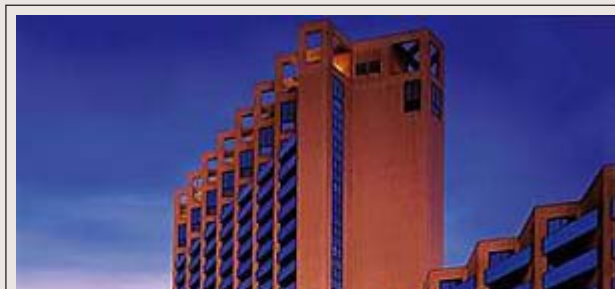


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# **CRT PLANNING ON A NAPKIN**

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# CRT PLANNING ON A NAPKIN

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## I. Introduction

Diagrams help you and your donors turn complex concepts into simple concepts. I want you to create more Charitable Remainder Trusts (CRTs) and I want you to talk with more donors and board members about creating CRTs. However, two hurdles (excuses) I continue to hear are “I need a CRT illustration” and “I can’t get my board members to understand how CRTs work in a short conversation”.

Simple solutions are often the best solutions. If you can describe how a CRT works with a few boxes and arrows, donors will grasp the concept. Computer presentations and printed proposals are nice. But when you meet face to face with a donor, a powerful way to convey your message is to use a few boxes and arrows that are personalized to her situation. On the other hand, if you cannot explain the concept on a napkin, then your donors and board members won't be able to explain it to their family and advisors. Let's learn how to do CRT Planning on a Napkin.<sup>1</sup>

The author has seen gift planners go to the absurd in creating lengthy CRT illustrations with even longer disclosure statements. Nevertheless, donors make decisions at least partly based on whether or not they understand the basic moving parts. On many occasions, the simple diagram of the cash flow is what sealed the decision.

Because you need to *know* the basics before you *describe* the basics, please brush up on CRT planning topics before you try this technique on a donor. Appendix A-2 contains minimal concepts you need to know before talking with a donor about CRTs.<sup>2</sup>

## II. Setting the Stage: Cocktail Party Meeting with a Donor

During 2007, 65% of all new CRTs were SCRUTs and 65% of all gifts to all kinds of CRTs were gifts of stock. Therefore, most donors create a SCRUT and fund it with publicly-traded stock. Start by learning how to explain this straight-forward concept with 3 boxes and 4 arrows.

**Your Situation:** You are meeting with a donor in a restaurant or at a conference break. You don't have time to prepare a printed proposal and you don't have fancy brochures with you. You have 60 seconds to get your point across. You

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<sup>1</sup> The author has used CRT cash flow diagrams on napkins and business cards for years and also recognizes Dan Roam's book, [The Back of the Napkin](#). Nevertheless, this paper does not necessarily follow the book's recommendations.

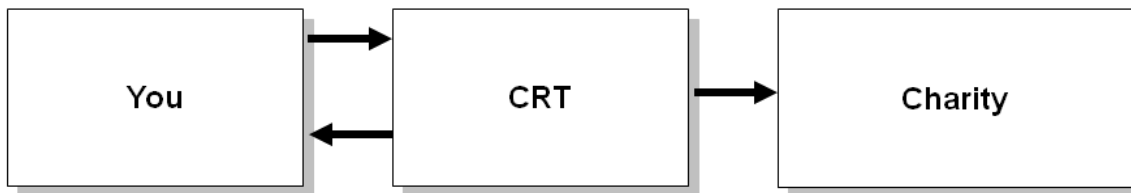
<sup>2</sup> By their nature, neither this paper nor a napkin diagram can cover a description of all CRT design issues. This paper presumes the reader understands how CRTs work or has access to a CRT primer such as the one available on the author's website at [www.CharitableTrust.com/pdf/CRT-Handbook.pdf](http://www.CharitableTrust.com/pdf/CRT-Handbook.pdf).

need a method that the donor can follow, will understand and will take back to her family and advisors.

Let's presume that you have already determined that the donor wants to support your organization in her estate but needs additional cash flow for herself and her husband during their lives. (Helpful Hint: This donor's goals should scream CRT or CGA to you.)

You pull out a napkin, business card, tablecloth, back of an envelope or some other handy paper and draw 3 Boxes and 3 Arrows shown in Figure 1-- Basic CRT Diagram.

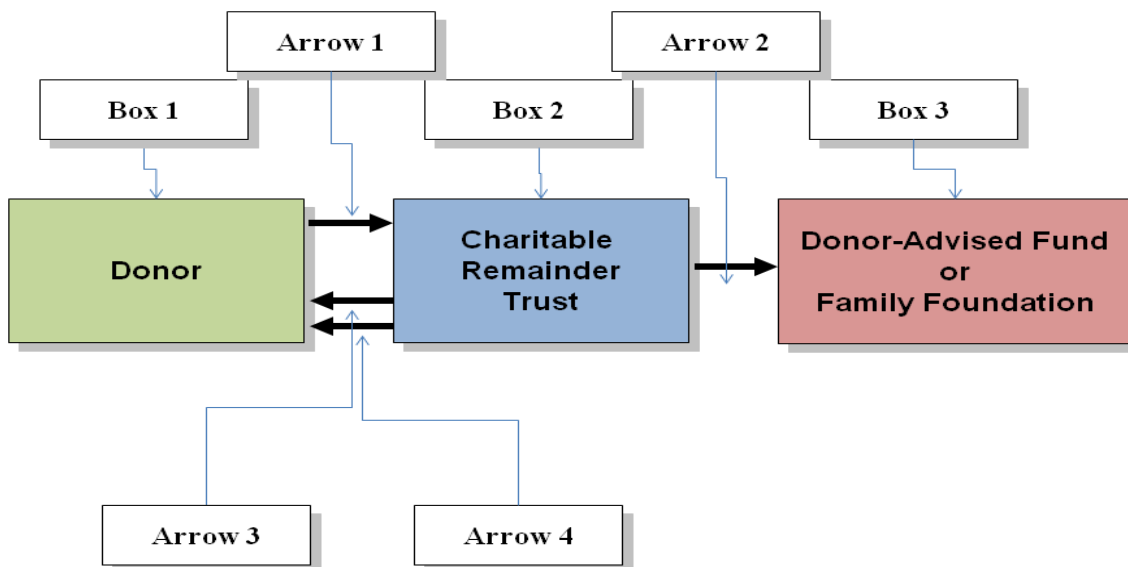
Figure 1-- Basic CRT Diagram



As you draw each item, describe its purpose to your donor. For example, as you draw the first box, the first arrow and the second box, you explain that you propose that she transfer \$400,000 of publicly-traded stocks to a CRT. As you draw the next arrow and last box, you say that her gift will eventually benefit your organization. By all means, include as much specific information you know your donor has revealed regarding her charitable dreams for this gift. As you add the returning arrow near the bottom left of the diagram, you add that for the rest of her life, the CRT will make payments back to her. In addition, because charity will receive something in the future, she can claim an income tax deduction now.

