A fresh look at CRTs, CRATs and CRUTs

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A charitable remainder trust ("CRT") allows you to support a favorite charity while potentially boosting your cash flow, shrinking the size of your taxable estate, and reducing or deferring income taxes. In a nutshell, you contribute stock or other assets to an irrevocable trust that provides you — and, if you desire, your spouse (or others you designate) — with an income stream for life or for a term of up to 20 years. At the end of the trust term, the remaining trust assets are distributed to one or more charities you've selected.

When you fund the trust, you're entitled to claim a charitable income tax deduction equal to the present value of the remainder interest (subject to applicable limits on charitable deductions). Your annual payouts from the trust can be based on a fixed percentage of the trust's initial value — this is known as a charitable remainder *annuity* trust ("CRAT"). Or they can be based on a fixed percentage of the trust's value recalculated annually — this is known as a charitable remainder *unitrust* ("CRUT").

CRUT advantages

Generally, CRUTs are preferable for two reasons. First, the annual revaluation of the trust assets allows payouts to increase if the trust assets grow, which can allow your income stream to keep up with inflation. Second, donors can make additional contributions to CRUTs, but not to CRATs.

The fixed percentage — called the unitrust amount — can range from 5% to 50%. A higher rate increases the income stream, but it reduces the value of the remainder interest and, therefore, the charitable deduction. In addition, to pass muster with the IRS, the present value of the remainder interest must be at least 10% of the initial value of the trust assets.

The determination of whether the remainder interest meets the 10% requirement is made at the time the assets are transferred. If the ultimate distribution to charity is less than 10% of the amount transferred, there's no adverse tax impact related to the contribution.

NIMCRUTs can provide an income boost

By designing a CRUT with a "net income with makeup" feature — known as a "NIMCRUT" — you can reduce or even eliminate payouts early in the trust term (when the trust may generate little or no income) and enjoy larger payouts in later years when you're retired or otherwise need an income boost.

Each year, a NIMCRUT distributes the *lesser* of the unitrust amount (say, 5%) or the trust's net income. The trustee can invest the trust assets in growth investments that produce little or no income, allowing the trust to grow tax-free and deferring distributions to later years. The deferred payouts accumulate in a "makeup account."

When you're ready to begin receiving an income, the trustee shifts the assets into income-producing investments. You can use the funds in the makeup account to increase your distributions beyond the unitrust amount (up to the amount of net income).

Handle with care

CRTs, CRATs and CRUTs require careful planning and solid investment guidance to ensure that they meet your needs. Please contact us to discuss your options before taking action.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com