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CHARITABLE REMAINDER TRUSTS

A Charitable Remainder Trust ("CRT") can be established during the lifetime of the creator of the trust (the "Grantor") or upon the death of the Grantor. Transfers to a CRT established during the lifetime of a Grantor will produce an income tax deduction for the Grantor. In addition to the income tax deduction provided to the Grantor who establishes a CRT during the Grantor's lifetime, the CRT itself is a tax exempt entity and will not recognize income resulting from the sale of long-term capital gain property contributed to the CRT by the Grantor. For example, if the Grantor contributes to a CRT appreciated and unencumbered real estate or marketable securities that the Grantor has owned for a period exceeding one year, and the trustee of the CRT later sells such appreciated long-term capital gain property, no taxable gain will be recognized by the CRT and, therefore, the assets comprising the CRT will not be diminished by the payment of federal income taxes.

A CRT created upon the death of a Grantor, although not providing the Grantor with an income tax deduction, can avoid the imposition of federal income taxes with respect to items of "income in respect of a decedent"("IRD"), such as funds in an individual retirement account (IRA), a qualified retirement plan account or an annuity contract.

Once created, a CRT generally distributes, at least annually, a flow of income to one or more individuals for either the life or lifetimes of the individual or individuals, or for a term of years not to exceed twenty years.

Besides the fact that a CRT can be created during the Grantor's lifetime (inter vivos) or upon the death of the Grantor (testamentary), there are two different types of CRTs. The Charitable Remainder Annuity Trust ("CRAT") is a CRT that pays a specific amount (a fixed annuity payment) to the non-charitable beneficiary or beneficiaries. The amount of the annuity payment will not change regardless of whether the value of the CRAT increases or decreases over the term of the trust. A Charitable Remainder Unitrust ("CRUT"), however, pays the non-charitable beneficiary a percentage of the value of the CRUT determined at the inception of the CRUT as to the first year of the CRUT. The payment from the CRUT to the non-charitable beneficiary in succeeding years is recomputed based on the percentage of the value of the CRUT at the beginning of each subsequent year of the CRUT. Moreover, unlike a CRAT, the Grantor can make additional contributions to the CRUT from time to time.

Reasons for establishing an inter vivos CRT would include being able to diversify investments without incurring capital gains taxes, converting non-producing or under-producing long-term capital gain property into higher producing investments without incurring capital gains taxes, creating what may be determined to be a non-commercial annuity that thus, may be determined to be exempt from judgments obtained by creditors under current Florida law, and attaining charitable goals by providing a future benefit to one or more charitable organizations. Oftentimes, a client who establishes an inter vivos CRT will use some of the extra cashflow he or she receives from the CRT to purchase a life insurance policy on his or her life in an "estate tax-free" environment, such as an irrevocable life insurance trust. This added strategy avoids a reduction in the wealth that will eventually pass to non-charitable beneficiaries, such as the client's children and grandchildren.

A client may establish a testamentary CRT to avoid the imposition of income taxes on IRD, such as an IRA or a qualified retirement plan account. By establishing a testamentary CRT and naming the testamentary CRT as the beneficiary of the IRA or qualified retirement plan account, those funds will not be subject to income tax when paid to the testamentary CRT, and a charitable estate tax deduction will be available based on the value of the charitable remainder interest as of date of death of the Grantor.

In drafting an agreement to establish a CRT, there are certain provisions that can provide the Grantor or members of the Grantor's family with flexibility, such as the power to change the ultimate charitable beneficiary or beneficiaries, and the power to change the individual or entity serving as the trustee of the CRT.

CRTs tend to be most popular during periods of higher interest rates because a high applicable federal mid-term rate results in a greater amount being able to be distributed to non-charitable beneficiaries without a consequential reduction in the amount of the income tax deduction and estate tax deduction that would otherwise be obtainable.

Because a CRT is irrevocable, i.e. it cannot be changed, significant thought should be put into the various provisions before the trust agreement is signed. Through the counsel provided by a knowledgeable and experienced estate planning attorney, a client can be made aware of the various issues that need to be considered in tailoring the trust agreement to fulfill the objectives of the client.

In conclusion, a CRT is an extremely viable tool to minimize or avoid the imposition of federal income taxes with respect to appreciated capital gain property and items of IRD, as well as to reduce estate taxes. As with all estate planning tools, the CRT has some disadvantages, but those disadvantages are often insignificant when compared to the potential income and estate tax savings.
