
Charitable Remainder Unitrust

A Charitable Remainder Unitrust (CRUT) is an irrevocable trust which pays a fixed *percentage of the value of its holdings* each year to a beneficiary such as the donor of the trust assets, his or her spouse, child, etc. Unlike the *fixed dollar payment* of a Charitable Remainder Annuity Trust (CRAT), the unitrust payments will fluctuate with the changing asset balance in the trust (revalued annually), reflecting year-to-year investment performance.



After the death of the income beneficiaries, or at the end of a set number of years (no more than 20), whatever assets remain in the trust are distributed to the charities named in the trust. Unlike a CRAT, additional contributions to a CRUT are allowed in later years, if desired.

CRUT Variations

The standard form of CRUT requires payment of the full stated percentage throughout the life of the trust, even if assets must be liquidated. Other CRUT variations include:

- **Net-Income CRUT:** A CRUT may be drafted to pay out less than the established percentage if the trust income during the year is less than the required payout percentage. This shortage can be made up in later years when the trust earns more than the required payout percentage.
- **“Flip” CRUT:** Under IRS regulations, a CRUT may begin life as a net-income trust, and, at some pre-determined future date or triggering event, permanently convert (“flip”) to a standard unitrust. A “flip” CRUT is an option for an individual seeking a current income tax deduction, tax-deferred buildup and increased income at a later date.

Income Tax Considerations

The charitable income tax deduction¹ is based on the current value of the charity’s right to receive the trust assets at some time in the future. Three factors are involved:

- The length of time, which the charity must wait; for example, a term of years (like 10, 15, 20, etc.) or for the donor’s or other person’s lifetime.

¹ The discussion here concerns federal income tax law. For individual taxpayers, the deduction for charitable gifts discussed here is one of a number of itemized deductions listed on Schedule A, Form 1040. In calculating taxable income, a taxpayer may choose to deduct from adjusted gross income either the standard deduction or the total allowable deductions from Schedule A. State or local income tax law may vary.

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- The percentage rate payable to the income beneficiaries each year and how frequently it is paid, e.g., annually, monthly, etc. The higher the payout, the less there will be for the charity; and, therefore, the smaller the charitable deduction.
- The current rate of return on investments, using the IRC Sec. 7520 rate, which is subject to change monthly.

These factors are applied to government tables to determine the current value of the charitable deduction. If the charitable deduction exceeds a certain percentage of the donor's adjusted gross income in the year of the gift, the excess is be carried over to future years.

Gift Tax Considerations

If the income from the CRUT is payable to someone other than the donor, it may be subject to federal gift taxation. If certain requirements are met, the income gift can be made to qualify for the annual gift tax exclusion of \$17,000 (in 2023) per beneficiary. Also, the marital deduction will usually eliminate any tax on payments to the donor's spouse.

Estate Tax Considerations

The value of the interest passing to the charity is deductible from the gross estate. If there are income beneficiaries other than the donor and his or her spouse, there may be an estate tax on the value of this income interest.

Some states allow a surviving spouse to "elect" to receive a portion of the deceased spouse's estate. Such laws are designed to prevent the surviving spouse from being completely disinherited. If state law allows assets in a CRUT to be used to satisfy the surviving spouse's election, the CRUT could cease to qualify as a charitable trust under federal law. As a result, previous income tax deductions can be lost and the assets in the trust could be added back to the deceased spouse's estate.¹

¹ The IRS originally provided a "safe harbor" for this situation in Revenue Procedure 2005-24, with a grandfather date of June 28, 2005. In Notice 2006-15, however, the federal government extended the June 28, 2005 date until "further guidance is issued by the Internal Revenue Service."

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Almost Everyone Benefits

A taxpayer can contribute an asset (often highly appreciated and low income producing) to a CRUT and receive a current income tax deduction. The trustee can sell the appreciated asset without the trust paying any capital gains tax and then reinvest the entire proceeds.

The trust will often pay out a higher rate of return than the donor previously received. This higher return, coupled with the federal charitable income tax deduction, can provide a substantial increase in cash flow. The cash payments received by the income beneficiaries are taxed under a four-tier system. Generally, ordinary income is paid first, followed by capital gain, other income, and trust principal.

Thus far, the only ones to lose are the donor's heirs. To solve this problem, many taxpayers use a portion of the increased cash flow to purchase a life insurance policy (outside of the estate) to replace the value of the asset placed in the trust. This arrangement lets almost everyone benefit.

Party	Benefit
Donor (and spouse)	Increased cash flow during retirement years
Children/heirs	Same size or larger inheritance (with insurance)
Favorite charity	Receives remaining assets after donor's death
Internal Revenue Service	Receives less income and estate tax

SECURE 2.0 of 2022

One section of the SECURE 2.0 Act of 2022 created a potential new source of funds for a CRUT. Earlier law provided for annual distributions – known as Qualified Charitable Distributions, or QCDs - of up to \$100,000 directly to a charity. SECURE 2.0 added a provision allowing for a one-time, direct distribution from either a traditional or Roth IRA of up to \$50,000 to a CRUT, a charitable remainder annuity trust (CRAT), or to a charitable gift annuity CGA).

The CRUT, CRAT, or CGA must benefit only the donor, his or her spouse, or both. The Act also requires that the trust or annuity be funded only with qualified charitable distributions. This new provision is effective for tax years beginning after December 29, 2022

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Seek Professional Guidance

Because of the complexities involved, the advice and guidance of trained, experienced tax, legal, and other financial professionals is highly recommended.

Disclosure Notice

The information that follows is intended to serve as a basis for further discussion with your financial, legal, tax and/or accounting advisors. It is not a substitute for competent advice from these advisors. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney. The application of other concepts may require the guidance of a tax or accounting advisor. The company or companies listed below are not authorized to practice law or to provide legal, tax, or accounting advice.

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