's child purchases property from the CRT; and
- A trustee makes a loan from the CRT to a business enterprise owned and operated by the trustee.

Consider the Danger of Unrelated Business Taxable Income (UBTI). In general, a CRT is exempt from Federal income taxation. However, for tax years in which a CRT has *unrelated business taxable income* (UBTI), the CRT will pay an excise tax of 100% on the UBTI received.³⁴ Certain types of assets produce UBTI and are, therefore, unsuitable for transfer to (or investment by) a CRT. Common examples of UBTI-producing assets or activities include:

- An interest in an active trade or business (regardless of whether it is classified as a sole proprietorship, a general partnership interest, a limited partnership interest, or a limited liability company (LLC) interest);
- A working interest in an oil and gas well; and
- Unrelated debt-financed income from trading on margin or other borrowing.

Consider the Grantor Trust Rules. While a CRT is generally exempt from the grantor trust rules,³⁵ the improper operation of a CRT can result in the application of one or more of the grantor trust rules. For example, using the income of the trust for the grantor's

benefit – such as making the donor's mortgage payments – will convert the trust into a grantor trust which disqualifies the CRT. Another example is using the CRT's income to pay life insurance premiums on a policy on the life of the donor or donor's spouse.³⁶

Drafting the CRT Document

Ensure the CRT Trust Document Supports the Plan Design. It is important to remember that a CRT is irrevocable. Therefore, it is critical to draft the document correctly the first time. An example is when the donor wants a SCRUT but the document is drafted as a CRAT. Or, the donor desires the flexibility to request that the trustee make accelerated distributions of trust principal to the charitable remainder beneficiary and the provision is omitted. This is an even greater danger when the attorney engaged to draft the CRT governing instrument was not involved in the entire planning process.

Beware of Using Generic Form Documents. Numerous sample CRT documents are available from a variety of sources. For example, the IRS issued a series of sample CRT documents in

³⁴ See IRC §664(c)(2). Treas. Reg. §1.664-1(c)(2) example 2 illustrates the use of the \$1,000 specific deduction described at IRC §512(b)(12) in computing a CRT's UBTI. This effectively allows for a *de minimis* amount of UBTI from partnerships, unrelated debt-financed income and income received from securities acquired on margin.

³⁵ See IRC §664(a) and Treas. Reg. §1.664-1(a)(4).

³⁶ See IRC §677(a)(3).

1989,³⁷ 1990³⁸, 2003,³⁹ and 2005.⁴⁰ Most books of trust forms have one or more samples—many based on the IRS' sample documents. Often, continuing legal education seminars will include a copy of the presenter's standard form. Alternatively, it is common to borrow from colleagues who have previously drafted CRTs.

While it is tempting to use a document from one of the above sources and only change the names of the parties, the payout rate and the term; the multitude of design variables (including trust format) makes this practice inadvisable. The author has seen many CRTs that include conflicting provisions (such as a SCRUT agreement that referenced the make-up amount) because the drafter failed to identify all of the edits necessary to convert a sample trust to one that conforms to the plan design. Other examples of errors include trust documents that:

- Reference a different client and/or the wrong charitable remainder beneficiary;
- Incorrectly specify multiple payout rates;
- Fail to properly address the gift tax ramifications of naming someone other than the donor or the donor's spouse as an income beneficiary;
- Prohibit the trustee from accepting specific types of assets—including

the asset actually contributed to the CRT;

- Directly authorize acts of self-dealing;
- Omit the power to change the charitable remainder beneficiary when the donor desires this power;
- Include the power to change the charitable remainder beneficiary when the donor doesn't desire this power, for example to qualify for donor recognition or gift matching;
- Restrict the charitable remainder interest to public charities when the donor intends to create a private family foundation; and
- Permit the charitable remainder interest to be paid to a private foundation, thereby limiting the donor's income tax charitable deduction to basis because of the type of asset contributed.

Adequately Define Principal and Income. Many charitable plans call for the use of a NIMCRUT or Flip-CRUT. These CRT formats must pay out the lesser of the trust's accounting income and the unitrust amount (note that for Flip-CRUTs we are referring to the "pre-flip" period).

The definition of trust accounting income is a function of the language of the trust's governing instrument and the applicable principal and income statute. Where one or more provisions of the trust's governing instrument are in conflict with

³⁷ See Revenue Procedures 89-20 (sample charitable remainder unitrust) and 89-21 (sample charitable remainder annuity trust). These Revenue Procedures were superseded by Revenue Procedures issued in 2003 and 2005.

³⁸ Revenue Procedures 90-30 and 90-31 (sample charitable remainder unitrust forms), and 90-32 (sample charitable remainder annuity trust forms). These Revenue Procedures were superseded by Revenue Procedures issued in 2003 and 2005.

³⁹ See Revenue Procedures 2003-53, 2003-54, 2003-55, 2003-56, 2003-57, 2003-58, 2003-59, and 2003-60 for sample charitable remainder annuity trust forms.

⁴⁰ See Revenue Procedures 2005-52, 2005-53, 2005-54, 2005-55, 2005-56, 2005-57, 2005-58, and 2005-59 for sample charitable remainder unitrust forms.

the applicable principal and income statute, the trust's governing instrument takes precedence.