### A. Detail Behind the Diagram

Figure 2 -- Basic Diagram with 3 Boxes and 4 Arrows



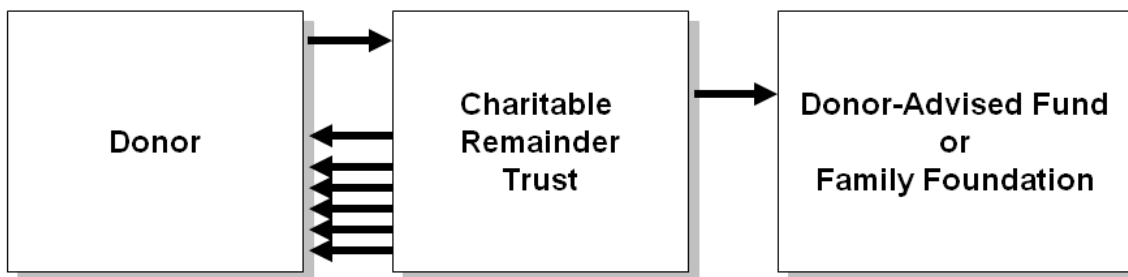
Let's unpack this a little more slowly by referring to each box and arrow. Review Figure 2 -- Basic Diagram with 3 Boxes and 4 Arrows for the following discussion: The basic cash flows of a SCRUT include the donor (Box 1) contributes cash or other assets (Arrow 1) to a newly-created SCRUT (Box 2). Because the SCRUT is required to pay (Arrow 2) to Charity (Box 3) whatever is left over, the donor is entitled to an immediate income tax charitable deduction (Arrow 3).

Normally, the donor and spouse are the only current income beneficiaries of the CRT and they receive the CRT's cash flow distributions (Arrow 4) for life. Note that if space is at a premium on your drawing paper, it may be helpful to combine the third and fourth arrows into one arrow.

### B. One Simple Variation

A variation of this theme is to use multiple arrows to indicate that there are multiple years of cash flow payments as contrasted with a single contribution to the CRT, a single income tax deduction and a single distribution to charity. See Figure 3 -- Basic CRT Diagram Showing Multiple Years of Distributions for an example of this concept.

Figure 3 -- Basic CRT Diagram Showing Multiple Years of Distributions



### III. Expanding to Other CRT Formats

Donors may create CRTs in formats other than SCRUTs. The other CRT formats are:

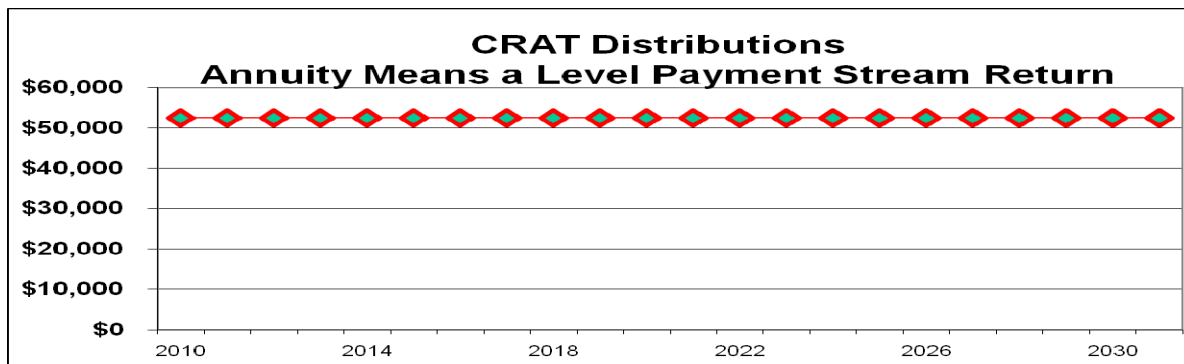
- CRATs (**Charitable Remainder Annuity Trusts**), which must pay a fixed amount to the income beneficiaries each year;
- NIMCRUTs (**Net Income with Make-up Charitable Remainder Unitrusts**), which must pay the lesser of a fixed percentage or net income to the income beneficiaries each year; and
- Flip-CRUTs (**Flip Charitable Remainder Unitrusts**), which act as a NIMCRUT until a triggering event and in future years act as a SCRUT.<sup>3</sup>

<sup>3</sup> Technically, another variation is the Net Income Charitable Remainder Unitrust (NICRUT). Note that this version has no make-up provision. In the author's experience, most of the relatively few examples of this format were due to plan design and/or drafting errors. Nevertheless, valid uses of the NICRUT do exist.

In drawing a CRAT, NIMCRUT or Flip-CRUT, the basic diagram does not change. However, in any CRT conversation or diagram you must make certain that the donor understands how cash flow distributions can vary. For example, a CRAT will distribute the same amount each and every year except the first year and the last year. For most CRATs, the last year is the year in which the surviving income beneficiary dies. However, for some CRATs, the last year is the year in which the CRAT runs out of assets.

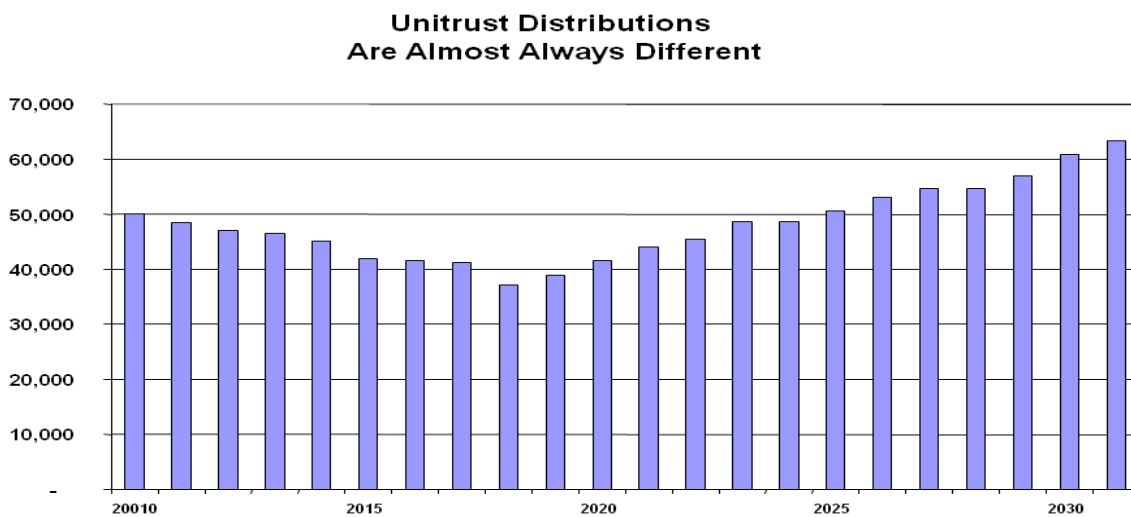
For SCRUTs, the cash flow will vary each year depending on that year's asset value. For NIMCRUTs, the cash flow depends primarily on the net income the trust generates. In the latter case, some planners prefer to use a dashed line on the cash flow arrow to represent the intermittent nature of a NIMCRUT's cash flow. Other planners use a thicker or thinner line to represent the size of the CRT's payout rate.

Figure 4 -- CRATs Make Level Cash Flow Distributions



Of course, a key difference between CRATs and CRUTs of all types is that CRATs must pay a level cash flow, while CRUTs pay a variable cash flow. One way to depict this is to add a simple chart or graph of the cash flow as shown in Figure 4 and Figure 5. Another option is to simply write the words “level cash flow” for a CRAT, “variable cash flow” for a SCRUT or “variable income” for a NIMCRUT.

