

CHARITABLE LEAD & REMAINDER TRUSTS



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Charitable Lead & Remainder Trusts

Charitable lead trusts (CLTs) and charitable remainder trusts (CRTs) represent sophisticated estate planning and philanthropic strategies that enable donors to achieve multiple objectives simultaneously: supporting charitable causes, reducing estate and gift taxes, and providing income streams or wealth transfer benefits to family members. These split-interest charitable vehicles offer significant advantages for high-net-worth individuals seeking to optimize their charitable giving while addressing complex financial planning goals.

Here's a comprehensive breakdown of establishing and managing charitable lead and remainder trusts.

Understanding Charitable Remainder Trusts (CRTs)

A charitable remainder trust is an irrevocable trust that provides income payments to one or more non-charitable beneficiaries (often the donor and/or family members) for a specified period, with the remainder interest passing to qualified charitable organizations.

Key characteristics:

- Income stream to non-charitable beneficiaries for life or a term of years (up to 20 years)
- Remainder interest passes to charity upon termination
- Immediate charitable income tax deduction based on the present value of the remainder interest
- Tax-exempt status allows for tax-free growth within the trust
- Avoidance of capital gains taxes on contributed appreciated assets

Types of CRTs:

- Charitable Remainder Annuity Trust (CRAT): Pays a fixed dollar amount annually (minimum 5%, maximum 50% of initial trust value)
- Charitable Remainder Unitrust (CRUT): Pays a fixed percentage of trust assets valued annually (minimum 5%, maximum 50%)
- Net Income Makeup Charitable Remainder Unitrust (NIMCRUT): Pays the lesser of net income or unitrust percentage, with makeup provisions
- Flip Charitable Remainder Unitrust (FlipCRUT): Converts from NIMCRUT to standard CRUT upon a triggering event

Understanding Charitable Lead Trusts (CLTs)

A charitable lead trust is an irrevocable trust that provides income payments to qualified charitable organizations for a specified period, with the remainder interest passing to non-charitable beneficiaries (typically family members).

Key characteristics:

- Charitable beneficiaries receive income payments during the trust term
- Remainder interest passes to family members or other non-charitable beneficiaries
- Potential gift and estate tax benefits through valuation discounts
- Effective wealth transfer mechanism with reduced transfer tax costs
- Income tax treatment varies based on grantor vs. non-grantor trust structure

Types of CLTs:

- Charitable Lead Annuity Trust (CLAT): Pays a fixed dollar amount annually to charity
- Charitable Lead Unitrust (CLUT): Pays a fixed percentage of trust assets valued annually to charity
- Grantor CLT: Donor retains certain powers and receives income tax deductions but pays income tax on trust income
- Non-Grantor CLT: Donor relinquishes control, trust pays its own taxes, but no income tax deduction for donor

Funding Strategies and Asset Types

Optimal assets for CRTs:

- Highly appreciated securities (stocks, mutual funds, ETFs)
- Appreciated real estate
- Private business interests
- Complex assets with significant built-in gains
- Assets expected to appreciate significantly after contribution

Optimal assets for CLTs:

- Assets expected to appreciate at rates exceeding the IRS Section 7520 rate
- Private business interests with valuation discounts
- Real estate with development potential
- Growth-oriented investments
- Assets that generate income to support charitable payments

Timing considerations: Establish trusts when Section 7520 rates are favorable to the intended strategy and when contributed assets have strong growth prospects.

Tax Benefits and Implications

Charitable Remainder Trusts:

- Income tax deduction: Present value of remainder interest (subject to AGI limitations: 30% for appreciated property, 50% for cash)
- Capital gains deferral: Gains recognized as distributions are received (except for net unrealized appreciation)
- Estate tax benefits: Removes asset appreciation from donor's estate
- Generation-skipping considerations: May trigger GST tax if grandchildren or younger generations are beneficiaries

Charitable Lead Trusts:

- Gift tax benefits: Remainder interest valued at discount due to charitable lead payments
- Estate tax benefits: Effectively freezes asset values and removes appreciation from donor's estate
- Income tax treatment: Varies significantly between grantor and non-grantor structures
- GST tax planning: Effective for transferring wealth to grandchildren with minimal transfer tax costs

Planning Opportunities and Strategies

Retirement planning with CRTs:

- Convert highly appreciated, low-yielding assets into income-producing trusts
- Supplement retirement income while supporting charitable goals
- Coordinate with other retirement planning strategies and Social Security optimization

Business succession planning with CLTs:

- Transfer business interests to family members at reduced gift tax values
- Maintain family business control during charitable lead period
- Coordinate with buy-sell agreements and other succession planning tools

Multi-generational planning:

- Use CLTs to transfer wealth across multiple generations with minimal transfer tax costs
- Structure trusts to benefit multiple family members over extended periods
- Coordinate with dynasty trust planning and GST tax exemption allocation

Important Considerations and Limitations



Irrevocable nature: Both CLTs and CRTs are irrevocable trusts that cannot be modified or terminated without specific court approval or beneficiary consent.



Investment risk: Trust assets are subject to market risk, which can impact income distributions (CRTs) or remainder values (CLTs).



Regulatory compliance: Trusts must comply with specific operational requirements to maintain their tax-advantaged status.



Beneficiary considerations: Income beneficiaries (CRTs) or remainder beneficiaries (CLTs) have limited or no control over trust operations.



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How PUREfi Wealth Can Help



Comprehensive Strategy Development: Evaluate charitable remainder and lead trusts alignment with wealth transfer, tax planning, and philanthropic goals within comprehensive financial plans.

Asset Selection and Timing: Identify optimal portfolio assets for trust contributions, analyzing tax implications, growth potential, and liquidity while coordinating market timing and tax opportunities.

Philanthropic Strategy Coordination: Develop comprehensive charitable giving strategies integrating trusts with donor advised funds, foundations, and direct giving for maximum impact and benefits.

Investment Policy Development: Create customized investment policies balancing charitable trust requirements with client risk tolerance, payout needs, and long-term objectives.

Tax Optimization Strategies: Coordinate trust strategies with income, estate, and gift tax planning for maximum efficiency while meeting charitable and family objectives.

Ongoing Trust Oversight: Monitor trust performance, investment results, and compliance with regular reviews and strategic adjustments as needed.

Multi-Generational Planning Integration: Align charitable trust strategies with dynasty trusts, generation-skipping tax optimization, and family governance for long-term wealth transfer goals.

CONTACT US



PUREfi Wealth LLC
10 Post Office Square, Suite 710
Boston, MA 02109



617-488-9320



contact@purefiwealth.com



www.purefiwealth.com



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