Charitable Remainder Trust

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What Is a Charitable Remainder Trust?

A charitable remainder trust is a tax-exempt irrevocable trust designed to reduce the taxable income of individuals by first dispersing income to the beneficiaries of the trust for a specified period of time and then donating the remainder of the trust to the designated charity. This is a “split-interest” giving vehicle that allows a trustor to make contributions, be eligible for a partial tax deduction, and donate remaining assets.

KEY TAKEAWAYS

- A charitable remainder trust is a tax-exempt irrevocable trust designed to reduce the taxable income of individuals.
- A charitable remainder trust disperses income to the trust beneficiaries for a specified period and donates the remainder to the designated charity.
- A charitable remainder trust allows a trustor to make contributions, be eligible for a tax deduction, and donate a portion of the assets.

Understanding Charitable Remainder Trust

A central idea of a charitable remainder trust is to reduce taxes. This is done by first donating assets into the trust and then having it pay the beneficiary for a stated period of time. Once this time-frame expires, the remainder of the estate is transferred to the charities deemed as beneficiaries.

Charitable remainder trusts are irrevocable. This means that they cannot be modified or terminated without the beneficiary's permission. The grantor or trustor, having transferred assets into the trust, effectively removes all of her rights of ownership to the assets and the trust upon creation of its irrevocable status. In contrast, a revocable trust allows the grantor modifications.

This charitable giving strategy also enables people to pursue philanthropic goals while still generating income. In addition to tax management, charitable remainder trusts can offer benefits for retirement and estate planning.

Two main types of charitable remainder trusts include:

1. Charitable remainder annuity trusts or CRATs that distribute a fixed annuity each year

2. Charitable remainder uni-trusts or CRUTs that distribute a fixed annual percentage based on the balance of the trust assets (CRATs do not allow for additional contributions, while CRUTs do permit this.)

Charitable Remainder Trust and Additional Types of Trusts

Additional types of trusts outside of charitable remainder trusts include a bare trust, in which the beneficiary has the absolute right to the capital and assets within the trust, as well as the income generated from these assets. While a trustee often oversees the investments within the trust, the beneficiary has the final say over how the trust's capital or income is distributed. In bare trusts, beneficiaries are taxed on the income that trust assets generate (i.e. interest, dividends, and rent).

In contrast, an alimony substitution trust is an agreement in which a divorced person agrees to pay spousal support via a trust's generated income. With regards to taxation, the ex-spouse responsible for providing payments is not required to pay income taxes on the trust's income, nor do they receive a tax deduction.

Special Considerations

It's important to note that there are new rules for IRA and 401(k) beneficiaries, according to the SECURE Act of 2019. The new ruling states that non-spousal IRA beneficiaries must withdraw all of the funds by the end of ten years following the death of the original account owner. Typically, trusts were established to allow IRA beneficiaries to receive the required minimum distribution (RMD) each year from the inherited IRA or 401(k). With the new ruling, the ten-year withdrawal rule applies to all accounts, including trusts. There are some exceptions, including for surviving spouses and those who are chronically ill, but trust account holders should consult a financial professional to review the rule changes.