Presented:
Nonprofit Organizations Institute

January 15-16, 2015
Austin, TX

Structured Charitable Giving Strategies: From Plain Vanilla to Rocky Road

John Sare

Author contact information:
John Sare
Patterson Belknap Webb & Tyler LLP
New York, NY 10036

jsare@pbwt.com
212-336-2760

Structured Charitable Giving Strategies:
From Plain Vanilla to Rocky Road

By John Sare[1]
Patterson Belknap Webb & Tyler LLP

Charitable Remainder Trusts

A qualifying charitable remainder trust ("CRT") is an irrevocable *inter vivos* or testamentary trust in which (among other requirements) a fixed amount or percentage of trust assets is paid at least annually to one or more non-charitable beneficiaries, usually individuals, either for life or for a fixed term of 20 years or less. After the non-charitable term, the CRT's assets pass to one or more charitable beneficiaries – sometimes named in the instrument, sometimes designated by exercise of a power of appointment and sometimes selected by the trustee. The CRT and its creator may benefit from favorable tax treatment so long as the trust meets the technical requirements of Section 664 and related provisions of the Internal Revenue Code (the "Code") and the Treasury Regulations.[2] The CRT structure is popular with donors with highly appreciated assets who wish to achieve diversification on a tax-advantaged basis.

- **Principal Motivators for Donors**
  - The creator of a qualifying CRT may be entitled to income and gift tax charitable deductions at the time the CRT is funded (or an estate tax charitable deduction, if the trust is funded at death).
  - In the case of a CRT funded with appreciated property, the trust avoids capital gains tax when the appreciated property is sold, and the trustee is able to re-invest 100% of the net proceeds on a tax-exempt basis. The income or gain is generally taxed only when it is distributed to the non-charitable beneficiary.
  - By deferring the commencement date of distributions to the non-charitable beneficiary, tax-advantaged compounding of the assets occurs within the CRT, similar to what happens in an Individual Retirement Account or other types of tax-exempt deferred compensation plans.
  - The donor is able to benefit both himself *and* a favored charity (or charitable cause) at the same time. Because of this dual benefit, donors sometimes propose creating charitable remainder trusts in support of capital campaigns.
  - If the charity is willing to serve as trustee and has a record of superb investment performance, the donor may believe he will benefit from the charity's investment expertise and its access to investments not necessarily available to the donor individually.

---

1 The author is a partner in the tax-exempt organizations group of the law firm of Patterson Belknap Webb & Tyler LLP in New York. He gratefully acknowledges the assistance of his colleague Susan Vignola in the preparation of this outline.

2 *See generally* 26 U.S.C. § 664; 26 C.F.R. 1.664-1 through 1.664-4.

- **Basic Elements/Tax Strictures**

  - A CRT's governing instrument must provide for distributions each year to one or more non-charitable beneficiaries (usually individuals) of at least 5% but no more than 50% of the initial value or annual value of the trust assets.[3] Distributions may be made once a year or on a semi-annual, quarterly or monthly basis.[4]

  - Payments must be made for the lifetime of each non-charitable beneficiary (who must be living when the CRT is created), or for a fixed term not to exceed 20 years.[5] On termination of the interests of the non-charitable beneficiaries, the CRT remainder must be paid to or for the use of (or held in trust for) one or more charitable organizations as described in Code Section 170(c).[6]

  - The value of the charitable remainder must be at least 10% of the trust corpus, valued as of the time the property is contributed to the trust.[7]

  - A CRT must be either a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT").[8]

    - CRAT: Payments to the noncharitable beneficiary must be a guaranteed sum certain expressed as a percentage of the initial value of trust assets,[9] no additions may be made to trust principal,[10] and the probability that trust assets will be exhausted before termination of the non-charitable interest must be 5% or less.[11] A donor who is not

---

3 *See* 26 U.S.C. § 664(d)(1)(A), (d)(2)(A).

4 *See id.*

5 *See id.*

6 *See* 26 U.S.C. § 664(d)(1)(C), (d)(2)(C). Code Section 170(c) is relatively broad, in that it encompasses both private foundations and public charities as possible remainder beneficiaries. Donors wishing to limit the scope of potential remainder beneficiaries in order to qualify for preferred charitable deduction treatment (discussed below) may opt to "narrow the lens" by permitting the remainder to be paid only to public charities and private operating foundations, commonly expressed by limiting the class of beneficiaries to organizations described in Code Section 170(b)(1)(1)(A) (a subset of Section 170(c) organizations).

7 *See* 26 U.S.C. § 664(d)(1)(D), (d)(2)(D). The 10% minimum remainder rule and the 50% cap on the rate of distributions discussed above were established in the 1990s due to concerns about potentially abusive CRTs from which charities were not likely to receive any financial benefit.

8 Although there were charitable remainder trusts prior to the Tax Reform Act of 1969, the modern CRT was an innovation of that law, which mandated, in order for a charitable deduction to continue to be allowed, that CRTs be in one or the other of these qualifying forms. A trust with life or term-of-years income beneficiaries and a charitable remainder was deemed to represent a non-qualifying (and therefore non-deductible) partial interest gift to charity unless it was either a CRAT or a CRUT. *See generally* 26 U.S.C. §§ 170(f)(2)(A) (income tax charitable deduction); 2055(e)(2)(A) (estate tax); and 2522(c)(2)(A) (gift tax).

9 *See* 26 U.S.C. § 664(d)(1)(A).

10 *See* 26 C.F.R. 1.664-2(b).

11 *See* Rev. Rul. 70-452, 1970-2 C.B. 199.

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary (utcle.org/elibrary)](utcle.org/elibrary)

Title search: Structured Charitable Giving Strategies: From Plain Vanilla to Rocky Road

Also available as part of the eCourse
[Exempt Organizations: Charitable Giving Structures and Strategies, plus Unusual Assets]()

First appeared as part of the conference materials for the
32nd Annual Nonprofit Organizations Institute session
"Structured Charitable Giving Strategies: From Plain Vanilla to Rocky Road"