
Charitable Remainder Trust Numerical Tests

Charitable remainder trusts (CRTs), including charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs), are subject to a complex maze of law and regulation. The failure of a CRT to meet all requirements the law imposes can result in it being disqualified as a “charitable” trust, with negative income, gift, and estate tax consequences, as well as defeating the donor’s charitable intent.¹

Numerical Tests

A number of these requirements involve specific numerical tests:

- **5% probability test:** This test, which applies only to CRATs, measures the theoretical possibility that a non-charitable beneficiary might live long enough to exhaust the assets in the trust, leaving nothing for the charity.² Using a complicated mathematical formula, and government interest and longevity tables, the probability of exhausting the assets is calculated at the time property is transferred to the trust. If the probability of exhaustion is greater than 5%, no income or estate tax deduction is allowed.
- **5% minimum payment test:** This test concerns the minimum annual payment which must be made from a charitable remainder trust. For CRATs, federal law requires the payment to be not less than 5% of the initial fair market value of all property placed in the trust. For CRUTs, the law requires the minimum payment to be a fixed percentage, not less than 5%, of the net fair market value of the CRUT’s assets, valued annually.
- **50% payout limitation test:** Federal tax law limits the annual payout from a CRAT to no more than 50% of the initial net fair market value of property in the trust. For CRUTs, annual payments are limited to no more than 50% of the net fair market value of the trust’s assets, valued annually. A CRT which fails this test will be treated as a complex trust, with all income taxed to either the trust or its beneficiaries.

¹ The discussion here concerns federal tax law. State or local law may differ.

² With a CRUT, exhaustion of the trust assets is considered impossible as payments from the trust are based on a percentage of trust assets, not a fixed dollar payment.

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- **10% minimum charitable benefit:** There is a minimum benefit that must ultimately pass to the charity. For CRATs, this minimum is 10% of the initial net fair market value of all property placed in the trust. For CRUTs, the remainder interest passing to the charity must be at least 10% of the net fair market value of trust property, valued as of the date the property is contributed to the trust.

Seek Professional Guidance

Because of the complexity of the law and regulations governing charitable remainder trusts, individuals considering a CRT are strongly advised to consult with an attorney, CPA, IRS enrolled agent, or other competent financial professional. Also, many charitable organizations have professionals on their staffs that can provide insight and guidance in designing and implementing charitable remainder trust planning.

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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