Understanding CRTs: Pros and Cons

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When it comes to securing a financial future and supporting meaningful charitable causes, a **charitable remainder trust**, or CRT, achieves both. This financial tool can be used to establish a legacy that makes a difference.

CRTs are desirable for people who want to:

- Grow investments tax-free within a trust
- Receive annual income payments
- Avoid capital gains tax when selling appreciated assets
- Support a charitable organization
- Receive a current-year income tax charitable deduction

As with any investment, there are pros and cons of charitable remainder trusts that should be considered. In this blog post we will explore many facets of CRTs and connect you with a consultant to help decide if establishing this type of trust is right for your clients.

What is a charitable remainder trust?

A CRT is a type of financial structure involving assets, such as money or property, put into a trust that provides income to the donor/beneficiaries for their lifetime or for a specified period of time, maxing out at 20 years. Afterward, any remaining assets in the trust are distributed to one or multiple charitable organizations selected by the donor.

Types of charitable remainder trusts

The following are variations of **charitable remainder trusts**, each with unique objectives.

- Charitable remainder annuity trust
  - Fixed annuity rate, allowing the donor to receive a guaranteed income stream each year.
  - The value of the annuity is calculated as a fixed percentage, between 5% and 50%, of the initial value of the trust's assets. Because the annuity is calculated based on the initial value of the trust assets, the donation can only be made once.
  - Must pass the 10% qualification test and 5% probability test
- Charitable remainder unitrust
  - Fixed percentage, between 5% and 50%, paid out to beneficiaries each year based on the value of the assets at the beginning of the year.
  - Flexibility to pay income to beneficiaries immediately or deferred for a period of time.
  - Donors can keep adding assets to the trust.
  - Any contribution must pass the 10% qualification test.

Pros and cons of charitable remainder trust

CRTs offer tax benefits, income streams, and opportunities to give to charity, but they also come with limitations. It's essential to weigh charitable remainder trusts pros and cons with trusted experts in order to align with your specific goals and financial situation.

Pros:

- Philanthropic impact
- Legacy giving
- Tax benefits
  - Capital gains are avoided on sale of appreciated assets
  - Current income tax deduction
  - Estate tax savings
- Increase cash flow

- Lower investment risk by diversifying a concentrated asset position
- Option to name a **donor-advised fund (DAF)** as a beneficiary of your CRT

Cons:

- Irrevocable
    - Even if your financial situation drastically changes, you cannot pull income beyond what the trust document allows
- Fixed income does not protect against inflation
- All remaining funds must be distributed to a charitable organization, or multiple, of a donors' choosing at the end of the CRTs term.
- Not the best choice if you would rather leave the money to your family.

How to establish a charitable trust remainder trust

The experts at Ren can help establish a CRT for your clients that will make an impact for years to come. Here is a brief overview of what the process will look like:

1. **Set a goal**
   What are your clients looking to accomplish financially and in terms of giving? Do they have a particular charity or cause in mind that they would like their money to contribute to? Ask them these questions in order to establish and refine their vision.

2. **Select beneficiaries and charities**
   Work with your clients to make a final decision regarding who will benefit from the funds contributed to their CRT. They will also need to appoint someone to manage the trust and associated assets. A trust company, bank, another individual or even they can take on the job as trustee.

3. **Partner with a professional to handle annual administration requirements**
   Ren takes the stress off of establishing and maintaining a CRT — reporting taxes, processing, administration, and accounting work — allowing you to work with the trustee to focus on the aspects they're passionate about.

4. **Create a trust agreement with an attorney**
   An attorney must be hired to draft CRT governing documents and obtain a tax identification number from the Internal Revenue Service (IRS).

5. **Transfer assets to fund the trust**
   All that remains is moving approved assets into the newly established trust.

Alternative to charitable remainder trusts

There are several options for long-term giving besides a CRT. Below are some highlights of four popular giving vehicles donors might prefer:

- **Donor-advised fund (DAF)**
    - Funds deposited into this type of account can grow in value, and once deposited, are granted to charities. Donors are also able to give directly to a sponsoring charity and receive an immediate tax deduction. Advisory privileges are also available once an irrevocable gift is given. A DAF may also be listed as the remainder beneficiary of a CRT.

- **Charitable lead trust**

    - This irrevocable agreement involves the transfer of assets to a trust, which then provides income to a charitable organization. The charitable lead interest can be designated to public charities, DAFs, or private foundations and is designed to provide either a charitable income tax or transfer tax deduction.

- **Pooled income fund**
    - A public charity is responsible for maintaining this type of irrevocable trust. Gifts from separate donors are pooled to provide income streams to beneficiaries. These gifts are commonly cash or securities.

- **Charitable gift annuity**
    - A donor and representative of a charity both sign a contract agreeing to an irrevocable transfer of assets. Among several benefits, the donor is given a fixed stream of income for the lifetime of up to two annuitants.