



#1 Free Legal Website

FindLaw.com is the leading and largest online resource for legal information. For basic legal issues to more complex ones, you'll find thousands of helpful articles, a legal community to get answers to your specific questions, an attorney directory, blogs, news, DIY forms, and much more.

Tax Incentives for a Charitable Remainder Trust

When you feel that you're ready to make a substantial gift to a charity, you may want to consider a charitable trust, which is a special type of trust. In addition to providing a benefit to your favorite charity, it also allows you to donate generously while giving you and your heirs tax benefits.

However, if you don't think that the time is right for you to make such a large donation, then it probably isn't time for you to consider a charitable trust, either.

Charitable trusts are irrevocable. When you consider starting such a trust, you need to keep this in mind. Once you start the trust and it comes into operation, you cannot take back what you have given.

How a Charitable Trust Works

A charitable remainder trust is the most common type of charitable trust. To set up a charitable remainder trust, you must first set up a trust and transfer to that trust all the property that you want to donate to charity. The charity that you choose must be approved by the Internal Revenue Service, which generally means that the charity must be exempt from taxes.

The charity will serve as the trustee of the charitable remainder trust and will be charged with the duty of investing, protecting and managing the trust funds. The charity will pay you, or someone you have named, a portion of the income that the trust funds accumulates. These payments will last for a set number of years, or for the remainder of your life, depending upon how you drew the documents up. The trust will end at the time of your death and the property that you donated will go to the charity.

Three Tax Advantages for a Charitable Trust

In addition to assisting your charity of choice, a charitable remainder trust also gives you three primary tax benefits.

First, after you have set up and donated to a charitable trust, you are allowed to take an income tax deduction and spread it over five years, for the value of your gift to charity. However, you do not get to deduct dollar for dollar the amount that you initially gave. Instead, the IRS calculates your total deduction as the amount you originally gave minus what you can expect to receive as a return through interest payments. For example, if you gave \$200,000 but are expecting to get back \$100,000 in interest over the course of your life, your total deduction would have to be \$100,000.

Second, because the property that you gave to the trust will go to the charity outright upon your death, the property will not be included in your estate for the purposes of determining your estate tax.

Third, and last, a charitable trust allows you to turn property that isn't producing income into cash without paying a tax on any profits gained. For example, if Lee held 5000 shares of stock that had appreciated in value from \$10/share to \$100/share in the years that he held it, he could not sell off the stock without paying a capital gains tax on it. However, if Lee donates the stock to a charitable trust, the trust can sell the stock and not pay a tax on the sale. Lee's charity can sell the \$500,000 worth of stock, invest the money in a mutual fund, and pay Lee the interest from this fund for the rest of his life, all without capital gains tax. If Lee had decided to sell the \$500,000 worth of shares by himself, he would have had to pay a capital gains tax on the proceeds.

Two Types of Income from a Charitable Trust

When you first set up a charitable trust, you will have a choice between two different ways of receiving an income from the fund.

· Annuity Payments

First, you can opt for a fixed annuity. Under this option, you elect to receive a fixed dollar amount from the trust each year. Even if the trust has a bad year and ends up losing money, you will still receive the same amount of money you did in the

years before. Once you set up how much you want the trust to pay you yearly, you cannot go back and change it.

There are a few considerations to take into account when determining how much to set annuity payments at. First, if you set it too low, you will never receive the full benefit of setting up a charitable trust, although your income tax deduction will be greater. Second, if you set the annuity too high, you may end up depleting the principal of the trust, thus leaving the charity with nothing at your death. Also, with annuities that are too high, your income tax deduction is lessened. Lastly, a charity is less likely to agree to be the trustee of a trust where annuity payments are too high because it may end up with nothing at the termination of the trust, having had to pay the entire principal in annuity payments.

Percentage Payments

Another, more common, option for payments is to set your annual payment as a percentage of the current value of the trust fund. No matter how much the trust made or lost in a year, you will still receive the same percentage share each year. As an example, Tony's trust documents indicate that he will receive 5% of the value of the trust each year. So, at the end of every year, the trust will be re-appraised to find its current value and will pay 5% of that value to Tony.

