The Benefits of Charitable Remainder Trusts

BRUCE D. STEINER, J.D., LL.M.
FREDERICK J. WERTLIEB, CLU, ChFC, CFP

This article illustrates the applications and tax benefits of charitable remainder trusts (CRTs).[1] A CRT is a trust in which one or more individuals have an income interest for life (or for a fixed term of up to 20 years), after which time the remaining balance of the trust assets (the remainder) must pass to charity.[2] By using a CRT, the donor can obtain income and estate tax benefits, as well as a higher level of income than he or she would without the CRT. Moreover, by using life insurance, the donor can replace the wealth passing to charity.

In a CRT, the annual income payable to the noncharitable beneficiaries is equal to a fixed percentage of the value of the trust assets (the payout rate). For example, if Alan creates a CRT with \$1,000,000 of assets and a payout rate of 8 percent, he will initially receive \$80,000 per year from the CRT, even if the actual income of the CRT is more than \$80,000. The donor may select the payout rate, but it must be at least 5 percent.[3]

A CRT offers significant income and estate tax benefits, and it allows a donor to accomplish his or her charitable objectives at little or no effective cost.

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The Various Types of CRTs

Annuity Trust

The simplest form of a CRT is an annuity trust. In an annuity trust, the trust assets are not revalued each year.[4] In the above example, if Alan creates an annuity trust he will receive a fixed annual payout of \$80,000 per year, regardless of changes in the value of the trust assets and regardless of the actual income of the trust. If the income of the annuity trust is less than the annual payout, the balance of the payout is taken from principal. Once an annuity trust is established, no additional contributions may be made to it. Indeed, the trust agreement must specifically prohibit future contributions.[5] Of course, if Alan wants to make additional contributions, he may create another annuity trust.

Standard Unitrust

Unlike an annuity trust, the assets of a unitrust are revalued each year.[6] In the above example, if Alan creates a standard unitrust and its value increases from \$1,000,000 to \$1,100,000, his annual payout will increase from \$80,000 to \$88,000, regardless of the actual income of the unitrust. If the income of the unitrust is less than the annual payout, the balance of the payout comes from principal. Since the assets of a unitrust are revalued each year, additional contributions to a unitrust are allowed.[7]

Net Income Unitrust

A net income unitrust differs from a standard unitrust in that the annual payout from a net income unitrust is limited to the actual amount of trust accounting income each year.[8] Charitable organizations favor this type of unitrust because the principal cannot be invaded to make the annual payout.

Net Income with Makeup Unitrust

A net income with makeup unitrust is a hybrid of the standard unitrust and the net income unitrust. Like the net income unitrust, the payout is limited to the trust accounting income. However, income in excess of the payout may be used to make up any prior shortfalls.[9] Because the shortfalls are made up if there is sufficient future income, the net income with makeup unitrust is often used for retirement planning.

The need to time and plan investment strategies to create trust accounting income makes this type of CRT the most difficult to understand fully and administer properly.

Three Major Tax Benefits of CRTs

A CRT provides three major tax benefits:

(1) Income Tax Deduction. A donor who creates a CRT during life gets an income tax deduction for the

If the contribution consists of appreciated property other than publicly traded stock, the deduction is limited to basis.

present value of the charity's remainder interest.[10]

The amount of the income tax deduction depends upon the payout rate, the life expectancies of the noncharitable beneficiaries, the prevailing interest rates at the time of the contribution, and whether the CRT is a unitrust or an annuity trust.

For deduction purposes, the value of the charity's interest is calculated based upon an interest rate equal to 120 percent of the average yield on United States obligations having between 3 and 9 years to maturity (the table rate).[11] The IRS updates the table rate each month. During 1991, it ranged from 8.6 percent to 9.8 percent.

The deduction valuation may be illustrated as shown in Table A, assuming a table rate of 9 percent and a single noncharitable beneficiary.

The rules limiting the income tax deduction for charitable contributions are complicated. However, they can be summarized as set forth below.

If the ultimate recipient must be a public charity, the income tax deduction is limited to 50 percent of the donor's contribution base (adjusted gross income without regard to any net operating loss carryback),[12] or 30 percent of the contribution base if the contribution consists of appreciated property.[13] Any excess may be carried over for five years.[14] However, if the donor elects to waive any deduction for the capital gain element (in other words, if the donor agrees to limit the deduction for contributions of capital gain property to basis), the regular 50 percent limitation applies.[15]

If the ultimate recipient is or may be a private foundation, the income tax deduction is generally limited to 30 percent of the contribution base,[16] or 20 percent of the contribution base if the contribution consists of capital gain property.[17] Any excess may be carried over for five years.[18] If the contribution consists of appreciated property other than publicly traded stock, the deduction is limited to basis.[19] In any case, where the deduction is limited to basis, only the portion of the basis allocable to the charity's remainder interest in the CRT is taken into account.[20]

In the case of contributions of capital gain property, the appreciation is a preference item for purposes of the alternative minimum tax (AMT), unless the donor elects to limit the deduction to basis.[21] If the donor does not want to limit the deduction to basis, the impact of the AMT can be reduced or eliminated by adding additional generations of noncharitable beneficiaries, such as children and grandchildren, increasing the payout rate or spreading the gift out over several years.

(2) Income Tax Exemption for CRTs. CRTs are exempt from income tax.[22] Thus, if appreciated property is transferred to a CRT, the CRT can sell the property income tax free. However, if the sale is prearranged, it may be imputed to the donor, who will then be taxed on the gain.[23]

Similarly, if a CRT is the beneficiary of a qualified plan or IRA benefits, the CRT will not be subject to income tax upon receipt of the benefits. As a result, there is a larger pool of assets available to earn income.

In addition, since a CRT is exempt from income tax, it can earn a higher net rate of return on its investment assets than will a taxable individual.

(3) Estate Tax Deduction. The donor's estate gets an estate tax deduction for the value of the charity's remainder interest.[24] Thus, for example, if a donor creates a CRT during his or her lifetime in which the remainder passes to charity upon death, the CRT is not subject to estate tax upon the death of the donor.

If a donor creates a CRT upon his or her death which provides for income to be paid to a child for life, with the remainder to charity upon the child's death, the amount of the estate tax deduction depends upon the payout rate, the child's age, the table rate at the date of the donor's death, and whether the CRT is a unitrust or an annuity trust.