Figure 5 – CRUT's Cash Flow Distributions Are Rarely Level



## IV. Helpful Hints

### A. Be Consistent

My number one rule in drawing diagrams is: Be Consistent. Consistency will help you and your donors. The first benefit to you is that you can continue your conversation with a donor weeks later and you can pick up the conversation without even seeing the diagram. Another benefit to you is that consistency helps you to become more comfortable describing CRTs to your donors and board members. The benefit to your donor is that they hear your organization's message the same way every time. The reality is that you *will* have the same conversation with the same donor visit after visit. You must move at your donor's pace. Using a consistent delivery method (your chosen diagram) reinforces your message.

### B. Four Basic Alternatives

If you like to highlight the donor's role in the process, then put the donor at the top of the diagram similar to Figure 6 -- Donor is the Top Box. An alternative to Figure 6 that highlights the donor even more is shown in Figure 7 -- Donor is the Largest Box.

Figure 6 -- Donor is the Top Box

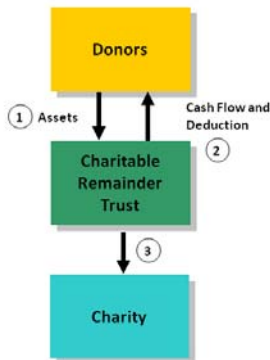
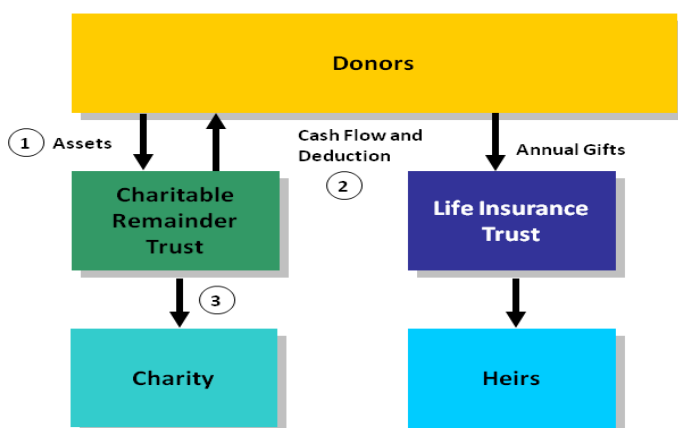
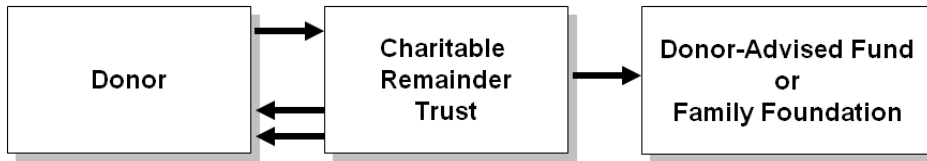


Figure 7 -- Donor is the Largest Box



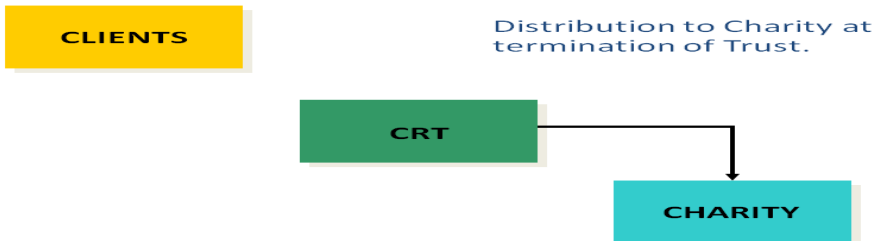
Other planners prefer to draw their diagrams with the 3 main boxes across the top as in Figure 8 -- Three Boxes are Side by Side.

**Figure 8 -- Three Boxes are Side by Side**



Note that the donor is still highlighted in this depiction since the donor is in the upper left corner. Another common method involves some form of cascading the boxes as shown in Figure 9 -- Example of Cascading Boxes.

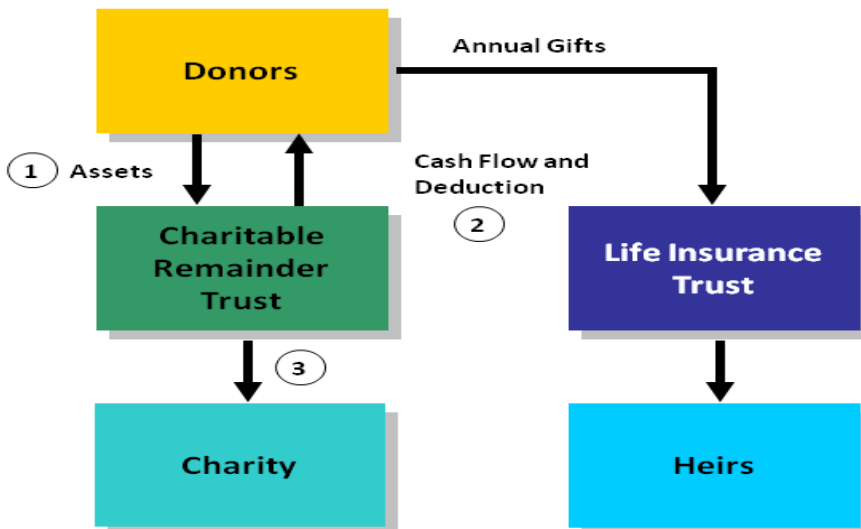
**Figure 9 -- Example of Cascading Boxes**



**C. Mind Your Margins**

Another useful habit is to leave room in the margins of your drawing if you expect the diagram to get more complex. For example, the most common addition to the basic CRT diagram is to depict insurance as a replacement of part or all of the charitable gift. See Figure 10 -- Example That Adds Insurance.

**Figure 10 -- Example That Adds Insurance**



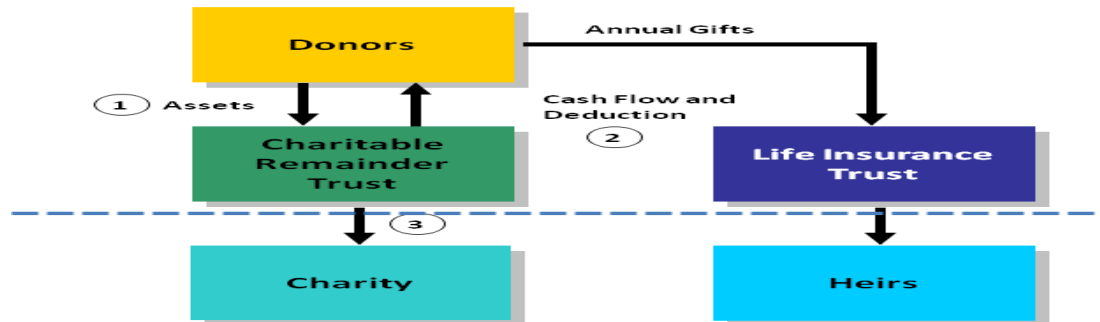
One benefit of using the diagram in Figure 10 is that the two lowest boxes and two lowest arrows illustrate events that occur relatively simultaneously. In other words, at the very time when the family no longer receives any benefit from the CRT's cash flow payments, the family starts to receive benefit from the life insurance trust. Further, the



charitable gift becomes complete in the truest sense of the word in that the donors' charitable dreams now become fulfilled.