It is sometimes the case that the trustee will select investment assets that do not produce income under the default provisions of the applicable principal and income statute. For example, realized capital gains are generally not considered income (but rather are treated as principal) under most state statutes. Therefore, it is desirable in the course of designing and drafting the trust's governing instrument to consider provisions that will match the anticipated investment practice with a definition of income that meets the plan design.

Consider Desirable Optional Provisions. A number of desirable optional provisions exist that can increase the utility and flexibility of a CRT. For example, the donor may retain the power to change the charitable remainder beneficiary. The donor may instruct the trustee to accelerate the distribution of principal to the charitable remainder beneficiary. The trust might have a spendthrift clause designed to restrict the income beneficiary's ability to alienate his or her interest, while still giving the income beneficiary the flexibility to make a charitable gift of his or her income interest.

Computing and Claiming the Income Tax Deduction

The deduction allowed for a transfer to a CRT is equal to the actuarial present value of the remainder interest (APVRI). The APVRI is computed by multiplying a remainder factor times the value of the asset transferred. In general, the present

value factor is applied to the fair market value of the contributed asset. However, the present value factor is applied to the donor's basis for certain gifts.⁴¹ Many inputs impact the computation of the remainder factor. Among them are the expected term of the trust, the payout rate, the prescribed federal rate, and the frequency of the income payments.

The bottom line is that the longer the charity must wait and the greater the income payments to the income beneficiaries, the lower the amount of the charitable deduction. This computation is complex and is generally performed using specialized software. Some websites and smartphone apps do offer limited versions of calculation software on either a pay, free, or trial basis.

For income tax purposes, the IRC limits the amount of the charitable deduction that individuals and C-corporations⁴² can claim in any year to a percentage of their adjusted gross income. The type of asset transferred and type of charity that could receive the remainder interest determine the specific percentage limitations that apply to individuals. To the extent these percentage limitations apply, any unused charitable deduction is carried forward for the donor's next five tax years. The percentage limitations do not apply for gift, estate, or GST tax purposes.

The type of asset transferred and type of charity that could receive the remainder interest may also invoke a separate set of rules that may reduce the income tax deduction. For example, if a private nonoperating foundation is permitted to receive a portion of the remainder interest, then the donor's income tax deduction is limited to smaller of the

⁴¹ See IRC §§170(e)(1) and 170(b)(1)(C)(iii).

⁴² Gifts by other entities are beyond the scope of this outline.

donor's basis in the asset or the asset's fair market value. The primary exception to this rule is for most gifts of unrestricted publicly traded stock.⁴³ For this reason, if the CRT will be funded with assets other than cash or unrestricted publicly traded stock, the charitable remainder interest is usually limited to a public charity. A public charity alternative to a private foundation that appeals to most donors is a donor-advised fund.⁴⁴

Because of the percentage limitations and reduction rules described above, it is a best practice for a CRT's governing instrument to either affirmatively permit or affirmatively disallow a private foundation as a potential remainder beneficiary. To affirmatively disallow a private foundation, the instrument should specify that permissible remainder beneficiaries must be described by IRC §170(b)(1)(A). This requirement is in addition to references to the relevant income (§170(c)), gift (§2522(a)), and estate (§2055(a)) tax provisions.

In order to claim an income tax charitable deduction, strict substantiation requirements must be met. For gifts of most unmarketable assets that result in claiming or reporting a deduction greater than \$5,000,⁴⁵ a Qualified Appraisal must be obtained.⁴⁶ Failure to obtain a required Qualified Appraisal will generally result in the disallowance of the income tax charitable deduction and may result in the application of negligence and other penalties. Additionally, if the claimed income tax charitable deduction

for a non-cash gift exceeds \$500,000, then the donor must attach a copy of the Qualified Appraisal to the tax return claiming the deduction.⁴⁷ If such a charitable deduction is carried over to a subsequent year, then the Qualified Appraisal and another Form 8283 must also be attached to each such return.⁴⁸

Selecting the Appropriate AFR. Among the various inputs used in computing the actuarial present value of a CRT's remainder interest (APVRI) is the applicable federal rate, or AFR, described at IRC §7520. When an income, estate, or gift tax charitable contribution deduction is allowable as the result of a transfer of property, IRC §7520(a) provides that a taxpayer may choose the AFR for the month of the gift or *the two previous months*.

This choice is important because selecting the highest available AFR for a CRT will increase the APVRI. Changes in the AFR have a significantly greater impact on the APVRI for CRATs than for CRUTs.

Income Taxation of CRTs

The Trust. In general, a CRT is exempt from Federal income taxation. However, for years in which a CRT has *unrelated business taxable income* (UBTI), the CRT will pay an excise tax of 100% on the UBTI received.⁴⁹ Taxation by the states is unique to each state. Some states (such as Pennsylvania and New Jersey) do not exempt the CRT from taxation. Other states (such as Indiana)

⁴³ See IRC §170(e)(5), which modifies the general rule found in IRC §170(e)(1)(B)(ii).