In exchange for obtaining tax benefits, the trust assets will eventually go to charity. If the value of the tax benefits is equal to the value of the charity's remainder interest, there is no cost to creating a CRT and giving away the remainder interest. Indeed, as set forth below, it is possible for the value of the tax benefits to exceed the value of the charity's remainder inter-

Table A
Value of Charitable Deduction
As a Percentage of the Contribution

	Annuity Trust			Unitrust		
Age	5% Payout Rate	7% Payout Rate	9% Payout Rate	5% Payout Rate	7% Payout Rate	9% Payout Rate
45	51%	31%	11%	26%	17%	11%
50	53%	34%	15%	31%	21%	15%
55	55%	38%	20%	37%	27%	20%
60	58%	42%	25%	43%	33%	25%
65	62%	47%	32%	50%	39%	32%
70	66%	52%	39%	57%	47%	39%
75	70%	59%	47%	64%	54%	47%
80	75%	65%	56%	71%	63%	56%

est, so that the donor will come out ahead by giving the remainder interest to charity through use of a CRT. It thus offers the best of both worlds. Like lifetime gifts to charity, the donor gets both current income tax benefit and an estate and gift tax benefit.[25] Like gifts to charity at death, the donor gets the benefit of the property during lifetime and an estate tax deduction at death, with the charity receiving benefits after the donor's death.

To qualify for a charitable deduction, the possibility that a charitable transfer will not become effective must be so remote as to be negligible.[26] In an annuity trust, if the payout rate is high enough, the CRT may be completely exhausted. If there is a more than 5 percent chance that this will happen, the IRS does not allow a deduction for the charity's remainder interest.[27] Moreover, the Service could argue that such a trust does not qualify as a CRT,[28] in which case the trust would be subject to income tax on its income and gains.

Depending upon the payout rate, the age of the noncharitable beneficiary, the initial value of the trust, the trustee and the anticipated annual administration expenses, a unitrust can also be exhausted. In such cases, the Service may disallow the deduction and argue that the trust does not qualify as a CRT.[29]

Tax, Actuarial and Interest Rate Assumptions

The remainder of this article is based upon the following tax and interest rate assumptions:

(1) A combined federal and state income tax rate (taking into account the deduction of the state income tax against the federal income tax) of 37 percent.

(2) The taxpayer is not subject to the AMT.

(3) The taxpayer has sufficient income to fully utilize the income tax deduction for charitable contributions.

(4) A marginal estate tax rate of 55 percent, consisting of federal estate tax (net of the credit for state death taxes) of 39 percent and state death tax of 16 percent. This assumes that the unified credit (the $600,000 exemption equivalent) and the lower rate brackets have been used on other transfers.

(5) Money not in a CRT is invested in tax-exempt bonds yielding 6.5 percent.

(6) An interest rate of 9 percent is used in valuing the charity's interest in the CRT.

(7) The 15 percent additional estate tax on excess retirement accumulations is disregarded, since it is not affected by the use of a CRT.[30]

Sale of Appreciated Property To Increase Income

Beth owns land worth $1,000,000,[31] for which she paid $100,000 many years ago. She wants to increase her income. If Beth sells the land for $1,000,000, she will have a capital gain of $900,000 and will pay $333,000 of income tax. Beth will receive only $43,355 per year of tax-exempt income on her remaining $667,000.

Instead of selling the land, Beth can increase her income by more than 50 percent by contributing the land to an annuity trust with a 9 percent payout. She will then receive $90,000 per year of income from the trust (or $56,700 after income tax).

In addition, Beth gets an income tax deduction for the value of the charity's remainder interest. If she is 72 years old, her income tax deduction is $419,689. This saves her $155,284 of income tax.[32] If she invests this $155,284, she will receive an additional $10,094 per year of tax-exempt income. When this $10,094 per year is added to Beth's $56,700 of after-tax income from her annuity trust, her total annual after-tax income with the CRT is $66,794, compared with $43,355 if she sells the land without a CRT. This example is illustrated in Figures 1 and 2 on page 62.

By creating an annuity trust rather than a unitrust, Beth can protect herself against a decrease in the value of the trust assets. If the net proceeds of the sale of the land are only $900,000, Beth will still receive $90,000 per year of income from her annuity trust, or $56,700 after income taxes. If Beth creates a unitrust and its assets decrease to $900,000, her income will drop to $81,000 (9 percent of $900,000), or $51,030 after income tax. Without a CRT, if Beth receives only $900,000 from the sale of the land, she will have a capital gain of $800,000, pay $296,000 of income tax, have $604,000 left after taxes and receive only $39,260 of tax-exempt income each year.

Of course, if the value of the land increases to more than $1,000,000, Beth will receive more income from a unitrust. (See chart on following page.)

Sale of Appreciated Property; Income Accumulated

Like Beth, Charles owns land worth $1,000,000, for which he paid $100,000. Charles does not need additional income. However, he wants to sell the land.

If Charles sells the land for $1,000,000, he also will pay $333,000 of income tax, with $667,000 remaining. If he invests this amount and accumulates the income, it will grow to $2,350,271 after 20 years, and to $4,441,782 after 30 years.

If Charles instead contributes the land to an annuity trust paying $90,000 per year, he will receive $56,700 after income taxes. If he accumulates the income, it will grow to $2,201,395 after 20 years, and $4,897,455 after 30 years.

If Charles contributes an undivided interest in the property to the CRT instead of contributing the entire property to the CRT, he will receive a pro rata portion of the tax benefits.

The following chart compares Beth's results with an Annuity Trust, a Unitrust, or no CRT at all.

	Annuity Trust	Proceeds	Unitrust Proceeds	Proceeds	Proceeds	No CRT Proceeds	Proceeds
		$900,000	$1,000,000	$1,100,000	$900,000	$1,000,000	$1,100,000
Initial value	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Proceeds	N/A	900,000	1,000,000	1,100,000	900,000	1,000,000	1,100,000
Basis	N/A	N/A	N/A	N/A	100,000	100,000	100,000
Capital gain	N/A	N/A	N/A	N/A	800,000	900,000	1,000,000
Capital gains tax	- 0 -	- 0 -	- 0 -	- 0 -	296,000	333,000	370,000
After-tax proceeds	N/A	900,000	1,000,000	1,100,000	604,000	667,000	730,000
Annual income before tax	90,000	81,000	90,000	99,000	39,260	43,335	47,450
Annual income tax	33,300	29,970	33,300	36,360	- 0 -	- 0 -	- 0 -
Annual income after tax	56,700	51,030	56,700	62,370	39,260	43,335	47,450

In addition, if Charles is age 65, he will receive an income tax deduction of $316,099. This saves $116,948 in income tax. If he invests this amount and accumulates the income, it will grow to $412,085 after 20 years, and $773,540 after 30 years.

