WARD AND SMITH, P.A.
ATTORNEYS AT LAW

Making a Difference: Charitable Trust Planning

Written By **Jennifer V. Boyer** (jvboyer@wardandsmith.com)
June 8, 2022

The past few years have exposed a lot of needs in our communities, and many of us feel even more compelled to give back what we can.

It seems more important now than ever to support worthy charitable organizations that are working hard in our communities to lift up our most vulnerable neighbors. But finding the balance between generosity and security is sometimes tricky – especially in volatile financial times. Charitable trusts, in particular, can help us answer the call and can be wonderful tools for impactful and tax-smart giving.

Charitable trusts often fall into two classifications: Charitable Lead Trusts and Charitable Remainder Trusts. As the names suggest, the timing of the charitable impact will vary based on the type of trust selected. Both types of trusts create a split interest: gifts are divided between charities and individuals, usually the trust creator or a member of their family. Within each of these categories, planners typically use either an "annuity" approach, with a fixed dollar amount payable to an annuity recipient each year, or a "unitrust" structure, with a fixed percentage of trust assets being payable each year during a set term.

Because these trusts are irrevocable, their funding will reduce the value of the donor's taxable estate and thus, estate taxes. By splitting these gifts between family and charitable recipients, donors can also often achieve desirable income tax outcomes, while both fulfilling their philanthropic goals and providing for their family's financial security.

Charitable Lead Trusts

A Charitable Lead Trust ("CLT") gives an immediate, steady income stream to a charitable beneficiary for a set term. At the end of the charitable term, the remaining trust assets typically pass to a child or grandchild of the donor.

Tax Facts and Features

- The value of the gift to the individual(s) is calculated at the time the trust is funded and is determined by subtracting the present value of the charity's annuity from the overall value of the assets transferred to the trust.
- When interest rates are low, the CLT can often be structured so that the value of the annuity is almost as high as the value of the gifted property, resulting in a very small taxable gift (one which is often fully

covered by the donor's lifetime gift and estate tax exclusion amount).
- The trust (or the donor, if the trust is structured as a "grantor trust") can take an income tax deduction for the payments made to the charity, subject to certain parameters.
- The trust principal (and most importantly, its appreciation over time) is removed from the grantor's taxable estate and ultimately passes to the individual beneficiaries free from estate and gift tax.

Charitable Remainder Trusts

A Charitable Remainder Trust ("CRT") is essentially the mirror image of the CLT. The CRT pays an income annuity or unitrust amount to one or more non-charitable beneficiaries (usually the trust's creator or a family member), with the remainder passing to charity at the end of the term. These trusts function much like a charitable gift annuity, but the donor's selected Trustee retains control over the management and investment of the CRT assets during the term.

CRTs can also be paired with the use of a Donor Advised Fund to increase flexibility and allow for additional family input in selecting the eventual charitable recipients.

Tax Facts and Features

- The donor receives a charitable income tax deduction in the year the CRT is funded, based on the assumed value of the remainder interest that likely will pass to charity.
- When interest rates are higher, the value of the annuity paid to the individual beneficiary is lower, resulting in a bigger charitable deduction.
- Because CRTs are not subject to income tax at the trust level, a CRT can sell appreciated property after it is contributed by the donor, avoiding the recognition of (potentially) significant capital gains. Even though some taxable gains will still be passed along to the individual income beneficiary through their annuity or unitrust payments, the capital gains taxes are spread out over time, and their negative impacts are alleviated significantly. Meanwhile, the trust is able to fully reinvest sale proceeds into high-yield assets to fuel the required annual income payments.
- As noted above, the income that individual beneficiaries receive from a CRT may be subject to income taxes, based on a tier system that looks to the nature of the assets and investments driving the income payments. But these obligations are often largely offset by the benefits of deferring or avoiding the capital gains liabilities during trust funding.

If you are interested in pursuing either of these strategies, our Ward and Smith estate planning team can help you consider your options and choose your best fit. Either way you choose, these trusts offer great opportunities to further your philanthropic legacy and make a difference!

--
© 2024 Ward and Smith, P.A. For further information regarding the issues described above, please contact Jennifer V. Boyer.

This article is not intended to give, and should not be relied upon for, legal advice in any particular circumstance or fact situation. No action should be taken in reliance upon the information contained in this article without obtaining the advice of an attorney.

We are your established legal network with offices in Asheville, Greenville, New Bern, Raleigh, and Wilmington, NC.