⁴⁴ See IRC §4966.

⁴⁵ For gifts of nonpublicly traded stock, the dollar threshold increases from \$5,000 to \$10,000. See Treas. Reg. §1.170A-13(c)(2)(ii)(B)(1).

⁴⁶ See Treas. Reg. §§1.170A-13(c)(1)(i), 1.170A-13(c)(2) and (3).

⁴⁷ See IRC §170(f)(11)(D).

⁴⁸ See *Instructions for Form 8283*, revised November 2019.

⁴⁹ See IRC §664(c)(2).

exempt CRTs from taxation, but require that a copy of the IRS Form 5227 be filed with the state taxing authority each year.

Income Beneficiaries. While a CRT is generally tax-exempt, its distributions to income beneficiaries are taxed under a unique system commonly called "4-tier accounting."⁵⁰ This system employs what is often described as the "worst-in-first-out" method for characterizing income distributions in the hands of the income beneficiaries. Each item of income earned by the trust must be separately tracked according to type (e.g. interest, dividends, capital gains, tax-exempt interest, etc.). Then each type of income is "used up" starting generally with items taxed at the highest rate and progressively moving to items that are taxed at the next lower rate.

The end result is that ordinary income items, such as interest and dividends, are passed out first, followed by short-term capital gains, then long-term capital gains, then tax-exempt interest, and finally trust principal. Any CRT earnings in excess of the income beneficiary distributions are retained in the trust in a tax-free environment and combined with future transactions for characterizing future income beneficiary distributions. Note that while the CRT avoids paying tax on capital gains realized from the sale of appreciated assets, such gains may be used to characterize the taxation of income beneficiary distributions for the year of sale and subsequent years.

Operation and Administration

Making Proper Payments. Several potential traps exist regarding the proper

amount to pay the income beneficiary. For example, like most other trusts, a CRT must use the calendar year as its tax year.⁵¹ As a result, the CRT will have a short tax year in its first and last year. It is sometimes overlooked that, for any short year, it is necessary to prorate the annuity or unitrust payment. The proration is done on a daily basis. The proration factor has as its numerator the number of days in the short year, inclusive of the first and last days of the year under consideration. The denominator is 365, or 366 if February 29 is included in the numerator.⁵²

Examples of other traps include:

- Assuming that the current year's unitrust payment will be the same as the prior year's unitrust payment, and
- Paying the income beneficiary of a NIMCRUT or a Flip-CRUT (pre-flip) the full fixed percentage amount without regard to the trust's accounting income.

Importance of Making Payments. It is important that the trustee of a CRT actually make the required payments to the income beneficiary. Similarly, it is important for the income beneficiary to demonstrate that he or she took possession of the payments (e.g., deposited the checks in a personal account). In *Estate of Melvine B. Atkinson v. Commissioner*,⁵³ the 11th Circuit Court of Appeals affirmed the Tax Court's ruling that the failure of the trustee to make the annuity payments of a CRAT caused it to fail to qualify for treatment as a CRT on operational grounds.

⁵⁰ See IRC §664(b) and Treas. Reg. §1.664-1(d).

⁵¹ See IRC §644.

⁵² See Treas. Reg. §1.664-2(a)(1)(iv)(a) and (b) and Treas. Reg. §1.664-3(a)(1)(v)(a) and (b).

⁵³ *Atkinson v. Commissioner*, 309 F.3d 1290; 90 A.F.T.R.2d 2002-6845; 2002-2 U.S.T.C. ¶ 60449 (11th Cir. 2002).

Tracking the Make-up Amount. Where a CRT is a NIMCRUT or a Flip-CRUT (pre-flip), then it is necessary to properly track the make-up amount. Note that additions to this amount occur each year that the trust accounting income is less than the unitrust amount. Deductions from this amount occur each year in which trust accounting income exceeds the unitrust amount. *Payments of the excess of trust accounting income over the unitrust amount are mandatory to the extent of the make-up amount.*

Respecting the Payment Frequency. One of the factors used to compute the APVRI is the frequency with which income beneficiary payments are to be made. While payments must be made each tax year, the trust's governing instrument may specify that payments are to occur more frequently than annually. Making payments *more frequently* than specified in the trust's governing instrument violates a key assumption used in computing the amount of the income tax charitable deduction and may call into question the validity of the deduction. In addition, failure to observe and respect the provisions of the trust's governing instrument may open the trustee to liability for breach of his or her fiduciary duty and/or may constitute an impermissible act of self-dealing. It is therefore clearly advisable to not make payments on a greater frequency than that specified in the trust agreement.

CRTs That Run Out of Money. It is possible for a CRT (particularly a CRAT) to exhaust. When a CRT created for the benefit of a key donor exhausts, it is tempting for a charity serving as trustee to continue to make payments to the donor from its general fund—much in the

same manner as a charitable gift annuity. However, this is a path to a bigger problem. Such payments constitute private inurement and may subject the charity to the Intermediate Sanctions of IRC §4958.

Tax Reporting by the Donor. In addition to claiming the income tax deduction on Form 1040 Schedule A, the donor may be required to prepare two other IRS forms with respect to his or her transfer to a CRT.