These results are shown in Table B.

Thus, by contributing the land to the CRT, Charles will have $2,613,478 after 20 years ($2,201,395 from accumulating the income from the CRT plus $412,083 from accumulating the income from the initial income tax benefit). This is more than the $2,350,271 that he will have after 20 years if he sells the land. Thus, if he lives his approximate life expectancy of 20 years, he is better off with the CRT than without it. The cost to Charles of making the charitable gift is negative.

Figure 3, on page 63, illustrates the examples for Charles' estate.

If Charles contributes an undivided interest in the property to the CRT instead of contributing the entire property to the CRT, he will receive a pro rata portion of the tax benefits.[33]

Table B

Annuity Trust

Year	Total Value Without CRT	Accumulated Income	Income Tax Deduction Plus Accumulated Income Thereon	Total
0	$667,000	0	$116,948	$116,948
5	913,848	322,829	160,229	483,058
10	1,252,051	765,134	219,527	984,661
15	1,715,418	1,371,129	300,772	1,671,901
20	**2,350,271**	**2,201,395**	**412,083**	**2,613,478**
25	3,220,075	3,338,931	564,590	3,903,521
30	4,411,782	4,897,455	773,537	5,670,992

To Receive Qualified Plan or IRA Benefits

Dena is over age 70 1/2 and has $1,000,000 in an IRA and $1,000,000 of other assets. Her son, Edward, is the beneficiary of her entire estate, including her IRA.

If Dena had died before reaching age 70 1/2, Edward could have taken Dena's IRA over his lifetime or life expectancy.[34] However, since Dena is over age 70 1/2, Edward must take the balance of Dena's IRA after her death as quickly as Dena had been receiving it.[35] If Dena recalculated her

Figure 1

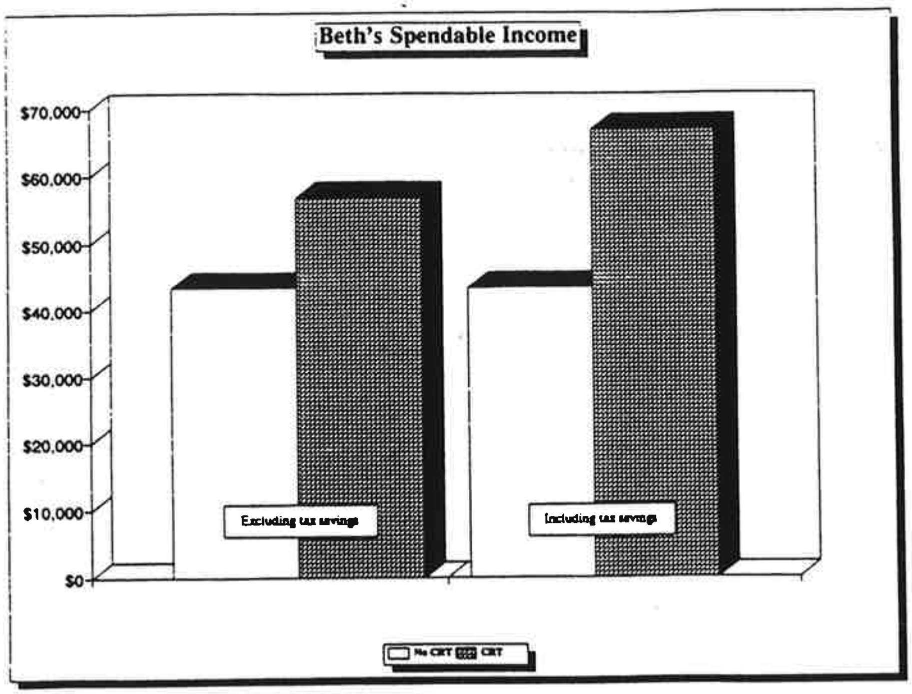
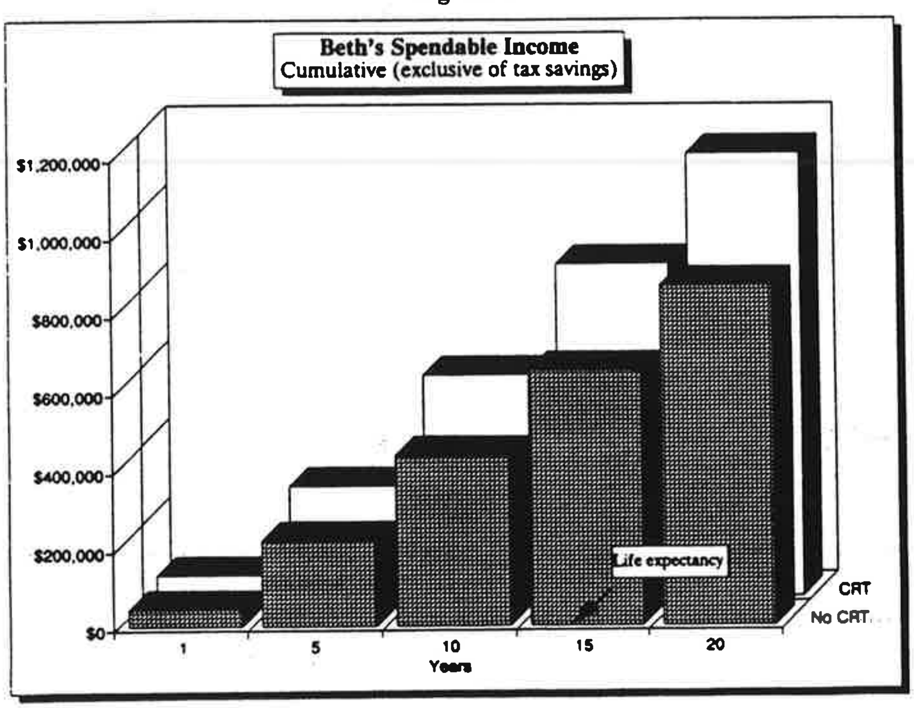


