The Allure of Charitable Trusts

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For years, the top tax rate on long-term capital gains was 15%, so certain tax-deferral techniques waned in popularity. That's no longer the case.

"Taxpayers in the top tax bracket now owe 20% on long-term gains as well as the 3.8% Medicare surtax on net investment income," says Chris Noland, principal and client strategist at Norfolk, Virginia-based Signature, an independent family office. "We're starting to see more interest in charitable remainder trusts for donations of highly-appreciated assets, usually publicly-traded securities."

When assets are transferred to a charitable remainder trust, the trust can sell them and avoid tax on any capital gain. Then the trust has 100 cents on the dollar to reinvest, while an individual selling those assets would be left with less than 77 cents, after tax. The trust can pay a lifetime income to income beneficiaries, perhaps the donor and a spouse, before the remainder of the trust assets passes to a designated charity.

"We typically suggest a CRUT," says Noland, referring to a charitable remainder unitrust. While a charitable remainder annuity trust has a fixed payout, a CRUT pays a fixed percentage of trust assets to the income beneficiaries. The minimum is 5%, and Noland says that CRUT creators often choose a percentage around that level. If the trust assets earn more than 5% per year, the payout to the income beneficiaries can increase over time. The taxation of charitable remainder trust payouts can be complex, but some of the cash flow likely will qualify for capital gains rather than ordinary tax rates.

In addition, creators of any type of a charitable remainder trust get an upfront tax deduction for the present value of the future donation; by law, this deduction must be at least 10% of the value of the donated assets. Given the tax benefits and the lifelong cash flow, what's not to like about these trusts?

"Clients should have a charitable intent, when they create this type of trust," says Noland. "They have to understand that the transfers to the trust are irrevocable so the assets are gone forever." Although clients can get lifetime cash flow from the trust, they no longer can sell the donated assets if they need cash or leave those assets to heirs.

"In addition," says Noland, "clients should realize that there is a lot of ongoing administration involved with a charitable remainder trust." The wrong moves can result in lost tax benefits.

Possible administrators include banks, trust companies, and firms specializing in this area; Noland says that the charity named as the remainder beneficiary might offer to act as trustee, taking responsibility for trust administration.

Considering the expense and trust management involved, Noland has found that these trusts work best when they're funded with a minimum of around $500,000 worth of assets.