This payment option is better suited to handling changing market conditions such as inflation. If the value of the dollar increases, your annual payments will reflect this change by also increasing. However, the Internal Revenue Service has ruled that a trust beneficiary must receive at least 5% of the value of the trust each year.

Here is an example that will hopefully clarify all of this information:

Suppose Rex is trying to figure out what to do with a bunch of stock he bought 10 years ago for \$200,000. The stock is currently worth \$4 million, but Rex sees little income from the stock as the dividends are small. One option for Rex would be to sell the stock off and invest the money in some sort of fund that would pay a larger income. However, if Rex decided to sell the stock, he would owe \$570,000 in capital gains tax.

Another option Rex has is to set up a charitable trust with his favorite museum. He would donate the stock to the trust which would be able to sell the stock for a \$3.8 million profit because of its tax exempt status. In addition, Rex would be able to claim an income tax deduction, spread over a period of five years, for his charitable donation.

The charity would then be in charge of investing and managing the \$3.8 million. In addition, the trust document that Rex drew up requires the trust to pay Rex 7% of the value of the trust annually for the remainder of Rex's life. During the first year the trust is in operation, Rex would receive \$266,000. This amount will most likely change depending upon how well the trust succeeds in investing and managing the money. If the trust does well, Rex will be paid more each year.

If you are interested in starting a charitable remainder trust, you should check out the [Better Business Bureau's website devoted to charitable giving](#) . There, you can research the trustworthiness of various charitable organizations that you may be interested in giving to.

FINDLAW.COM EMPOWERS PEOPLE WITH TRUSTED, TIMELY AND INTELLIGENT LEGAL INFORMATION

BLOGS – FindLaw Blogs present timely news that has real-life implications, deliver important information and discuss law-related entertainment.

FINDLAW ANSWERS – A vibrant, interactive online community where everyday people can ask legal questions and get real-time answers from legal professionals and others with similar experiences.

NEWS & NEWSLETTERS – Updated throughout the day and night and covering a wide range of legal topics, FindLaw.com's News page presents current legal news, keeping people informed and educated.

FIND A LAWYER – An easy-to-search database of more than one million lawyers and law firms. It provides detailed information, enabling people to contact a qualified lawyer when they are ready.



DO-IT-YOURSELF FORMS & CONTRACTS – FindLaw.com provides accurate legal documents for common legal matters. Choose from a library of easy-to-use, low-cost, accurate legal forms for everyday legal issues.

FINDLAW VIDEO – On FindLaw.com, you'll find an online directory of more than 1,500 short videos dedicated exclusively to legal topics and attorney and law firm profiles.

Connect With Us

FindLaw.com has an entire social media team dedicated to providing our users with as many options as possible to join, participate in, and learn from the FindLaw community. Some of the social key channels are the following:



[FindLaw for Consumers on Facebook](#)

Making the law easy to access with interactive legal updates aimed at starting conversations, informing followers of their legal rights and providing a forum for questions and resources



[@FindLawConsumer on Twitter](#)

Tweeting interesting, entertaining and informative legal news everyday

HAVE A LEGAL QUESTION?
NEED TO FIND AN AFFORDABLE,
QUALIFIED ATTORNEY?

Protect yourself, your family or
your business with a legal plan
or form from LegalStreet

www.LEGALSTREET.com

Copyright © 2013 FindLaw, a Thomson Reuters business. All rights reserved. The information contained in this article is for informational purposes only and does not constitute legal advice. The use and distribution of this article is subject to the Creative Commons BY-NC-ND license, which can be viewed at <http://creativecommons.org/licenses/by-nc-nd/3.0/>. You must attribute the article by providing the title of the article, FindLaw copyright notice and link to the original work. You may not use the article for commercial purposes and you may not alter or transform this article in any way.

FindLaw[®]
A Thomson Reuters Business