Form 8283 Noncash Charitable Contributions is attached to the donor's Form 1040 to report the income tax charitable deduction claimed by the donor for a gift to a CRT of non-cash property valued in excess of \$5,000. Additionally, if the donor claims a charitable deduction for a non-cash gift that exceeds \$500,000, then the donor must attach a copy of the Qualified Appraisal to the tax return claiming the deduction. If the deduction is carried over to a future year's return, the Qualified Appraisal and another Form 8283 must also be attached to each such return.⁵⁴

Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return is used to report the charitable gift for gift tax purposes. The same form is also used to report taxable gifts to the spouse and/or other income recipients. However, this is not without benefit because filing Form 709 starts the running of the statute of limitations on the valuation of the contributed asset for gift tax purposes.

Funding a testamentary CRT, however, requires filing **Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return** to claim the estate tax charitable deduction.

⁵⁴ See *Instructions for Form 8283*, revised. November 2019.

Tax Reporting by the Income Beneficiary. In general, an income beneficiary that receives distributions from a CRT is required to include the amounts reported on the CRT's Schedule K-1 on the income beneficiary's federal tax returns. Where applicable, such amounts are also required to be included on state returns. Subject to the income thresholds of the 3.8% surtax on Net Investment Income, a CRT's income beneficiary may also need to file Form 8960 *Net Investment Income Tax -- Individuals, Estates, and Trusts* to report how much of the year's distribution is treated as Net Investment Income and how much is exempt from treatment as Net Investment Income.

Tax Reporting by the CRT

Proper 4-Tier Classification. The key to accurate tax reporting by the CRT is the proper classification of all trust activity according to the 4-tier classification method unique to CRTs.⁵⁵ This method requires the tracking of trust activity according to income type (e.g., non-qualified dividends, interest, royalties, rents, annuity income, qualified dividends) and tax rate (e.g., short-term capital gains, 28% rate gains, 25% unrecaptured §1250 gains, 20%/15% long-term capital gains, etc.). In effect, these refined classifications act as “sub-tiers” within the more broadly defined 4-tiers (ordinary income, capital gains, tax-free income, and corpus). As described above, income beneficiary payments result in relieving each sub-tier of the same tax rate within a tier on a pro-rata basis—beginning with the ordinary income tier until it is exhausted, continuing through the capital gain tier

until it is exhausted, and so on. For tax years after 2012, CRT distributions paid to income beneficiaries will likely include amounts subject to the 3.8% surtax on Net Investment Income.⁵⁶ CRT trustees must track and report this information to income beneficiaries annually on Schedule K-1 for potential inclusion on each income beneficiary's personal tax returns.

Filing the Proper Form. Revenue Procedure 83-32 lists the filing requirements for CRTs. In general, a CRT only needs to annually file Form 5227 *Split-Interest Trust Information Return*. A copy of the trust instrument accompanied by a certification of its conformity to the original must be submitted with the initial Form 5227 for the CRT. All IRS Forms 5227 are subject to public inspection. Any person may submit IRS Form 4506-A *Request for Public Inspection or Copy of Exempt or Political Organization IRS Form* to the IRS to receive the public portion of a copy of a CRT's IRS Form 5227 that was filed for a particular year. Further, at various times in the past, the IRS has published the CRT's name, EIN, value, and trustee's name and address for each CRT either as part of its IRS Business Master File or as a separate file.⁵⁷ For this reason, clients who are concerned about privacy no longer use their name as part of their CRT's name.

Other potential filing requirements in conjunction with the funding or operation of a CRT include:

Form 8283 Noncash Charitable Contributions. The CRT trustee should sign the donee

⁵⁵ See IRC §664(b) and Treas. Reg. §1.664-1(d).

⁵⁶ See IRC §1411 and Prop. Treas. Reg. §1.1411-3(c)(2)(iii).

⁵⁷ See www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-fo-bmf.

acknowledgement section of Form 8283.

Form 8282 Donee Information Return. If Form 8283 was prepared for the contribution to the CRT and the contributed asset is sold within 3 years of the gift date, then the CRT trustee must file Form 8282 to report the sale price of the asset.⁵⁸ The return must be filed within 125 days after disposition of the contributed property. Note that this potentially provides a way for the IRS to compare the value used to claim the deduction with the amount realized by the CRT.

Form 4720 Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code. As previously noted, a CRT is subject to the private foundation rules regarding self-dealing. If a CRT has engaged in an act of self-dealing with a disqualified person, then Form 4720 is used to disclose the act, describe the corrective action taken and compute the excise taxes on the foundation manager (i.e., the trustee) and the disqualified person. A CRT also must file Form 4720 for each year in which it has UBTI.

State Registration Requirements. Some states (for example Illinois and Oregon) require that CRTs register as charitable trusts with the state Attorney General. This requirement complements the Federal information return requirements and any state income tax reporting requirements.