Figure 2



life expectancy each year, so as to maximize her own income tax deferral, then Edward must receive (and pay income tax on) Dena's IRA benefits all at once.[36] Either way, the estate tax on the IRA benefits and the additional estate tax on the excess accumulation, if any, are due nine months after Dena's death.[37]

The total estate and income tax on the IRA upon Dena's death without a CRT (net of the income tax deduction for the federal estate tax) is $775,700, as follows:

Estate tax (55% of $1,000,000)		$550,000
Income tax		
IRA	$1,000,000	
Deduction for federal estate tax	(390,000)	
Taxable income	$610,000	
Tax rate	37%	
Income tax	$225,700	225,700
Total estate and income tax		$775,700

The total estate and income tax on the IRA is thus over 75 percent, leaving Edward with only $224,300 from the IRA. If Edward cannot fully deduct his state income tax (because he does not prepay the state income tax in the year he receives the IRA benefits or because he is subject to the AMT), or if Dena is subject to either the pension excise tax or state death taxes in excess of the federal credit, then Edward could end up with even less than $224,300 from the IRA after taxes.

Edward will thus inherit a total of $674,300 after estate and income taxes, as shown in Table C.

If Edward invests the $674,300, he will receive an annual income of $43,030 tax-free. If he is 59 years old at the time of Dena's death, his life expectancy is 25 years.[38] If he reinvests the income, it will grow to $3,255,318 after 25 years. If he spends the income, he will have only the principal of $674,300 at his death.

If Edward accumulates his entire $50,400 per year after-tax income from the CRT, he will accumulate $2,967,939 after 25 years.

Table C
Edward's Inheritance

	IRA	Dena's Other Assets	Total
Amount before taxes	$1,000,000	$1,000,000	$2,000,000
Estate taxes	(550,000)	(550,000)	(1,100,000)
Income taxes	(225,700)	-0-	(225,700)
Net after taxes	$224,300	$450,000	$674,300

Instead of leaving her IRA directly to Edward, Dena could create a CRT to receive her IRA upon her death, with Edward as the life beneficiary of the CRT. In this way, the CRT receives the entire IRA all at once, free of income tax. However, Edward is only taxable on the income he receives each year from the CRT. In addition, Dena's estate gets an estate tax deduction for the value of the charity's remainder interest in the CRT following Edward's death.[39]

For example, if Dena leaves her $1,000,000 IRA benefit to an annuity trust which pays Edward 8 percent per year, with remainder to charity upon Edward's death, Dena's estate will get an estate tax deduction of $325,304. Her estate tax will be $921,083, as follows:

IRA	$1,000,000
Other assets	1,000,000
Total estate	$2,000,000
Charitable deduction	(325,304)
Taxable estate	$1,674,696
Tax rate	55 percent
Estate tax	$921,083

Because Dena's estate tax must be paid out of her $1,000,000 of assets other than her IRA (to the extent the estate tax is paid out of the IRA, the desired tax benefits are lost), Edward receives the remaining $78,917 of other assets, plus the income interest in the CRT.

Edward's after-tax income will thus initially be $55,530, as follows:

Income from other assets (6.5% of $78,917)		$5,130
Income from CRT		
Income before tax	$80,000	
Income tax	(29,600)	
Net after tax	50,400	50,400
Total income		$55,530

Since the CRT in this example is an annuity trust, Edward's income from the CRT will remain fixed at $80,000 before taxes, or $50,400 after taxes. If he spends $43,830 per year (what his income would have been without the CRT) and saves the remaining $6,570, he will accumulate $386,892 after 25 years. In addition, his original $78,917 of other assets will grow to $380,988 after 25 years, so that he will have a total of $767,880 after 25 years, as compared to only $674,300 without the CRT.

If Edward accumulates his entire $50,400 per year after-tax income from the CRT, he will accumulate $2,967,939 after 25 years. In addition, his original $78,917 of other assets will grow to $380,988 after 25 years, so that he will have a total of $3,348,927 after 25 years, compared to only $3,255,318 without the CRT. Edward is thus better off with an income interest in the CRT than he would be if he received Dena's IRA outright. In addition, the balance of the CRT ($1,000,000 plus any income and growth during Edward's lifetime in excess of the $80,000 per year payments to Edward) will go to Dena's favorite charity upon Edward's death.