Another way to clarify when that dual distribution will occur is to add a distribution line as shown in Figure 11 -- CRT and Life Insurance with a Distribution Line.

Figure 11 -- CRT and Life Insurance with a Distribution Line

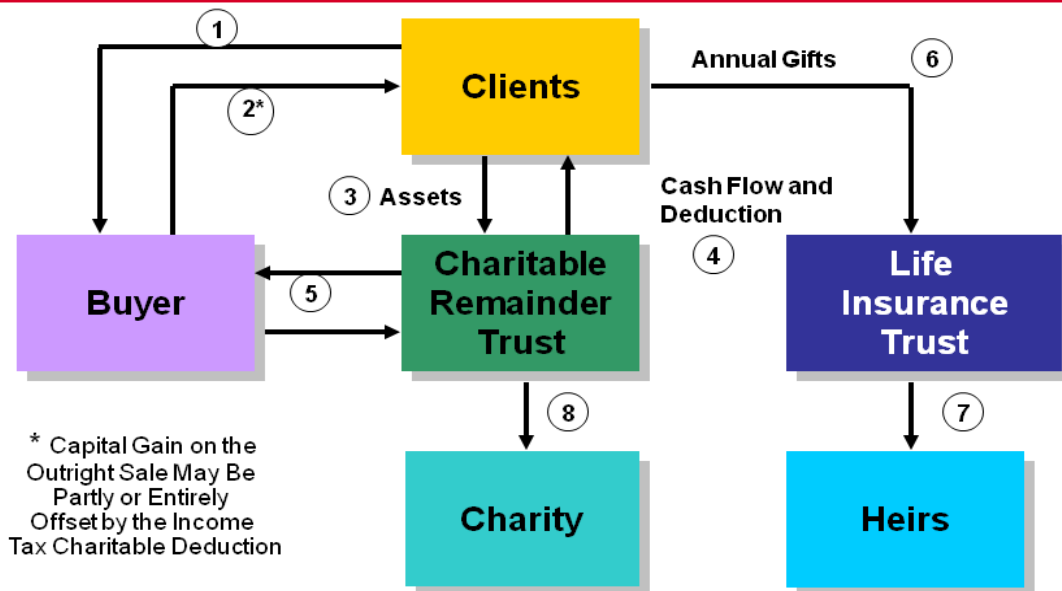


#### D. Adding Other Parties

Examples of additional complexity include describing the roles of other parties. Figure 11 shows heirs. Other parties that could be added include a purchaser of the contributed asset, other trusts and multiple charitable beneficiaries.

Some assets also create additional complexity. For example, you may want to show that the donor cannot purchase or use assets of the CRT. You may want to use a diagram similar to Figure 12 -- Part Outright Sale, Part Gift to CRT to show the donor contributing part of the chosen asset to the CRT and selling part of the asset outright to the same purchaser.

Figure 12 -- Part Outright Sale, Part Gift to CRT



## E. Practice to Improve

As with any skill, you will improve the more often you use this new technique. Eventually, you will be able to create these diagrams and look casual as you draw them. I highly recommend that you use these diagrams even when you are discussing charitable plans on the phone and no one else can see your drawing.

Creating diagrams while on the phone not only improves your drawing skill, but also keeps you actively engaged in the conversation. The less time you spend writing words (because your picture is worth a thousand words), the more time you spend listening to your donor to catch the magic words that describe their charitable dreams.

Further, the combination of hearing the words, drawing the diagram and seeing the diagram improves your understanding and remembrance of the conversation.

**Slight Diversion Using a Different Tool but the Same Theme:** I was recently at a lunch meeting with a client who asked about life insurance trusts and estate planning. Instead of drawing on a napkin (I needed mine), I used the potato chips bag, lunch boxes and cookies as my visual examples.

We had three lunch boxes from a local sub shop and had previously joked about saving the chips and cookies for others in the office. I said that the lunch box was my estate and when I die, everything I still own will be collected by my executor and included in my estate. (I physically moved the cookie and potato chips into the box.)

Then, I said that I could create a life insurance trust during my life (I pulled over a second lunch box). I could add money to the life insurance trust each year to pay the annual premiums (I started moving items from the first lunch box into the second lunch box).

Then I said that when I die, my estate and my life insurance trust are completely separate entities (I pushed the two lunch boxes further apart) and my estate does not include whatever is in the life insurance trust.

Further, the life insurance trust now has cash from the death benefit on the policy and can purchase illiquid items from my estate such as my closely-held business.

My intention with this lunch box diversion is to show that you can use nearly any physical tool at your disposal to visually represent a complex planning strategy.

## F. Marketing

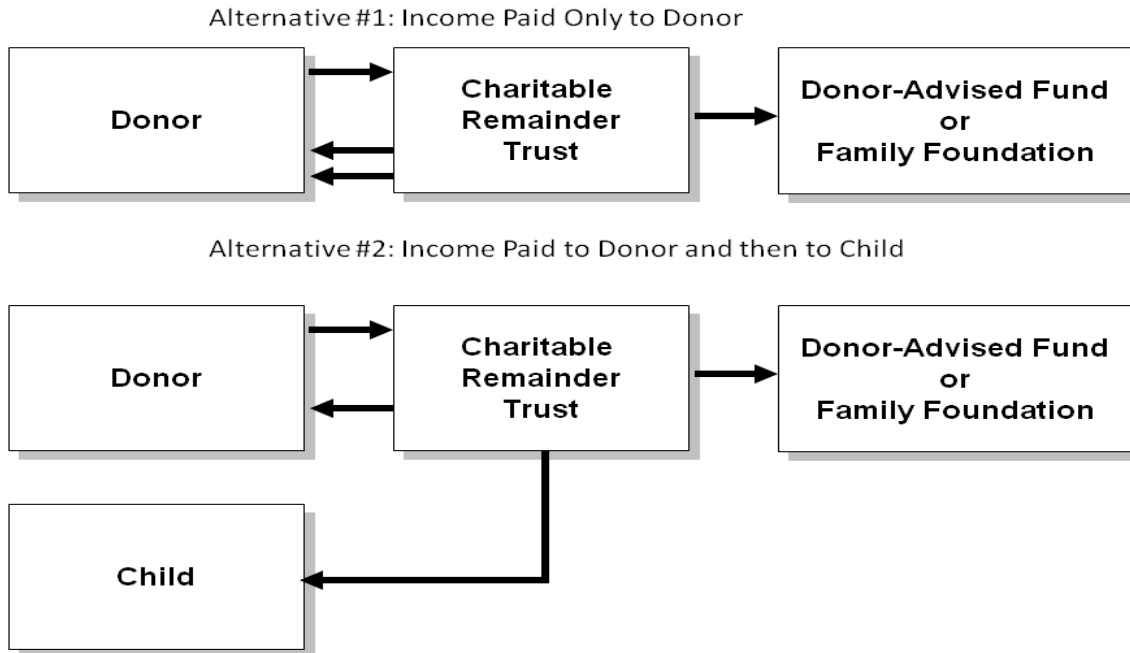
Another helpful hint is to draw your diagrams in a manner that parallels your organization's marketing materials. You want to portray a consistent message across all of your organization's communications, whether that message is on your website, in your newsletter or in your drawings.