Valuation. Unmarketable assets provide the greatest challenge in valuing a trust's assets. A CRT trustee will need to know the value of the trust's assets in a number of situations. For example:

- Valuing the initial contribution to the trust;
- Determining the annual valuation of the trust's assets and liabilities required to compute the unitrust amount;
- Valuing additional contributions for the incremental change in the unitrust amount; and
- Computing how much of an asset to transfer to make an in-kind distribution.

Treasury Regulation §1.664-1(a)(7) provides the trustee with two alternative methods for securing the value of a CRT's unmarketable assets. First, the valuation can be determined exclusively by an independent trustee. Second, the value can be determined by a current Qualified Appraisal.

Compliance. In order to ensure the continued qualification of a CRT, it is important for the trustee, the investment manager, the administrator, the attorney (and any other professional advisor) to be familiar with the laws and regulations governing CRTs and the terms of the governing instrument. All of the parties to a CRT must continually monitor the activity of the trust for compliance. Among the specific areas of concern are trustee powers, principal and income allocations, prohibited investments, self-dealing transactions, and activities or assets that could produce UBTI.

Annual Reporting. In some states, the trustee is required to make a periodic

⁵⁸ See IRC §6050L(a).

statement or accounting to the income beneficiaries, remainder beneficiaries, and/or a court. Charities that prepare financial statements in accordance with generally accepted accounting principles (GAAP) are required to include certain information about charitable remainder trusts. The type of information to be included depends on whether the charity serves as trustee (or not) and whether the charity's interest is revocable or irrevocable.

Investments

Prudent Investor Standard. In selecting a CRT's investment portfolio, the trustee must be aware of the standard under which his or her investment decisions may be evaluated. Since its promulgation in 1994, 43 states and the District of Columbia have enacted a version of the Uniform Prudent Investor Act.⁵⁹ This act permits a trustee to invest for total return based on Modern Portfolio Theory. A trustee is therefore evaluated on the performance of a portfolio considered as a whole, rather than the performance of each individual asset.

Warning: "Total Return Unitrust" (TRU)⁶⁰ provisions alter the definition of trust accounting income. In regulations, the IRS has specifically ruled that a NIMCRUT may not use a TRU definition of income—even if otherwise permitted by state law.⁶¹

Don't Be a Slave to the Payout Rate. It is not necessary, and may be undesirable, to match the investment return to the payout rate. For example, if a CRT uses a 12% payout rate, it would

not be necessary to invest speculatively to achieve a 12% or greater investment return. Similarly, if the payout rate were 5%, it is not necessarily correct (or prudent) to only seek a 5% total investment return. Rather, a CRT trustee should invest for total return while keeping in mind all of the relevant factors (e.g., the synthesized risk/reward profile of the income and remainder beneficiaries, the trust format, liquidity requirements, etc.).

Make Sure the Investment Philosophy (i.e., the Risk Profile) is that of the CRT—not Just the Income Beneficiary and not Just the Charity. By definition, a CRT is a split-interest trust. As such, the trustee has a duty to impartially balance the interests of both the income and remainder beneficiaries. This duty extends to the identification of a risk profile that blends the relative risk profiles of the income and remainder beneficiaries. In identifying the CRT's risk profile, the trustee should consider such factors as the remaining term of the trust, the sophistication of the income and remainder beneficiaries, prevailing economic conditions, anticipated inflation, the required trust payout, the trust format and liquidity needs, tax efficiency as it relates to the expected income beneficiary distributions, and restrictions in the governing instrument. Because these factors may differ from CRT to CRT, it follows that not all CRTs should be invested in the same way.

Make Sure the Person Picking the Investments Knows the Rules. The person selecting a CRT's investment portfolio must be aware of certain rules

⁵⁹ See www.uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Investor%20Act.

⁶⁰ As applied to non-CRT trusts, the "Total Return Unitrust" concept creates an environment that permits trustees of those trusts to invest for total return without the necessity for computing an income beneficiary's payment on traditional definitions of trust accounting income.

⁶¹ See Treas. Reg. §1.664-3(a)(1)(i)(b)(3).

peculiar to CRTs. For example, the trustee should avoid: purchasing assets that produce UBTI; purchasing securities on margin or otherwise borrowing funds which may create unrelated debt-financed income (a form of UBTI); and entering into transactions that are subject to the IRC §4941 excise tax on self-dealing. If there is a charitable income interest, then the trust must avoid excess business holdings (IRC §4943) and jeopardizing investments (IRC §4944).⁶²

Because a CRT's distributions to the income beneficiaries are taxed under the quasi-passthrough "4-tier" system,⁶³ it is important for the trustee to understand how the investment portfolio selected interacts with the 4 tiers. For example, the tiers segregate earnings by income class and the tax rate imposed on the beneficiary. If the selected investment produces income that populates lower tax rate tiers, then it is possible for income beneficiary distributions to be taxed at a lower rate. However, the carryover nature of the tiers means that carryovers within a higher tax rate tier will override current year income that is otherwise taxed at a lower rate. The classic example of this phenomenon is that a large capital gain carryover (typically from the sale of a contributed asset in a prior year) overrides the current production of tax-free municipal bond interest in determining the tax character of income beneficiary distributions.