The above example is a conservative one. If Dena expects that the CRT

Figure 3

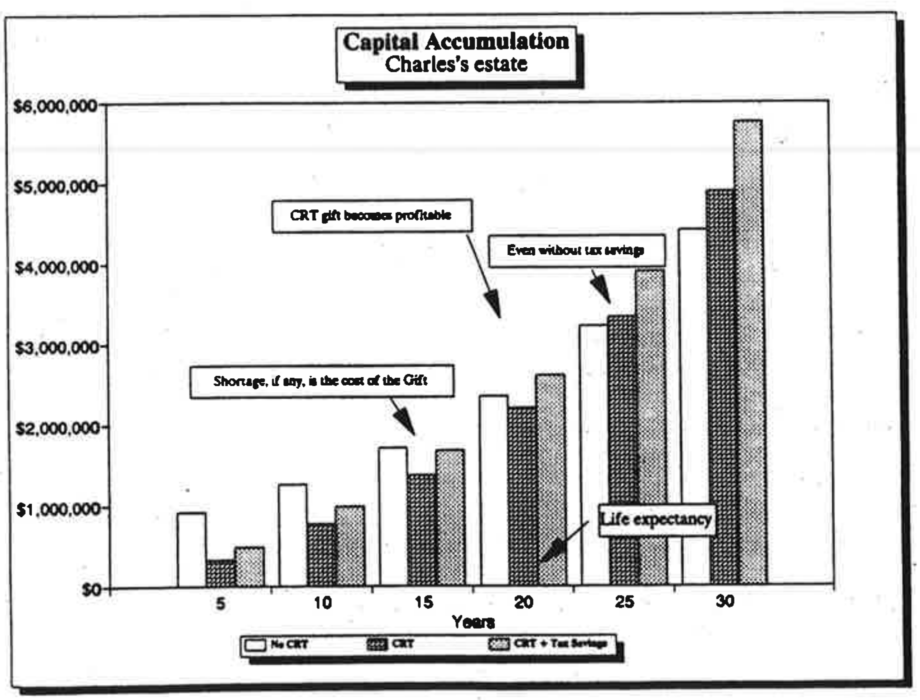
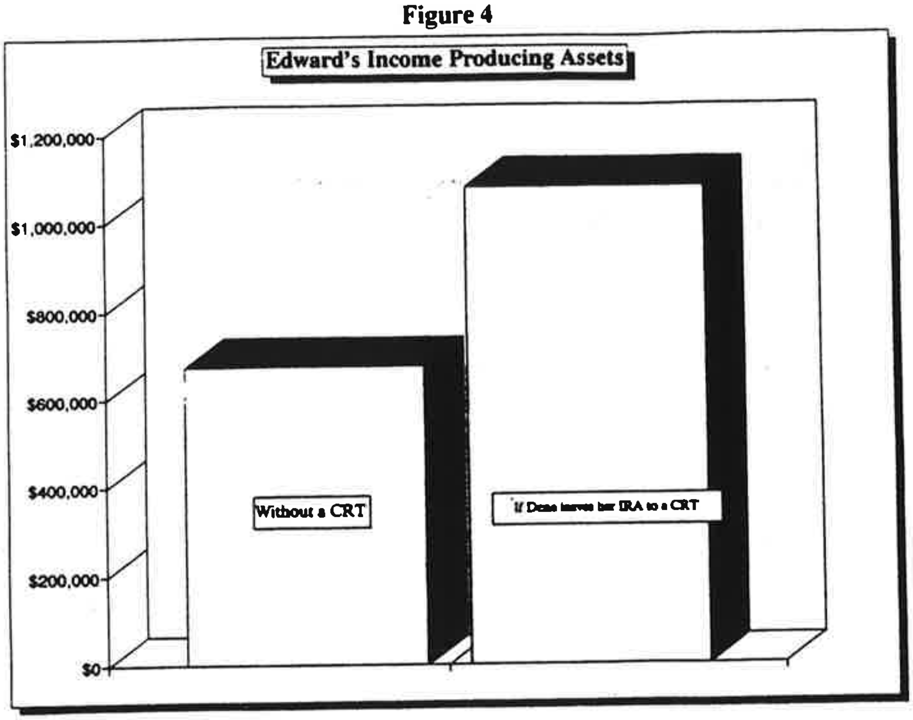


Figure 4



will earn more than an 8 percent total return (income plus growth) on its assets, she could have selected either an annuity trust with a payout rate higher than 8 percent, or a unitrust. The effect of a unitrust having an investment return in excess of the payout rate is discussed below.

Life Insurance in Connection With a CRT

As set forth above, a CRT generally ends upon the death of the last noncharitable beneficiary, at which point the remainder passes to charity.

In some cases, the noncharitable beneficiaries will accumulate the additional income generated as a result of the CRT, in effect replacing the wealth passing to charity. However, to make sure that the wealth passing to charity is replaced for the children of the noncharitable beneficiaries if the noncharitable beneficiaries do not accumulate the additional income or do not reach their life expectancies, insurance can be purchased on the life of the last noncharitable beneficiary. The premiums can be paid out of the income tax savings or from the additional income generated as a result of the CRT.

Thus, in the above examples, Beth and Charles can purchase insurance on their own lives to replace for their children the wealth passing to charity (or the wealth which would have passed to their children but for the CRTs) upon their deaths, and Dena can purchase insurance on Edward's life to replace for Edward's children the wealth passing to charity (or the wealth which would have passed to Edward's children upon Edward's death but for the CRT) upon Edward's death.

Dena can also purchase insurance on her own life, so as to provide the necessary liquidity to pay her estate tax. In this way, she can leave her entire IRA to a CRT, as set forth above.

If the insurance is owned by and payable to the insured's children or a trust for their benefit, it is possible to avoid estate tax on the insurance proceeds, thus providing substantial additional tax benefits. If the insurance is held by a trust, it is also possible to keep the proceeds from being included in the children's estates, thus obtaining additional transfer tax savings upon the children's deaths.[40]

Indeed, the use of life insurance can make even a cash gift more attractive. For example, suppose Fern and George receive $65,000 per year of tax-exempt income from $1,000,000 of municipal bonds. If they spend the income each year, their children will inherit the $1,000,000, or $450,000 after estate tax. If Fern and George contribute the $1,000,000 to a CRT, they can retain the same income from the CRT that they were previously receiving.

While the balance of the CRT will pass to charity upon their deaths, they will obtain an immediate income tax deduction upon making the contribution to the CRT. If they use their income tax savings to pay for $450,000 of insurance (to be owned by and payable to their children or a trust for the benefit of their children), they will have replaced the wealth that their children would have otherwise inherited. If their income tax savings are sufficient to purchase more than $450,000 of insurance, then the family will be better off as a result of the combination of the CRT and the life insurance.

Administration of the Trust

At least once a year, the amount payable to the noncharitable beneficiary must be calculated and paid.[41] If the CRT is a unitrust, the assets must be revalued each year in order to calculate the amount to be paid.[42]

The trustee of the CRT must keep accurate and permanent records of the CRT's assets, income and disburse-

"An advantage of the unitrust is that it offers protection against inflation."

ments, and must file annual returns on Forms 1041-A and 5227 to report the CRT's income, distributions and assets.[43] Distributions to the noncharitable beneficiaries are treated as ordinary income to the extent of the CRT's current and prior undistributed ordinary income.[44] If the distributions exceed the CRT's ordinary income, the excess carries out capital gains, tax-exempt income and principal, in that order.[45]

The trustee may be the donor, the charity (where permitted by local law), a bank or trust company, or other independent trustee. However, in the case of a unitrust, the assets of which must be valued each year, if the trust contains assets such as real estate which cannot be valued objectively, it may be necessary to have an independent trustee.[46] In any event, the trustee should be a person or institution with the ability to keep the necessary records and properly administer the trust (regardless of whether professional advisers are also employed).

Since the trustees are acting in a fiduciary capacity, they must invest the trust assets prudently, with due regard to the interests of both the charitable and the noncharitable beneficiaries.