If you can add color to your drawings, your donors will be more likely to remember the drawing in later conversations. If you can draw your organization's logo in the "charity" box, you also increase the likelihood that donors will remember your organization.

## G. Do Over and Duplication

If you don't like the drawing, tear it up and start over. These drawings do not have to be works of art. You can start over. Make several drawings if necessary to illustrate alternative options the donor could choose. Most donors will prefer a separate drawing instead of a single drawing that covers all options. An example of an alternate drawing is shown in Figure 13 -- Showing Two Alternative CRT Diagrams. Imagine your donor's confusion if you labeled a drawing with income to both the Donor and Child when your conversation was 90% about a CRT for the Donor only.

**Figure 13 -- Showing Two Alternative CRT Diagrams**



## H. Follow-up (AKA Compliance and Ethics)

My final helpful hint is to follow-up with the donor. Of course, you will want to follow-up to keep the conversation going. But, you will also need to follow-up for compliance purposes. Standards 2, 3, 5, 8 and 9 of the Model Standards of Practice for the Charitable Gift Planner<sup>4</sup> each touch on reasons why you need to follow-up with the donor. Because a simple diagram cannot provide a “full description and an accurate representation of all aspects” of the proposed gift plan, you absolutely must follow-up with a normal CRT illustration that includes a fuller description, adequate disclosures, how the donor can get more information about the proposal and encouragement to discuss the proposed gift with competent independent legal and tax advisors of the donor's choice.

<sup>4</sup> The Model Standards are available at a number of sources including [www.ncpg.org/ethics\\_standards/model\\_stds.asp](http://www.ncpg.org/ethics_standards/model_stds.asp).

## V. Magic Words Donors Say that Should Trigger a CRT Conversation

Donors want to make charitable gifts. They make gifts during life and at death. They make outright gifts and planned gifts. They give cash and complicated assets. Sometimes they give because their CPA tells them it makes financial sense and sometimes they give despite their CPA telling them it makes no financial sense. Through it all, donors give. The real questions are:

- How will they give?
- When will they give?
- Will they support *your organization*?

You need to listen to the magic words that donors say that should trigger a CRT conversation.

The easiest example is when a donor calls you ready to make the planned gift. Every organization that creates charitable gift plans has at least one story about a wonderful donor that simply mailed in a check along with the gift annuity application. I'll never forget the first time I got a \$75,000 check in the mail along with a CGA application. To my knowledge, we had previously only had passive conversations with this donor about CGAs.

Gifts that come in over the transom are nice, but the most rewarding charitable gifts are gifts where you looked the donor in the eye and worked with the donor to clarify their financial and charitable goals and then developed the charitable gift plan that met his unique needs, goals and dreams.

In his classic book on fundraising, [The Artful Journey](#), William Sturtevant describes what happens when donors reach the “stop and think” level in considering larger gifts. Sturtevant applies concepts from [Spin Selling](#) to fundraising. One of his key points is that as the size of the gift decision increases, the discussion becomes increasingly rational but the decision becomes increasingly emotional.<sup>5</sup> The donor’s “passionate belief”<sup>6</sup> in the charity will ultimately drive the charitable gift, but as the dollar value and complexity of the gift increases, you will need to provide additional documentation and illustrations and source material that support the gift.

When a complex charitable gift plan such as a CRT bogs down, you absolutely need to provide that documentation AND you need to return to what motivates the donor. For most gift plans, the motivation is the donor’s dream for the charitable portion of the gift. The basic diagram you created weeks or months (years !?!) ago provides a simple method for you to help the donor recall the key benefits of the CRT plan including the charitable impact he will make through your organization.

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<sup>5</sup> Sturtevant, William, [The Artful Journey](#), page 25, applying four key points from Rackham, Neil, [Spin Selling](#).

<sup>6</sup> Sturtevant, page 26.

## A. I Know a Donor Who. . .

I like to play a game in class with fellow gift planners that I call “I Know a Donor Who. . .” The basic rules are that someone describes a donor’s situation and goals, while the other planners provide solutions. However, when answering, you cannot use the name of the Planned Giving tool or Estate Planning technique that you propose would meet the donor’s goals. Obviously, you cannot use industry jargon such as CRT or ByPass Trust in your answer either.

The game begins now.

- I Know a Donor Who wants to support my organization with a \$150,000 gift in her estate and also needs to increase cash flow for herself and her husband during their lives.
- I Know a Donor Who wants to support my organization with a \$1,000,000 gift and also wants to ensure her three children get a lifetime cash flow they cannot outlive.
- I Know a Donor Who owns one stock valued at \$1,500,000 with a \$300,000 basis and that stock is 70% of his net worth. The donor loves your charity and 2 others in the city. The donor needs to increase his cash flow but wants to minimize taxes.
- I Know a Donor Who converted \$1,000,000 of her IRA to a Roth IRA earlier this year and is now faced with a large income tax bill for 2011 and 2012. She has several stocks in her portfolio and loves working in your church’s flower ministry and choir.

