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Charitable Remainder Trusts Can Enhance Your Planned Giving Program

Planned, or deferred, giving opens up a whole new range of donors for your organization and enables your current supporters to increase their level of giving. It also helps you develop a solid, long-term financial base, freeing you from a reliance on grants and annual fund-raising efforts.

For your donors, planned giving techniques can significantly reduce estate, income, and gift taxes, allowing them to benefit their chosen charities while obtaining significant tax advantages.

Planned giving is a long-term proposition. Your organization won't realize the value of the gifts until some time in the future. In addition, it can take several years to establish an effective deferred giving program and still more time before you receive any actual revenue.

Because of the complex nature of the gifts and their benefits, your organization must be willing to invest in a sophisticated effort to identify, educate, and solicit donors. The benefits of deferred gifts are substantial, but they need to be explained to the donor in person. Mass mailings or telephone campaigns are ineffective in soliciting donors; one or more face-to-face meetings are essential.

Deferred giving programs can take many forms. They can be as simple as a bequest in a will, but most programs are considerably more complex. In this article, we focus on the various types of charitable remainder trusts.

Charitable Remainder Trusts

In a charitable remainder trust (CRT), a donor places assets in trust to benefit the charity. Donors can transfer assets to the CRT either during their lifetimes or upon their death. The donor receives a current income tax deduction when the donation is made. He or she also realizes eventual estate tax savings, because the donated property is not included in the estate.

A CRT is a split-interest trust because two classes of beneficiaries have an interest in the gift. The noncharitable beneficiaries receive distributions of income from the CRT either for life or for a term of years. When the noncharitable beneficiaries die

or the term of years ends, the remaining assets of the CRT are distributed to the charitable beneficiaries.

There are three charitable remainder trust options: annuity trusts, unitrusts, and pooled income funds. The essential difference among them is in how the income paid to the donor is calculated.

Annuity Trust

In a charitable remainder annuity trust (CRAT), the donor places assets in trust and chooses a trustee who holds the principal in a separate account and invests it to earn a regular income.

The yearly payout from the trust is guaranteed, and can be either a fixed dollar amount or a fixed percentage of the initial value of the assets transferred to the trust. The annuity amount must be at least 5 percent of the value of the original assets contributed to the trust, but may not be more than 30 percent of that value.

If investment earnings are insufficient to pay the beneficiary, the trustee must make up any shortfall from accumulated trust earnings or principal.

Because CRATs are irrevocable, donors receive a charitable deduction for a portion of their gift in the year they make it. The exact amount of the deduction is determined by the donor's age, the percentage payout, and other factors.

Advantage: An annuity trust is attractive because the donor knows he or she will receive the same amount each year, guaranteed by the assets of the trust.

Disadvantage: The noncharitable beneficiaries do not benefit from any appreciation of the value of the trust's assets. In addition, inflation may erode the purchasing power of the annuity payments.

Unitrust

Instead of providing a fixed payout, a charitable remainder unitrust (CRUT) provides payouts that are adjusted annually to reflect the increase or decrease in the value of the trust's assets. The percentage payout remains constant and is determined at the time the trust is established. Each year, the trust assets are revalued and the annual payout is recalculated.

Advantage: A unitrust is good for someone looking for a specific percentage return. This can be used to keep up with inflation if the trust value continues to grow over the years. The donor can make additional contributions to the CRUT and is entitled to an income tax deduction for each additional contribution.

Disadvantage: If the CRUT doesn't earn any income or appreciate in value in the first year, the trustee would have to use principal to make the payment. This would reduce the value of the trust principal in the next year, thus reducing the payment in the second year.

Pooled Income Funds

A pooled income fund combines gifts from numerous donors in a single fund managed by the charity. Unlike annuity trusts or unitrusts, where annual distributions are determined by the value of the assets, the annual distribution from a pooled income fund is determined by the performance of the fund's investments.

The major difference between a pooled income fund and a CRUT or CRAT is that

the donor does not create or control the trust. Instead, the pooled income fund must be maintained by the public charity to which the irrevocable remainder interest is contributed. Property contributed to pooled income funds is limited to cash and publicly traded securities.

Advantage: With a pooled income fund, donors receive the benefit of professional management of fund assets and the assurance that distributions will not erode the value of gift assets, since they are limited to fund income. Typically, individual donations to pooled income funds can be smaller than those made to charitable remainder trusts.

Disadvantage: A pooled income fund donor receives only a share of the trust's annual income, with no promise that the donor will receive a certain amount each year.

Commitment Required

The commitment of effort and resources your organization must make to effectively pursue deferred gifts is substantial. A successful program requires the combined services of a lawyer, an accountant, an insurance adviser, and a fund-raising consultant, in addition to your own staff.

But the financial payoff can be well worth the time, effort, and resources you invest in your planned giving program.



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