Flexibility to Change the Charitable Beneficiary

The donor may retain the power to change the ultimate charitable recipient. Similarly, the donor may permit another noncharitable beneficiary to change the ultimate charitable recipient. In either case, the ultimate recipient must be a qualified charitable organization. However, it should be noted that the limitations on the income tax deduction for charitable contributions are more restrictive where the ultimate recipient is or may be a private foundation rather than a public charity.[47]

Selection of Annuity or Unitrust and Investment of The CRT Assets

As set forth above, the assets of a unitrust are revalued each year in determining the amount to be paid to the beneficiary. By contrast, the annual payout from an annuity trust is not affected by subsequent changes in the value of the trust assets.

An advantage of the unitrust is that it offers protection against inflation. This is particularly useful if the income and growth of the CRT is expected to exceed the amounts distributed, so that the value of the CRT will grow. This is likely to occur if the payout rate is low. Protection against inflation may also be important if the beneficiaries are young, so that the CRT is expected to run for a long period of time.

Since the annual payout from an annuity trust remains constant, regardless of fluctuations in the value of the CRT's assets, an annuity trust offers protection against a decrease in the value of the assets. An annuity trust is useful if the payout rate is high, the assets are expected to be invested conservatively, the beneficiary wants to be assured of a fixed income, and the CRT is not expected to last for a long time or the assets are difficult to value.

In the case of an annuity trust, the noncharitable beneficiaries' concern is that the performance of the CRT's investments is sufficient to permit the annual payments to be made. Since the noncharitable beneficiary receives the same amount each year from an annuity trust, regardless of its investment performance, the charity's interest in an annuity trust is highly leveraged. For example, if an annuity trust initially has $1,000,000 and pays out $100,000 per year, after 15 years its assets will decline to $456,958 if it earns 8 percent, and to $246,129 if it earns 7 percent. On the other hand, if it earns 12 percent on its assets, it will

Table D
Effect of Various Rates of Return on an Annuity Trust With a 10 Percent Payout Rate and an Initial Principal of $1,000,000

Year	7% Earnings	8% Earnings	12% Earnings
0	$1,000,000	$1,000,000	$1,000,000
1	970,000	980,000	1,020,000
2	937,900	958,400	1,042,400
3	903,553	935,072	1,067,488
4	866,802	909,878	1,095,587
5	827,478	882,668	1,127,057
6	785,401	853,281	1,162,304
7	740,379	821,544	1,201,780
8	692,206	787,267	1,245,994
9	640,661	750,249	1,295,513
10	585,507	710,269	1,350,975
11	526,492	667,090	1,413,092
12	463,346	620,457	1,482,663
13	395,781	570,094	1,560,582
14	323,485	515,702	1,647,852
15	246,129	456,958	1,745,594

grow to $1,745,594 after 15 years. These possibilities are illustrated in Table D on the preceding page.

The charity's interest is less dependent upon the CRT's investment performance in a unitrust than in an annuity trust. Instead, the investment return of a unitrust affects both the income beneficiaries and the charity.

For example, if a unitrust is initially created with $1,000,000, and has a payout rate of 9 percent, the initial payout will be $90,000 per year. If the unitrust earns 9 percent per year on its assets, the payout will always be $90,000 per year, and the value of the trust will always be $1,000,000. If the unitrust earns less than the payout rate, so that it pays out more money than it earns, the value of the trust will decrease, and hence the annual payout will also decrease. On the other hand, if the unitrust earns more than the payout rate, the value of the trust will increase, and hence the annual payout will also increase, as shown in Table E.

Table E
Effect of Various Rates of Return on a Unitrust
With a 9 Percent Payout Rate and an Initial Principal of $1,000,000

Year	8% Earnings	9% Earnings	10% Earnings
0	$1,000,000	$1,000,000	$1,000,000
10	904,382	1,000,000	1,104,622
20	817,907	1,000,000	1,220,190
30	739,700	1,000,000	1,347,849
40	668,972	1,000,000	1,488,864

The enormous leverage of the annuity trust is illustrated by Figures 5 and 6. Figure 5 compares the annuity trust and unitrust where the CRT earns 10 percent but pays out only 9 percent. In such a case, a $1,000,000 annuity trust will grow to $5,425,926 after 40 years, while a $1,000,000 unitrust will grow to only $1,488,864.