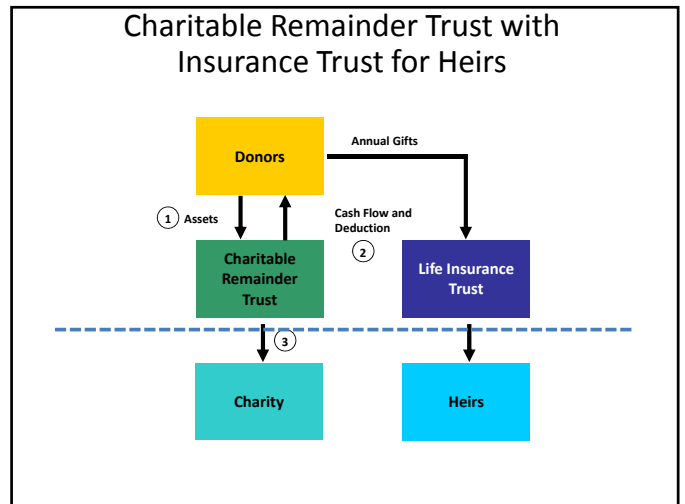
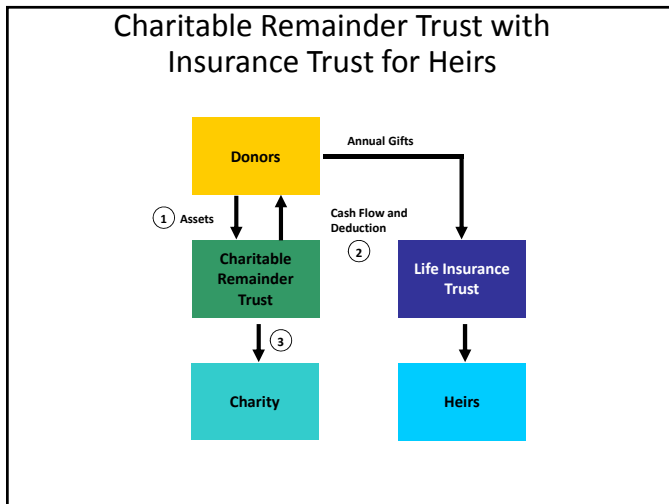
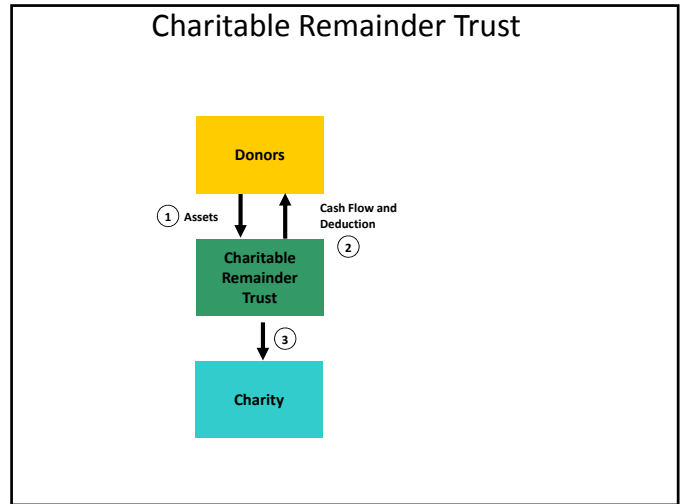
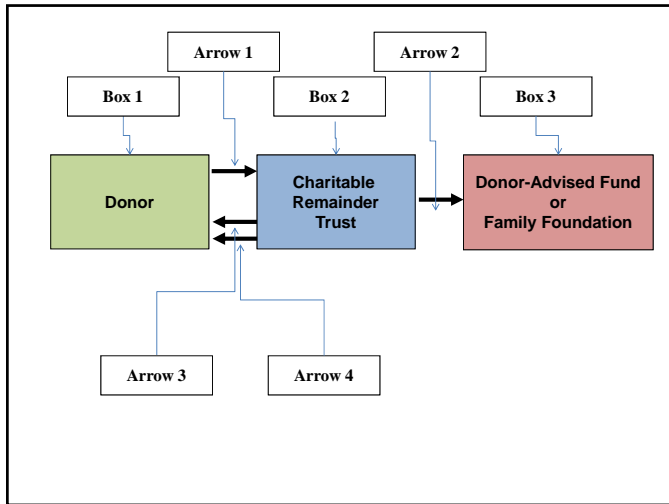
## Concluding Remarks

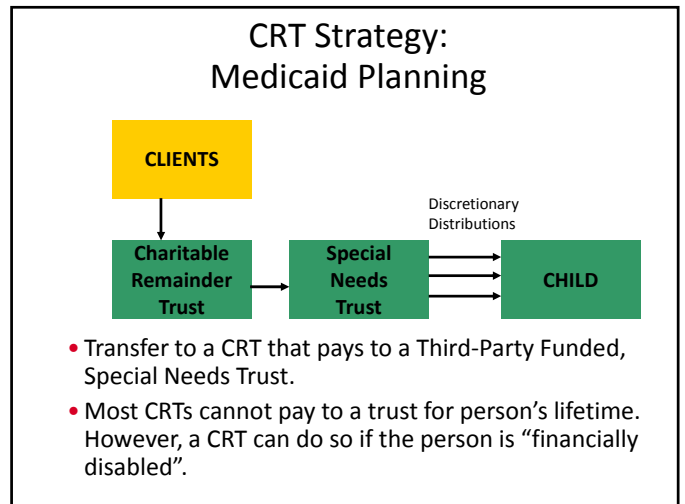
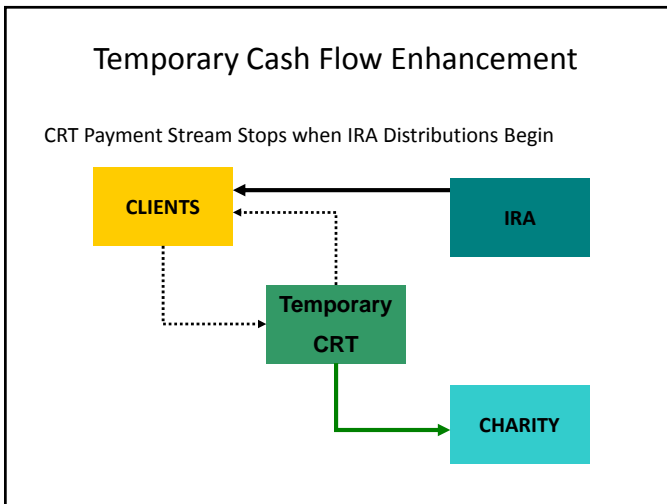
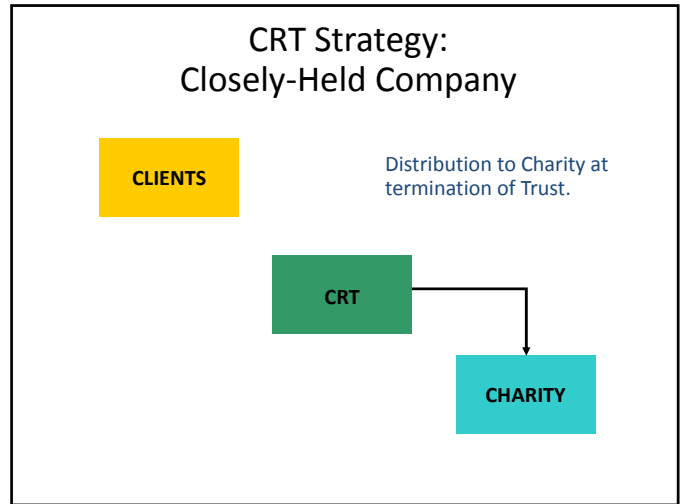
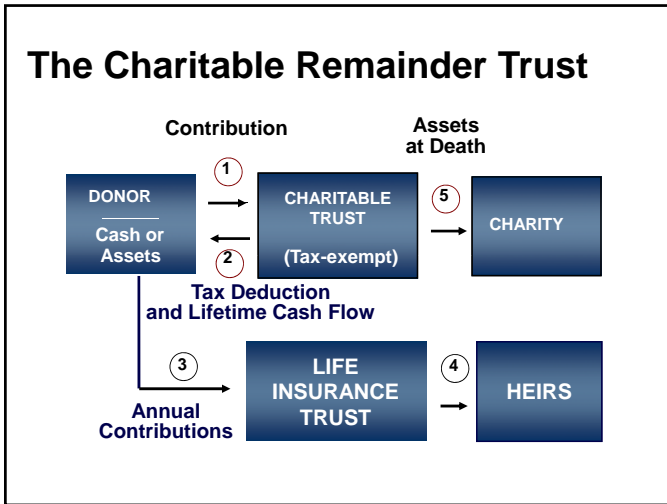
Your donors’ gift plans should reflect their interests. The overwhelming majority of Americans do make charitable gifts. Charitable Remainder Trusts are one of several common charitable tools that can be used with many of your donors.

CRT Planning on a Napkin is a simple way to explain to donors and board members how CRTs work. Yet, this technique is still flexible enough to cover the advanced topics that donors need to know to determine when a CRT is right for them. Listen for the magic words donors say so you can catch the CRT opportunities. Use your diagrams to explain CRT benefits to your donors and board members and you will find that your organization will create more CRTs.