Gift, Estate, and GST Tax Considerations

General Comments. Even in an era of \$11,000,000 transfer tax exemptions that are indexed for inflation, it is a trap for persons who create a CRT to be unaware of the impact of transfer taxes in CRT planning. A charitable remainder trust should not pay the estate tax or gift tax of the donor. In addition to creating potential self-dealing issues, this is expressly prohibited by Revenue Ruling 82-128. The best practice is for all CRT governing instruments to echo this express prohibition.

Gift Tax. The creation of an income interest for a person other than the donor creates a gift equal to the value of the property transferred less the APVRI. If the donor's spouse is the only person other than the donor to receive an income interest, then the gift tax marital deduction (IRC §2523(g)) eliminates most gift tax concerns. If the CRT is properly designed, no gift tax will be due for the gift of the charitable interest.

If the donor or the donor's spouse is not a recipient of any income interest (e.g., the donor's children are the named recipients), then the donor has made a taxable gift to the income beneficiary. This gift may qualify for the gift tax annual exclusion to the extent it is an immediate interest valued at \$15,000 or less.⁶⁴ To the extent that the gift of an immediate interest to any person is greater than \$15,000, then the donor's lifetime gift tax

⁶² However, the trust must be subject to §§4943 and 4944 beginning at the end of the CRT term if by it's the trust continues as a private foundation.

⁶³ See IRC §664(b) and Treas. Reg. §1.664-1(d).

⁶⁴ The gift tax annual exclusion under IRC §2503(b)(1) is indexed for inflation under IRC §2503(b)(2). For gifts made from 2002 through 2005, the gift tax annual exclusion for a present interest gift was \$11,000. The gift tax annual exclusion increased to \$12,000 for gifts made from 2006 through 2008. It increased to \$13,000 for gifts from 2009 through 2012. It increased to \$14,000 for gifts made between 2013 and 2017. It increased to \$15,000 for gifts made after 2017.

applicable exclusion amount will be reduced or gift tax will be due.⁶⁵ Of course, the donor's lifetime gift tax applicable exclusion amount will also be reduced by the amount of any gift to such a CRT that does not otherwise qualify for either the charitable deduction or the gift tax annual exclusion.

A third variation is to create an income interest for the donor succeeded by his or her spouse succeeded by one or more children. While this can be a powerful planning technique, it does produce a challenging gift tax result. The inclusion of a non-spousal recipient nullifies any gift tax marital deduction for the spouse's interest.⁶⁶ This means that both the children and the spouse's interests are presently subject to gift tax. By retaining a testamentary right to revoke all income interests (but his or her own), a donor can eliminate the gift tax.⁶⁷ However, if the donor fails to revoke each surviving child's interest in the CRT, at the donor's death, the donor will only receive an estate tax charitable deduction for the remainder interest—there will not be a marital deduction for the spouse's interest. So long as the Gift Tax Exemption remains sufficiently high for the donor, the loss of the marital deduction will be irrelevant to many donors.

Estate Tax. It is common for the assets of a CRT to be included in the donor's gross estate. This can occur for a variety of reasons including:

Retaining an Income Interest. IRC §2036 requires estate inclusion of trust assets of a trust created by the donor if the donor retained a lifetime income interest.

Retaining a Right to Revoke a Surviving Income Recipient. IRC §§2036 and 2038 require estate inclusion of trust assets for trusts created by the donor if the donor retained a power to designate a beneficiary. The power to revoke a surviving income recipient fits this category.

Retaining a Right to Change the Charitable Beneficiary. IRC §§2036 and 2038 require estate inclusion of trust assets for trusts created by the donor if the donor retained a power to designate a beneficiary. The power to change the charitable beneficiary fits this category.

As a reminder, any one of these items—by itself—is sufficient to cause the assets to be included in the donor's gross estate. However, this does not mean that there is a tax due for single-life or spousal CRTs. Between the estate tax charitable deduction and (for spousal CRTs) the estate tax marital deduction, the value of the CRT assets included in the donor's estate is effectively eliminated.⁶⁸ However, the fact that the gross estate net of the available deductions is less

⁶⁵ Retention of a testamentary right to revoke an income interest complicates determining the gift tax. See PLR 8637084 in which the IRS ruled that each year's unitrust payments to the child would separately qualify as annual exclusion gifts when the CRT included a testamentary right to revoke the child's interest.

⁶⁶ IRC §2523(g).

⁶⁷ See Treas. Reg. §1.664-2(a)(4) for annuity trusts and Treas. Reg. §1.664-3(a)(4) for unitrusts. Both regulations permit this power to be exercised only at death and only by will.

⁶⁸ For a limited number of estates, inclusion of the value of the CRT's assets in the donor's gross estate may limit the estate's eligibility to claim a special use valuation, IRC §6166 deferral of tax, or IRC §303 redemption.

than the estate tax applicable exclusion amount does not eliminate the requirement to file Form 706.

