Please Note:

Issues of *Futures* appear as they were originally published. Information in these publications has not been updated to reflect changes that could affect calculations given in case examples.

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Futures

Summer 2008

A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

Charitable Gift Annuities and Charitable Remainder Trusts: How They Work and When to Use Them

By Deborah D. Hunt, Esq., Partner, Sebaly Shillito + Dyer

"Clearly a CRT is more complicated and costly to create and administer than a CGA…."

– Deborah D. Hunt

Despite the current downturn in the economy, clients continue to look for ways to incorporate charitable giving into their estate plans. For those who wish to make a charitable gift, but retain an income stream for themselves or their loved ones, a Charitable Gift Annuity (CGA) or a Charitable Remainder Trust (CRT) may be the answer. The Dayton Foundation has long experience in working with the advisor community to assist advisors' clients with both of these income-producing, charitable vehicles.

Deborah D. Hunt, Esq.

How They Work

A CGA is a private agreement between a specific charity and a donor. Pursuant to a written contract, the donor transfers cash or other property to the charity in exchange for the charity's promise to pay the donor (or others identified by the donor) a fixed annuity for a defined term. The term of a CGA can be a specific number of years or the lifetime of the annuitant(s). Because the annuity is paid from the general assets of the charity, and not from the property transferred, there is almost no risk that a well-established charity will default.

CGAs can be created during the donor's lifetime or following the donor's death (by will or trust), and the annuity payments can begin immediately or be deferred to some later date. The value of the property transferred to the charity, less the value of the annuity, is a charitable gift that is eligible for an income tax charitable deduction (*inter vivos* transfers) or an estate tax charitable deduction (testamentary transfers). For purposes of calculating the tax deduction, the value of the annuity is determined by using IRS annuity tables, which incorporate factors that include (i) how long the annuity will be paid, (ii) the amount of each annuity payment, (iii) the 7520 rate (the rate that the IRS requires to calculate the value of the CGA), (iv) the date the annuity payments will begin, and (v) the frequency with which the annuity payments will be made.

A CRT also can be used to combine a charitable gift and a stream of payments to one or more non-charity beneficiaries. Created by statute and governed by IRC Section 664(d), a CRT involves a grantor's transfer of property to an irrevocable trust that establishes (i) an annuity interest (fixed or variable) for the life of one or more individuals or for a term of no more than twenty years and (ii) a remainder interest that passes to one or more qualified charities.

CRTs come in two distinct varieties – a Charitable Remainder Annuity Trust (CRAT) and a Charitable Remainder Unitrust (CRUT). While both require at least annual payments to the non-charity beneficiaries, a CRAT pays a fixed dollar amount annually and a CRUT pays a fixed percentage of the value of the trust assets as recalculated annually. There are many similarities and differences between a CRAT and a CRUT, but a CRT must function exclusively as one or the other from its creation.

Like a CGA, a CRT can be established during the grantor's lifetime or by a testamentary provision, and

Continued…

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Dayton Foundation donors and families who have stepped forward to become the 2007-2008 "I Believe! Partners" of The Dayton Foundation. Their commitment underwrites a full year of Dayton Foundation publications, thereby freeing resources for the Foundation's other community work.

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the grantor will receive a charitable income or estate tax deduction based upon the actuarial value of the remainder interest passing to charity. The IRS has established special rules for CRTs, including requirements to ensure that a charitable transfer ultimately occurs. Toward that end, the annual distributions to the non-charity beneficiaries must be no less than 5% and no more than 50% of the fair market value of the trust assets (calculated annually for a CRUT and at the initial transfer of property for a CRAT). In addition, a trust will not qualify as a CRT if (i) the actuarially determined present value of the charitable remainder interest is less that 10% of the fair market value of the assets transferred to the trust or (ii) there is more than a 5% probability that the annuity payments from a CRAT will exhaust the trust, leaving nothing for the charity.

Clearly a CRT is more complicated and costly to create and administer than a CGA, requiring compliance with many statutory and regulatory requirements and the filing of annual tax returns by the trustee. The good news for planners, however, is that the IRS has recognized these technical hurdles and published sample forms of trusts that qualify as CRTs. (See Rev. Proc. 2003-53 through 2003-60 for CRATS and Rev. Proc. 2005-52 through 2005-59 for CRUTs.)

When to Use Them

When working with a client who is interested in making a charitable gift while retaining an income stream (for himself or herself or for others), the unique needs and characteristics of the client will determine whether a CGA or CRT is the best technique for accomplishing the client's goals. Factors the planner should consider include donor/annuitant's age, risk tolerance, and control issues; the nature and value of the property transferred; the length of time income will be needed; and whether the annuity payments need to keep pace with inflation.

For example, an elderly couple who desires a steady and consistent income stream, has little tolerance for risk or administrative costs, and wants to make a gift to a well-known charity, would be well served by a CGA. By making a gift of appreciated stock, they would receive the same annuity payment each year until the death of the survivor of them, avoid capital gains tax, and get a charitable income tax deduction.

A charitably inclined client with a higher tolerance for risk and a greater desire for control, however, is likely to favor a CRUT. Consider the client who wishes to donate appreciated commercial real estate to charity, but wants to delay the sale of the real estate until the market improves. By transferring the real estate to a CRUT where he or she is the co-trustee, the client can control when the property is sold, enjoy a stream of annually recalculated payments, and achieve favorable capital gains treatment. In addition, the client will receive a charitable deduction.

CGAs and CRTs are just two techniques available to facilitate charitable gifts. Determining whether they, or some other planning tool, best promote a client's objectives is really no different from any other planning engagement. An advisor must first and foremost take the time to understand the client's unique facts and issues. The Dayton Foundation is a good partner in this process and is uniquely equipped to work with estate and financial advisors to find the best vehicle to meet their clients' needs. ❧

Note: Solutions differ from case to case. The above does not constitute professional financial or tax advice.

Deborah D. Hunt is a partner in the law firm of Sebaly Shillito + Dyer, where she specializes in Estate Planning. She is a co-developer of Estate Docs Express, an estate planning document assembly software program available to Ohio lawyers through SS+D Legal Docs, LLC. She holds a B.A. from West Virginia University, an M.B.A. from Wright State University, and a J.D. from the University of Dayton.

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