# Appendix 1: Selected Examples of CRT Drawings

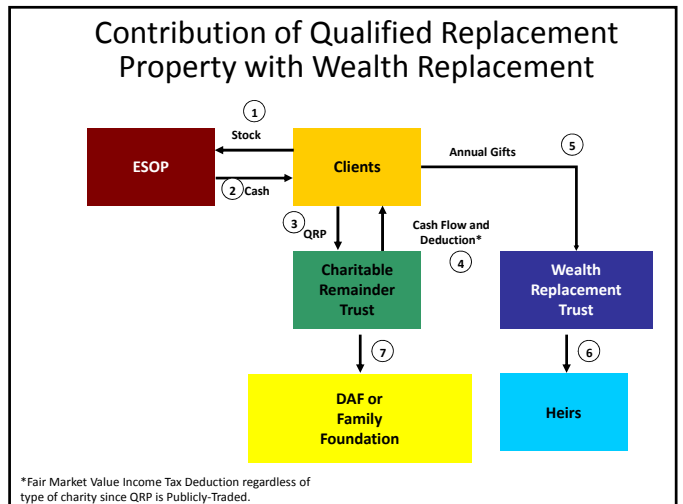
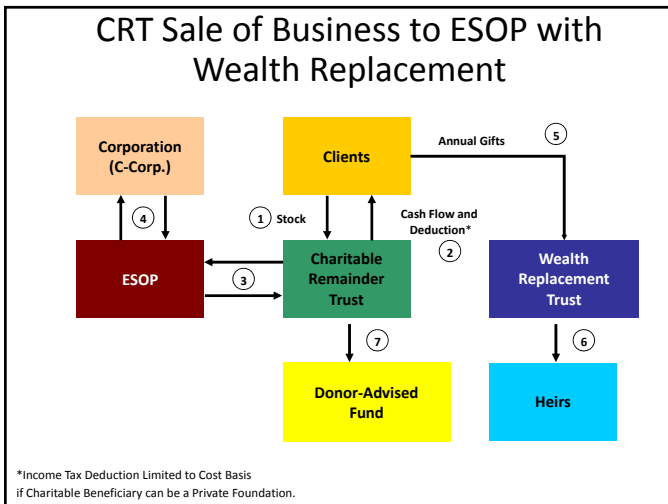
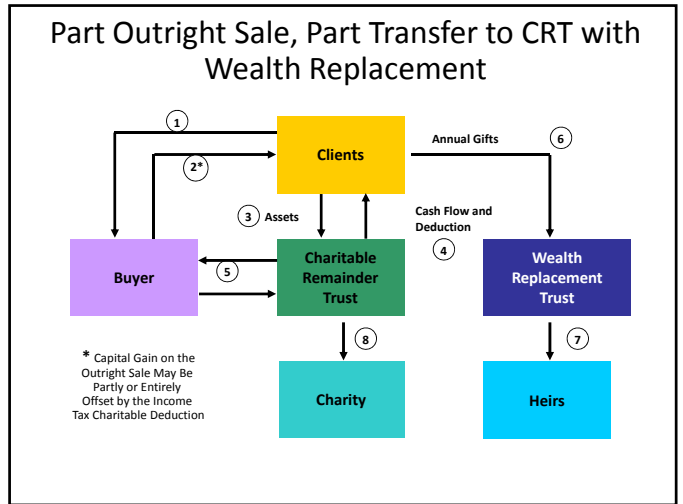
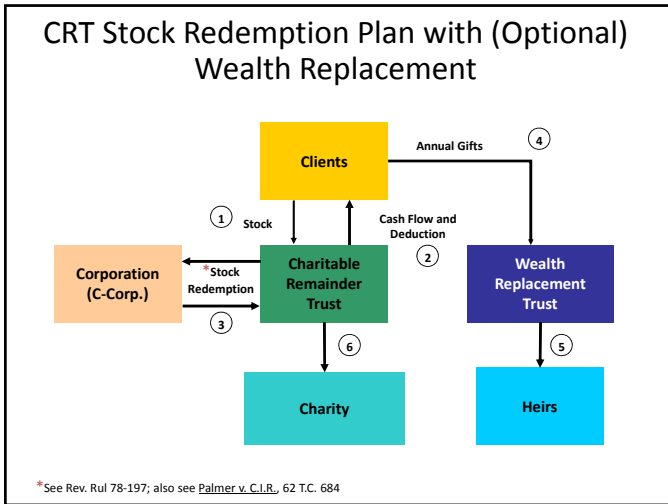
# CRT Planning on a Napkin: Appendix 1



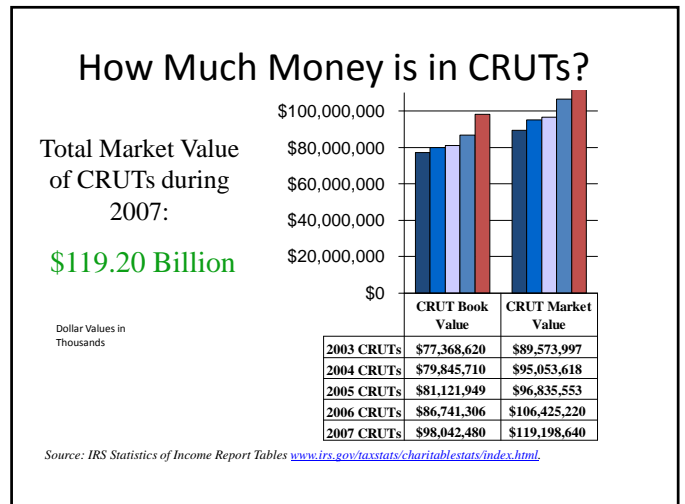
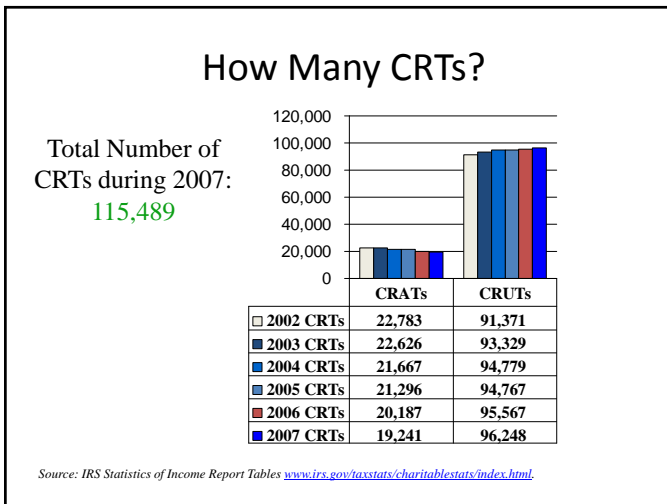
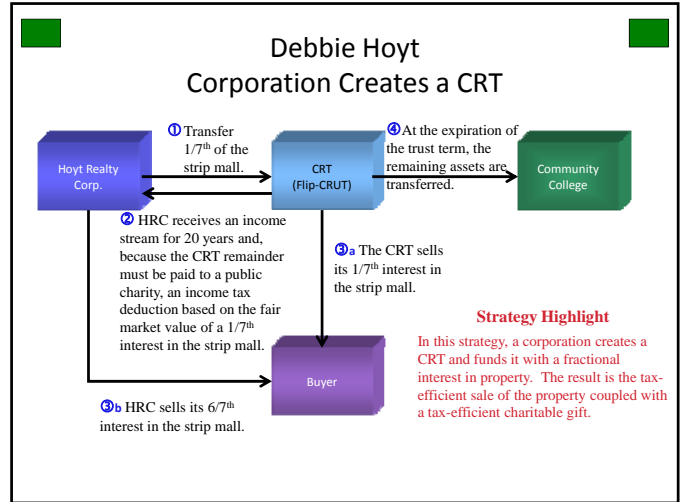
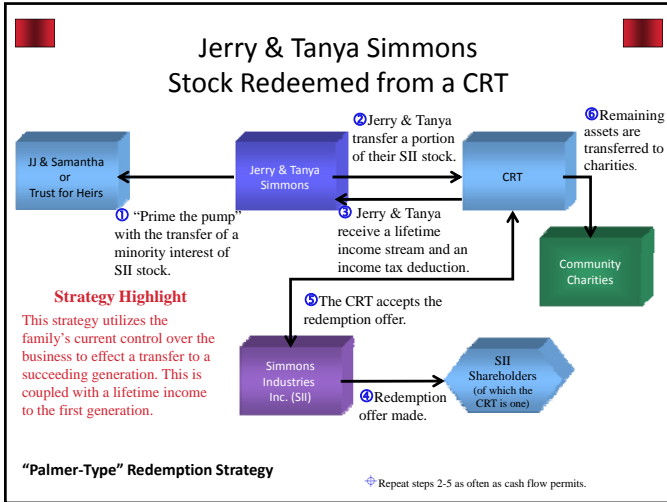