Figure 5
A Comparison

ANNUITY TRUST 1,000,000					STANDARD UNITRUST Appraised Value				
Year	Trust Corpus Beg of Yr.	Earnings @ 10.00%	Payout @ 9.00%	Trust Corpus End of Yr.	Year	Trust Equity Beg of Yr.	Earnings 10.00%	Payout @ 9.00%	Trust Corpus End of Yr.
1	1,000,000	100,000	90,000	1,010,000	1	1,000,000	100,000	90,000	1,010,000
2	1,010,000	101,000	90,000	1,021,000	2	1,010,000	101,000	90,900	1,020,100
3	1,021,000	102,100	90,000	1,033,100	3	1,020,100	102,010	91,809	1,030,301
4	1,033,100	103,310	90,000	1,046,410	4	1,030,301	103,030	92,727	1,040,604
5	1,046,410	104,641	90,000	1,061,051	5	1,040,604	104,060	93,654	1,051,010
6	1,061,051	106,105	90,000	1,077,156	6	1,051,010	105,101	94,591	1,061,520
7	1,077,156	107,716	90,000	1,094,872	7	1,061,520	106,152	95,537	1,072,135
8	1,094,872	109,487	90,000	1,114,359	8	1,072,135	107,214	96,492	1,082,857
9	1,114,359	111,436	90,000	1,135,795	9	1,082,857	108,286	97,457	1,093,685
10	1,135,795	113,579	90,000	1,159,374	10	1,093,685	109,369	98,432	1,104,622
11	1,159,374	115,937	90,000	1,185,312	11	1,104,622	110,462	99,416	1,115,668
12	1,185,312	118,531	90,000	1,213,843	12	1,115,668	111,567	100,410	1,126,825
13	1,213,843	121,384	90,000	1,245,227	13	1,126,825	112,683	101,414	1,138,093
14	1,245,227	124,523	90,000	1,279,750	14	1,138,093	113,809	102,428	1,149,474
15	1,279,750	127,975	90,000	1,317,725	15	1,149,474	114,947	103,453	1,160,969
16	1,317,725	131,772	90,000	1,359,497	16	1,160,969	116,097	104,487	1,172,579
17	1,359,497	135,950	90,000	1,405,447	17	1,172,579	117,258	105,532	1,184,304
18	1,405,447	140,545	90,000	1,455,992	18	1,184,304	118,430	106,587	1,196,147
19	1,455,992	145,599	90,000	1,511,591	19	1,196,147	119,615	107,653	1,208,109
20	1,511,591	151,159	90,000	1,572,750	20	1,208,109	120,811	108,730	1,220,190
21	1,572,750	157,275	90,000	1,640,025	21	1,220,190	122,019	109,817	1,232,392
22	1,640,025	164,002	90,000	1,714,027	22	1,232,392	123,239	110,915	1,244,716
23	1,714,027	171,403	90,000	1,795,430	23	1,244,716	124,472	112,024	1,257,163
24	1,795,430	179,543	90,000	1,884,973	24	1,257,163	125,716	113,145	1,269,735
25	1,884,973	188,497	90,000	1,983,471	25	1,269,735	126,973	114,276	1,282,432
26	1,983,471	198,347	90,000	2,091,818	26	1,282,432	128,243	115,419	1,295,256
27	2,091,818	209,182	90,000	2,210,999	27	1,295,256	129,526	116,573	1,308,209
28	2,210,999	221,100	90,000	2,342,099	28	1,308,209	130,821	117,739	1,321,291
29	2,342,099	234,210	90,000	2,486,309	29	1,321,291	132,129	118,916	1,334,504
30	2,486,309	248,631	90,000	2,644,940	30	1,334,504	133,450	120,105	1,347,849
31	2,644,940	264,494	90,000	2,819,434	31	1,347,849	134,785	121,306	1,361,327
32	2,819,434	281,943	90,000	3,011,378	32	1,361,327	136,133	122,519	1,374,941
33	3,011,378	301,138	90,000	3,222,515	33	1,374,941	137,494	123,745	1,388,690
34	3,222,515	322,252	90,000	3,454,767	34	1,388,690	138,869	124,982	1,402,577
35	3,454,767	345,477	90,000	3,710,244	35	1,402,577	140,258	126,232	1,416,603
36	3,710,244	371,024	90,000	3,991,268	36	1,416,603	141,660	127,494	1,430,769
37	3,991,268	399,127	90,000	4,300,395	37	1,430,769	143,077	128,769	1,445,076
38	4,300,395	430,039	90,000	4,640,434	38	1,445,076	144,508	130,057	1,459,527
39	4,640,434	464,043	90,000	5,014,478	39	1,459,527	145,953	131,357	1,474,123
40	5,014,478	501,448	90,000	5,425,926	40	1,474,123	147,412	132,671	1,488,864

Earnings higher than payout

Of course, the leverage works in reverse where the payout rate exceeds the CRT's rate of return on its assets. Figure 6 compares the annuity trust and unitrust where the CRT pays out 9 percent but earns 8 percent. In such a case, a $1,000,000 annuity trust is exhausted in 29 years, while a $1,000,000 unitrust drops only to $747,172 after 29 years.

The selection of a unitrust or an annuity trust also affects the amount of the income or estate tax deduction. If the payout rate is less than the table rate, the assets of the CRT are expect-

A CRT is an excellent tool to increase one's income, while at the same time providing a benefit to charity.

Figure 6
A Comparison

ANNUITY TRUST					STANDARD UNITRUST				
1,000,000					Appraised Value				
Year	Trust Corpus Beg of Yr.	Earnings @ 8.00%	Payout @ 9.00%	Trust Corpus End of Yr.	Year	Trust Equity Beg of Yr.	Earnings @ 8.00%	Payout @ 9.00%	Trust Corpus End of Yr.
1	1,000,000	80,000	90,000	990,000	1	1,000,000	80,000	90,000	990,000
2	990,000	79,200	90,000	979,200	2	990,000	79,200	89,100	980,100
3	979,200	78,336	90,000	967,536	3	980,100	78,408	88,209	970,299
4	967,536	77,403	90,000	954,939	4	970,299	77,624	87,327	960,596
5	954,939	76,395	90,000	941,334	5	960,596	76,848	86,454	950,990
6	941,334	75,307	90,000	926,641	6	950,990	76,079	85,589	941,480
7	926,641	74,131	90,000	910,772	7	941,480	75,318	84,733	932,065
8	910,772	72,862	90,000	893,634	8	932,065	74,565	83,886	922,745
9	893,634	71,491	90,000	875,124	9	922,745	73,820	83,047	913,517
10	875,124	70,010	90,000	855,134	10	913,517	73,081	82,217	904,382
11	855,134	68,411	90,000	833,545	11	904,382	72,351	81,394	895,338
12	833,545	66,684	90,000	810,229	12	895,338	71,627	80,580	886,385
13	810,229	64,818	90,000	785,047	13	886,385	70,911	79,775	877,521
14	785,047	62,804	90,000	757,851	14	877,521	70,202	78,977	868,746
15	757,851	60,628	90,000	728,479	15	868,746	69,500	78,187	860,058
16	728,479	58,278	90,000	696,757	16	860,058	68,805	77,405	851,458
17	696,757	55,741	90,000	662,498	17	851,458	68,117	76,631	842,943
18	662,498	53,000	90,000	625,498	18	842,943	67,435	75,865	834,514
19	625,498	50,040	90,000	585,537	19	834,514	66,761	75,106	826,169
20	585,537	46,843	90,000	542,380	20	826,169	66,093	74,355	817,907
21	542,380	43,390	90,000	495,771	21	817,907	65,433	73,612	809,728
22	495,771	39,662	90,000	445,432	22	809,728	64,778	72,876	801,631
23	445,432	35,635	90,000	391,067	23	801,631	64,130	72,147	793,614
24	391,067	31,285	90,000	332,352	24	793,614	63,489	71,425	785,678
25	332,352	26,588	90,000	268,941	25	785,678	62,854	70,711	777,821
26	268,941	21,515	90,000	200,456	26	777,821	62,226	70,004	770,043
27	200,456	16,036	90,000	126,492	27	770,043	61,603	69,304	762,343
28	126,492	10,119	90,000	46,612	28	762,343	60,987	68,611	754,719
29	46,612	3,729	50,341		29	754,719	60,378	67,925	747,172
30					30	747,172	59,774	67,245	739,700
31					31	739,700	59,176	66,573	732,303
32					32	732,303	58,584	65,907	724,980
33					33	724,980	57,998	65,248	717,731
34					34	717,731	57,418	64,596	710,553
35					35	710,553	56,844	63,950	703,448
36					36	703,448	56,276	63,310	696,413
37					37	696,413	55,713	62,677	689,449
38					38	689,449	55,156	62,050	682,555
39					39	682,555	54,604	61,430	675,729
40					40	675,729	54,058	60,816	668,972

Earnings lower than payout

ed to grow. In a unitrust, as the value of the CRT increases, the income payable to the noncharitable beneficiaries also increases. However, in an annuity trust, the income payable to the noncharitable beneficiaries remains the same. Therefore, if the payout rate is less than the table rate, the value of the charity's remainder interest, and hence the tax deduction, is greater in an annuity trust than in a unitrust.

