Charitable Remainder Trusts

If you want to make a substantial gift to a charity, a special kind of trust, called a charitable trust, lets you donate generously to charity and gives you and your heirs a big tax break.

You need to do some serious thinking before setting up a charitable trust, however, because Charitable trusts are irrevocable. Once you create one and it becomes operational, you cannot change your mind and regain legal control of the trust property.

How Does It Work?

The most common type of charitable trust is called a charitable remainder trust or (CRT). Here's how it usually works.

First, you set up a trust and transfer to it the property you want to donate to a charity. The charity must be approved by the IRS, which usually means it has tax-exempt status under the Internal Revenue Code. Good property to put into a CRT is low cost basis, high value property. This can include property such as real estate.

The charity serves as trustee of the trust, and manages, sells, or invests the property so it will produce income for you. The charity pays you (or someone else you name) a portion of the income generated by the trust property for a certain number of years, or for your whole life. You specify the payment period in the trust document. Then, at your death or the end of the period you set, the property goes to the charity.

What's In It For You?

In addition to helping out your favorite charity, you get several big tax advantages from this arrangement.

Income Tax Deduction

You can take an income tax deduction, over five years, for the value of your gift to the charity. The value of your gift is not simply the value of the property; the IRS deducts from that value the amount of income you're likely to receive from the property.

Estate Tax

When the trust property eventually goes to the charity outright (at your death or the end of the payment period you specified), it's no longer in your estate -- so it isn't subject to federal estate tax.

Capital Gain Tax

One of the most desirable aspects of a charitable trust is that it lets you turn appreciated property (property that has gone up significantly in value since you acquired it) into cash without paying capital gain tax on the profit. If you simply sold the property, you would have to pay capital gain tax on your profit. But charities, unlike individuals, don't have to pay capital gain tax. So if you give the property to the trust and the charity sells it, the proceeds stay in the trust and aren't taxed.

A charity usually sells any non-income-producing asset in a charitable trust and uses the proceeds to buy property that will produce income for you.

Example: Fred owns vacant land worth $300,000. He paid $20,000 for it 20 years ago. He creates a charitable trust, naming CASA as the charity-beneficiary, and funds his trust with his real estate. CASA sells the real estate for $300,000 and invests the money in a mutual fund. Fred will receive income from this $300,000 for his life. Had Fred sold the real estate himself, he would have had to pay capital gain tax on his $280,000 profit. But no capital gain tax is assessed against the charity.

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