As with all estate tax computations, if the gross estate (including the CRT assets

Generation-Skipping Transfer Tax (GSTT). The enactment of the 10% remainder test in 1997 significantly reduced the capacity to name young beneficiaries in a lifetime CRT and

Table 1. Gift, Estate, and GST Tax Rates and Exclusion Amounts

Year	Highest Estate and GST Tax Rates	Estate Tax Applicable Exclusion Amount	GST Exemption Amount	Highest Gift Tax Rate	Gift Tax Applicable Exclusion Amount
2011	35%	\$5,000,000	\$5,000,000	35%	\$5,000,000
2012	35%	\$5,120,000	\$5,120,000	35%	\$5,120,000
2013	40%	\$5,250,000	\$5,250,000	40%	\$5,250,000
2014	40%	\$5,340,000	\$5,340,000	40%	\$5,340,000
2015	40%	\$5,430,000	\$5,430,000	40%	\$5,430,000
2016	40%	\$5,450,000	\$5,450,000	40%	\$5,450,000
2017	40%	\$5,490,000	\$5,490,000	40%	\$5,490,000
2018	40%	\$11,180,000	\$11,180,000	40%	\$11,180,000
2019	40%	\$11,400,000	\$11,400,000	40%	\$11,400,000
2020	40%	\$11,580,000	\$11,580,000	40%	\$11,580,000

and other lifetime gifts) is valued at less than the estate tax applicable exclusion amount, the inclusion of the CRT assets will not create an estate tax liability. For estates whose value exceeds the estate tax applicable exclusion amount, a testamentary CRT may be a strategy for reducing the value of the estate below the limit, while providing a benefit to the donor's spouse, heirs and charity.

Table 1 lists the estate, gift and generation skipping transfer tax rates and applicable exclusion amounts. The Gift, Estate, and GST tax rates and Exclusion Amounts will continue to be indexed for inflation each year.

consequently significantly reduced the danger that a CRT will cause generation skipping transfer tax (GSTT) concerns. Nevertheless, where a skip person with respect to the donor is or *could become* a beneficiary of a CRT, then the GSTT ramifications must be considered.⁶⁹ Of special concern is the danger when a non-skip person (who is named as a beneficiary when the CRT is created) subsequently dies and is succeeded by a skip person. Distributions by a CRT to a skip person are taxable distributions.⁷⁰

Allocation of GST Exemption. Even though a transfer to a CRT may be a generation-skipping transfer, it is possible for the donor to allocate all or a

⁶⁹ See IRC §2613 for the definition of a skip person. See IRC §2651(d) for the rules related to generation assignment of persons who are not lineal descendants.

⁷⁰ See IRC §§2612(b) and 2621 for more on taxable distributions.

portion of his or her GST exemption to the transfer.

Post-Mortem Planning with CRTs

The actuarial present value of a CRT's remainder interest must be at least 10% of the value of the contributed assets. The combined life expectancies of all measuring lives are a key factor in computing the remainder interest. Unfortunately, when designing a donor's estate plan it is impossible to know what the combined life expectancies of the donor's children will be at the donor's death. Therefore, it is advisable to determine the degree of discretion the donor is willing to grant the executor in altering the terms of a testamentary CRT to pass the 10% test.

For example, some donors find comfort in knowing that a 20-year term-certain CRUT with a payout rate of 10% or less will always pass the 10% test. Alternatively, because fewer measuring lives increases the probability that a trust will pass the 10% test, the donor can grant the executor discretion to create separate CRTs for the life of each child.

Three primary options are available for CRTs that fail the 10% test. All three options are available both when the CRT is initially funded as well as for each additional contribution to a CRUT. First, the CRT (or the additional contribution) can be declared null and void *ab initio*.⁷¹ A second, more common solution is to reduce the CRT's payout rate until the 10% test is met.⁷² The third solution is to reduce the payout period.⁷³ The third

solution could include removing one or more noncharitable income beneficiaries, changing the payout term from lives to a term of years or reducing the term of years.

Disclaimer Planning with CRTs.

Opportunities exist for donors to use disclaimer planning to create alternative scenarios in their estate plan. For example, a donor's will could provide that \$4 million be transferred outright to her spouse, however if her spouse disclaims his interest,⁷⁴ then the \$4 million would be transferred to a CRT for the benefit of their children and a named charity.

Benefits to Donors

The charitable remainder trust has become a familiar tool in the gift planner's toolbox. CRTs are flexible enough to solve a myriad of donor charitable, financial and non-financial goals. A best practice is to use a CRT to accomplish multiple donor goals. For example, CRTs can:

- Increase cash flow
- Defer capital gain taxes
- Reduce income, gift and/or estate taxes
- Plan the donor's estate
- Transfer money to heirs
- Maximize charitable giving
- Diversify concentrated stock positions or illiquid assets
- Preserve wealth for the family

⁷¹ See IRC §2055(e)(3)(J)(i). See also PLR 201040021 in which the CRT was declared null and void multiple years after the purported CRT was initially funded.

⁷² See IRC §2055(e)(3)(J)(ii).

⁷³ See IRC §2055(e)(3)(J)(ii).

⁷⁴ See IRC §2518.

Much of the power behind the CRT is based on its tax-exempt status and irrevocable nature. CRTs can be funded with a variety of assets including stocks, bonds, mutual funds, restricted securities, exchange traded funds, real estate in various forms, partnership interests, limited liability companies (LLCs), S-corporations,⁷⁵ C-corporations, and art and other tangible personal property. When combined with an irrevocable life insurance trust, the CRT can solve many of a donor's noncharitable goals within a charitable context.