The opposite is true if the payout rate is greater than the table rate. In such a case, the assets of the CRT are expected to decrease. In a unitrust, as the value of the CRT decreases, the income payable to the noncharitable beneficiaries also decreases. However, in an annuity trust, the income payable to the noncharitable beneficiaries remains the same. Therefore, if the payout rate is greater than the table rate, the value of the charity's remainder interest, and hence the tax deduction, is greater in a unitrust than in an annuity trust.

Conclusion

A CRT is an excellent tool to increase one's income, while at the same time providing a benefit to charity. However, careful consideration must be given to the structure and design of the CRT and the investment of the CRT assets.**J**

(I/R Code 1600.04/8000.00)

Bruce D. Steiner, J.D., LL.M., is tax counsel to the New York City law firm of Kleinberg, Kaplan, Wolff & Cohen, P.C. He is a member of the New York, New Jersey and Florida Bars, and has written and lectured extensively on tax and estate planning topics.

Frederick J. Wertlieb, CLU, ChFC, CFP, is president of Financial Care, Inc., a Franklin Lakes, New Jersey, firm specializing in the administration of charitable remainder trusts for both individual and institutional trustees. Fred is also the founder of the Second Opinion Club which provides consulting and computer modeling to professional adviser members.

(1) IRC §664; Treas. Reg. §1.664-1. All statutory references are to the Internal Revenue Code of 1986, as amended.
(2) IRC §664(d); Treas. Reg. §1.664-1(a)(1)(i).
(3) Id.
(4) IRC §664(d)(2); Treas. Reg. §1.664-3.
(5) Treas. Reg. §1.664-2(b); Rev. Rul. 72-395, 1972-2 C.B. 340.
(6) IRC §664(d)(2); Treas. Reg §1.664-3(a)(1).
(7) Treas. Reg. §1.664-3(b)
(8) IRC §664(d)(3)(A).
(9) IRC §664(d)(3); Treas. Reg. §1.664-3(a)(1)(b).
(10) IRC §170(f)(2)(A); Treas. Reg. §§1.664-2(c) and 1.664-4.
(11) IRC §§1274(d) and 7520(a).
(12) IRC §170(b)(1)(A); Rev. Rul. 79-368, 1979-2 C.B. 109.
(13) IRC §170(b)(1)(C)(i).
(14) IRC §170(b)(1).
(15) I.R.C §§170(b)(1)(C)(iii) and 170(e)(1).
(16) IRC §170(b)(1)(B); Rev. Rul 79-368, supra note 12.
(17) IRC §170(b)(1)(D)(i).
(18) IRC §170(b)(1)(B).
(19) IRC §§170(e)(1)(B)(ii) and 170(e)(5).
(20) IRC §170(e)(2).

(21) IRC §57(a)(6).
(22) IRC §664(a).
(23) Rev. Rul. 60-370, 1960-2 C.B. 203.
(24) IRC §2055(e); Treas. Reg. §§1.664-2(c) and 1.664-4.
(25) IRC §§2055 and 2522.
(26) Treas. Reg. §§1.170A-1(e), 20.2055-2(b) and 25.2522(c)-3(b).
(27) Rev. Rul. 77-374, 1977-2 C.B. 329; Rev. Rul. 70-452, 1970-2 C.B. 199. See IRC §§673(a), 2037(a)(2) and 2042(2) for the significance of a 5% reversionary interest.
(28) See Gen. Couns. Mem. 37,770 (Nov. 30, 1978).
(29) Id.
(30) IRC §4980A(d).
(31) To obtain an income tax deduction, the taxpayer must attach an appraisal summary (from a qualified independent appraisal) to his or her income tax return. Treas. Reg. §1.170A-13.
(32) It should be noted that Beth would need to have a very large income in order both to use her entire income tax deduction in one year and avoid the AMT.
(33) IRC §170(f)(3)(B)(ii).
(34) IRC §§401(a)(9)(B)(iii) and 408(a)(6); Prop. Treas. Reg. §§1.401(a)(9)-1, Q&A C-1, and 1.408-8, Q&A A-1.
(35) IRC §§401(a)(9)(B)(i) and 408(a)(6); Prop. Treas. Reg. §§1.401(a)(9)-1, Q&A B-4, and 1.408-8, Q&A A-1.
(36) Prop. Treas. Reg. §§1.401(a)(9)-1, Q&A E-8, and 1.408-8, Q&A A-1.
(37) IRC §§4980A(d), 6075(a) and 6151.
(38) Treas. Reg. §1.72-9, Table V.
(39) IRC §2055(e); Treas. Reg. §§1.664-2(c) and 1.664-4.
(40) A discussion of the generation-skipping transfer tax is beyond the scope of this article.
(41) IRC §664(d); Treas. Reg. §§1.664-2(a) and 1.664-3(a).
(42) IRC §664(d)(2)(A); Treas. Reg. §1.664-3(a)(1).
(43) Treas. Reg. §§1.664-1(a)(1)(ii), 1.6012-3(a)(6) and 1.6034-1(a).
(44) IRC §664(b)(1); Treas. Reg. §1.664-1(d)(1)(i)(a).
(45) IRC §§664(b)(2), (3) and (4); Treas. Reg. §1.664-1(d)(1)(i)(b), (c) and (d).
(46) H.R. Rep. No. 413 (Part 1), 91st Cong., 1st Sess. 50 (1969).
(47) IRC §§170(b)(1)(B) and 170(b)(1)(D); Rev. Rul. 79-368, 1979-2 C.B. 109.