Protective

CHARITABLE GIVING CONCEPTS

Charitable Remainder Annuity Trust vs. Unitrust

The Concept…

- A charitable remainder trust is a “split-interest” gift that pays the donor—or someone chosen by the donor—an income from the trust, and ultimately distributes the trust remainder to a qualified charity when the trust term expires.
- The value of the charity’s remainder interest must be at least 10% of the trust value and is calculated at the inception of the trust.
- Income payouts from the trust must be made annually and may last for a term of up to 20 years, or for the lifetime of the donor and/or other beneficiaries.

Distinctions…

- Charitable remainder trusts are irrevocable and come in two basic forms: the charitable remainder annuity trust (CRAT) and the charitable remainder unitrust (CRUT).
- A CRAT pays a fixed percentage (at least 5%) of the trust’s initial value every year until the trust terminates. The donor cannot make additional contributions to a CRAT after the initial contribution.
- A CRUT, by contrast, pays a fixed percentage (at least 5%) of the trust’s value as determined annually. Thus, the payout is adjusted each year as the value of the trust assets goes up or down. A donor can make additional contributions to a charitable remainder unitrust.

Variations…

While the CRAT comes in only one basic form, the CRUT comes in four sub-varieties:

- A **straight charitable remainder unitrust** makes annual distributions based on a payout rate that is a set percentage of trust assets. A payout tied to the trust’s annual value can act as a hedge against inflation when trust assets increase, but it can also mean a lower annual payout if trust assets decline in value.
- A **net income unitrust** pays out a stated percentage or the actual income earned by the trust (whichever is less). Donors funding a trust with non-income-producing assets, such as real estate, may prefer this option.

- A **net income unitrust with a make-up provision** (NIMCRUT) includes a provision that allows the trust to make up any payout deficits in years when the trust earned less income than the stated payout percentage. This arrangement is most often used to enhance retirement income.
- A **flip unitrust** begins as a net income unitrust and later switches to a straight unitrust, giving the donor added flexibility. The flip option appeals to donors who want to fund the unitrust with non-liquid assets such as real estate or closely held stock. If the asset is not sold right away and does not earn any income inside the trust, the net-income limitation relieves the trustee from the obligation to pay an annual amount to the income beneficiary (often the donor). However, once the non-liquid asset is sold and the proceeds are reinvested, the income beneficiary may prefer a more predictable payout. The flip provision allows the trustee to make the fixed-percentage payout after the “flip” occurs, without being bound to the original net income limitation.

The Choice...

- Choosing between a CRAT and a CRUT depends on the donor’s particular wishes and priorities.
- A CRAT is a logical choice for a donor who wants a stable, fixed income, and who is satisfied making only an initial contribution to the trust.
- A CRUT may be more suitable for a donor who wants a potential hedge against inflation, a chance to make additional contributions and the opportunity to fund the trust with illiquid assets such as real estate. In this case, it makes sense to contribute assets that can be readily valued every year, since this is necessary in a charitable remainder unitrust.

The Bottom Line...

Distinctions aside, it’s clear that a charitable remainder trust—whether a CRAT or a CRUT—gives donors a chance to reward a favorite charity without sacrificing needed income. The trust is flexible enough that the donor can tailor it to fit his or her personal lifestyle and objectives.

SUMMARY

What Is a Charitable Remainder Trust?

A charitable remainder trust is a qualified “split-interest” gift providing donors the opportunity to benefit a favorite charity without sacrificing needed income. The trust pays the named beneficiaries an annual income until the end of the trust term, then distributes the remaining assets to one or more charities.

The charity’s projected remainder interest must be at least 10% of the initial value of the trust. Distributions from the trust to non-charitable beneficiaries may last for a term of up to 20 years, or for the beneficiary’s lifetime. The trust must make income payouts at least annually, and when the trust expires, the named charity receives the trust principal.

What Are the Types of Charitable Remainder Trusts?

Charitable remainder trusts are irrevocable and come in two basic forms—the charitable remainder annuity trust (CRAT) and the charitable remainder unitrust (CRUT).

Every year the CRAT pays out a fixed percentage—at least 5% but no more than 50%—of the initial value of the trust assets. The donor cannot make additional contributions to a CRAT after the initial contribution.

The CRUT also pays out a fixed percentage of the trust’s value, but the payout is recalculated every year as a percentage of the value of the trust assets at that time. The donor selects the payout rate when creating the trust (at least 5% but not more than 50%). The donor can make additional gifts to a CRUT at any time.

Are There Other Variations?

A CRAT comes in only one form. A CRUT, however, comes in several variations, each of which offers unique advantages.

A net income unitrust pays out either the stated percentage of trust assets as valued every year or the income actually earned by the trust (whichever is less).

Another choice is the net income unitrust with make-up provision (NIMCRUT). This variation includes a provision letting the donor make up any payout deficits in years when the trust earned less income than the stated payout percentage.

Finally, a flip unitrust begins as a net income unitrust and later switches to a straight unitrust. This gives the donor added flexibility to fund the unitrust with illiquid assets such as real estate or closely held stock, and to switch the form of payout after the asset is sold.

Which Trust Is the Right Choice?

Each donor’s personal objectives will determine the best option among the charitable remainder trust variations.

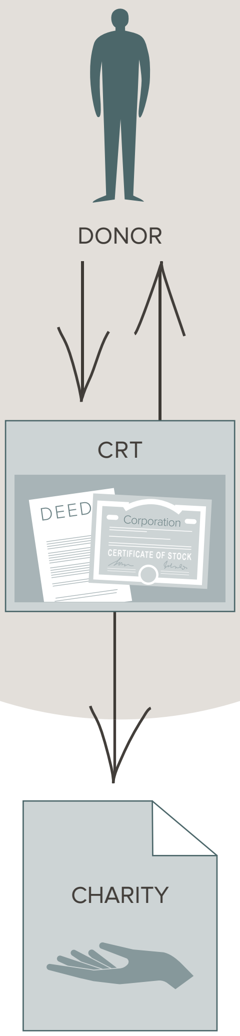
The CRAT is better for donors who want a fixed stable income. Donors can be assured of receiving the same fixed payment even if the value of the trust assets declines.

The CRUT is a good fit for donors who want a hedge against inflation. It's also attractive to donors who intend to fund the trust with illiquid assets such as real estate; some unitrust designs can defer payments until the asset is sold.

The flexibility of trusts is particularly evident in the choices available to individuals who want to remember a favorite charity and still need income from the assets ultimately intended for the charity. It's simply a matter of choosing the trust design that best fits the donor's objectives.

1

The donor irrevocably transfers property to the trustee of a charitable remainder trust. The donor qualifies for a federal income tax deduction for the present value of the charity's remainder interest, subject to limitations.



2

The trustee pays an income to the donor or other beneficiary. An annuity trust (CRAT) pays a fixed percentage of the initial value. A unitrust (CRUT) pays a specified percentage of the trust assets as revalued each year.

3

When the trust ends, the trustee transfers the remaining trust assets to the charity.

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