All donors like to be thanked and many like to be recognized. A CRT can enable donors to realize charitable goals that seem beyond their reach. For example, making a current gift to endow a chair in the donors' name at their *alma mater* may not be feasible, but by utilizing a CRT, this goal can be achieved.

Often the same CRT can be used again and again to address a donor's charitable, financial, and non-financial goals.

Benefits to Charities

CRTs are a bread-and-butter part of any full-service planned giving program. The most obvious benefit is the payment of the charitable remainder. Other benefits include enhanced donor relations (with the prospect of other current gifts), possible income beneficiary opportunities, testimonials, creating opportunities to engage donors with new and exciting programs, etc.

⁷⁵ Note that while S-corporation stock can be transferred to a CRT without disqualifying the CRT, doing so will immediately terminate the corporation's S-election. Therefore, this type of transfer should only be done where all other shareholders and any prospective purchaser of the corporation do not require that the S-election remain intact.

Appendix A

IRS Charitable Remainder Trust Statistics⁷⁶

Between 1998 and 2011, the Statistics of Income division of the IRS published tables and an annual paper based on a statistical study of IRS Forms 5227, which were filed for a tax year.⁷⁷ The second and third tables below present a compilation of selected statistics from 2004 through 2011 based on the IRS' data.

The data indicate that the 80/20 rule applies to the breakdown of CRUTs vs. CRATs, with CRUTs comprising around 80% of all CRTs. However, when reviewing the “Book Value” of all CRTs, CRUTs comprise over 90% of the Book Value of CRT Assets. Note that the CRUT values include both Book Values and Market Values while the CRAT statistics include only Book Values because CRUTs report additional information to the IRS.

During tax year 2010, most CRUTs (85.0%) had a unitrust amount between 5% and 10%. Further, 79.1% of CRUTs were SCRUTs, another 16.7% were NIMCRUTs and the remaining 4.2% were NICRUTs.

For tax years 2016 through 2018, the IRS reported 105,370; 103,106; and 98,068 total split interest trusts, respectively. These numbers include CRATs, CRUTs, Charitable Lead Trusts, Pooled Income Funds, and possibly some other miscellaneous types of trusts. Unfortunately, the IRS data did not distinguish between types of split interest trusts in their report. Our *best estimates* of CRT data for these years are reflected below in the first table.

IRS CRT Statistics (for Tax Years 2016 through 2018)

	2016	2017	2018
Number of CRUTs (all types)	84,581	82,764	78,720
Percentage of Total Number	80.27%	80.27%	80.27%
Number of CRATs	13,540	13,249	12,601
Percentage of Total Number	12.85%	12.85%	12.85%
TOTAL NUMBER OF CRTs	98,121	96,013	91,321

⁷⁶ Source: Internal Revenue Service, www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-ee-bmf and www.irs.gov/uac/SOI-Tax-Stats-Split-Interest-Trust-Statistics.

⁷⁷ Because the study covers IRS Form 5227, the formerly annual study also addresses some data about Charitable Lead Trusts and Pooled Income Funds.

IRS CRT Statistics (for Tax Years 2008 through 2011)*Money amounts are in thousands of dollars*

	2011	2010	2009	2008
Number of CRUTs (all types)	91,250	93,829	93,825	95,928
Market Value of CRUTs	\$92,712,995	\$98,256,070	\$97,349,477	\$92,165,720
Book Value of CRUTs	\$85,240,003	\$86,901,148	\$91,582,144	\$96,060,677
Percentage of Total Number	86.19%	85.54%	84.71%	83.78%
Number of CRATs	14,616	15,862	16,937	18,572
Book Value of CRATs	\$6,447,093	\$7,136,591	\$7,494,666	\$8,139,773
Percentage of Total Number	13.81%	14.46%	15.29%	16.22%
TOTAL NUMBER OF CRTs	105,866	109,691	110,762	114,500
Total Book Value of CRTs	\$91,687,096	\$94,037,739	\$99,076,810	\$104,200,450

IRS CRT Statistics (for Tax Years 2004 through 2007)*Money amounts are in thousands of dollars*

	2007	2006	2005	2004
Number of CRUTs (all types)	96,248	95,567	94,767	94,779
Market Value of CRUTs	\$119,198,640	\$106,425,220	\$96,835,553	\$95,053,618
Book Value of CRUTs	\$98,042,480	\$86,741,306	\$81,121,949	\$79,845,710
Percentage of Total Number	83.34%	82.56%	81.65%	81.39%
Number of CRATs	19,241	20,187	21,296	21,667
Book Value of CRATs	\$8,931,574	\$9,080,252	\$9,041,175	\$9,540,935
Percentage of Total Number	16.66%	17.44%	18.35%	18.61%
TOTAL NUMBER OF CRTs	115,489	115,754	116,063	116,446
Total Book Value of CRTs	\$106,974,054	\$95,821,558	\$90,163,124	\$89,386,645