# CRT Planning on a Napkin: Appendix 1



# CRT Planning on a Napkin: Appendix 1



## Appendix 2: Selected Tidbits of Basic CRT Knowledge

A CRT is an irrevocable agreement in which a donor<sup>7</sup> transfers assets to a trust in exchange for an income interest<sup>8</sup>. The trust's remainder interest is designated for the benefit of one or more charitable beneficiaries, including public charities, donor-advised funds and private foundations.

### A. Types of CRTs

In order to qualify as a tax-exempt trust and provide the donor with an income tax deduction, the trust must specify that the income interest will be paid as a *fixed amount* (a **Charitable Remainder Annuity Trust** or CRAT) or paid as a *fixed percentage* of the trust's assets revalued annually (a **Charitable Remainder Unitrust** or CRUT).

Within the unitrust format, there are three varieties:

- **Standard Charitable Remainder Unitrust (SCRUT)**. As described above, a SCRUT must pay a *fixed percentage* of the trust's assets revalued annually. Therefore, as the value of the trust's assets rises and/or falls, payments to the trust beneficiaries will rise and fall.
- **Net Income with Make-up Charitable Remainder Unitrust (NIMCRUT)**.<sup>9</sup> A NIMCRUT differs from a SCRUT in three key aspects. First, in determining the amount of the payments to the income beneficiaries, the trustee must compare the fixed percentage unitrust amount to the trust's accounting income<sup>10</sup> and pay the *lesser* of these two amounts to the current income beneficiaries.<sup>11</sup> Second, for each year that the trust's accounting income is less than the unitrust amount, the difference (or deficiency) is accumulated as an amount that might be "made up" (i.e., the "make-up amount") in future years.<sup>12</sup> Third, for each year, payments of the make-up amount *must* be made to the extent that the trust's accounting income in any year exceeds the fixed percentage unitrust amount.
- **Flip Charitable Remainder Unitrust (Flip-CRUT)**. The life cycle of a Flip-CRUT is generally characterized by two phases. In the initial phase, a Flip-CRUT acts like a NIMCRUT and only distributes the trust's accounting income to the income beneficiaries. In the second phase, following the

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<sup>7</sup> For purposes of this paper, the terms donor and client will be used interchangeably.

<sup>8</sup> In some cases, the income interest may be designated to a person or persons other than the donor and the donor's spouse. See below for a discussion of the gift tax implications of this choice.

<sup>9</sup> Technically, another variation is the **Net Income Charitable Remainder Unitrust (NICRUT)**. Note that this version has no make-up provision. In the author's experience, most of the relatively few examples of this format were due to plan design and/or drafting errors. Nevertheless, valid uses of the NICRUT do exist.

<sup>10</sup> See IRC §643(b) for a definition of trust accounting income.

<sup>11</sup> See IRC §664(d)(3) and Treas. Reg. §1.664-3(a)(1)(i)(b).

<sup>12</sup> See IRC §664(d)(3) and Treas. Reg. §1.664-3(a)(1)(i)(b)(2).

occurrence of a predetermined triggering event,<sup>13</sup> the trust switches or “Flips,” to a SCRUT and pays out a fixed percentage of the trust’s annual fair market value. The change in the payout method commences on January 1<sup>st</sup> of the year following the triggering event. A charitable remainder trust can flip only once; and then, only from a NIMCRUT<sup>14</sup> form into a SCRUT form.

For example, if the triggering event is July 4, 2020, then the trust will act as a NIMCRUT until December 31 of 2020. It operates as a SCRUT starting the next year (January 1, 2021). Also, any NIMCRUT “make-up amount balance” that is not paid to the income beneficiary before the end of the year in which the triggering event occurs is “lost” forever when the trust becomes a SCRUT.<sup>15</sup>

See the enclosed tables for a summary of IRS statistics on CRTs. Based on these statistics, approximately 80% of all CRTs use the unitrust format. Note that the CRUT values include both Book Values and Market Values while the CRAT values include only Book Values because each type of trust reports slightly different numbers to the IRS.

**IRS CRT Statistics** (for Tax Years 2004 through 2007)<sup>16</sup>  
*Money amounts are in thousands of dollars*

	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Number of CRUTs (all types)</b>	96,248	95,567	94,767	94,779
Market Value of CRUTs	\$119,198,640	\$106,425,220	\$96,835,553	\$95,053,618
Book Value of CRUTs	\$98,042,480	\$86,741,306	\$81,121,949	\$79,845,710
Percentage of Total Number	83.34%	82.56%	81.65%	81.39%
<b>Number of CRATs</b>	19,241	20,187	21,296	21,667

<sup>13</sup> See Treas. Reg. §1.664-3(a)(1)(i)(d) for the permissible triggering events.

<sup>14</sup> Again, a NICRUT could be used during the initial phase of a Flip-CRUT instead of a NIMCRUT. See note 3 above.

<sup>15</sup> See Treas. Reg. §1.664-3(a)(1)(i)(c)(3). Note that the trustee could make a payment after the end of the year to the income beneficiary under the make-up provision rules, but only if such payment is with regard to the time when the CRT was governed by the NIMCRUT rules. For example, if the CRT converts to a SCRUT starting with the year 2012 and the CRT earns sufficient excess income during 2011, the CRT trustee must distribute such excess income to the income beneficiary. This is true even if the CRT trustee does not learn about the excess income until 2012.

<sup>16</sup> Sources: Internal Revenue Service, *Statistics of Income Bulletin*, Spring 2003, “Split-Interest Trusts, 2000,” Washington D.C. [www.irs.gov/pub/irs-soi/00spintr.pdf](http://www.irs.gov/pub/irs-soi/00spintr.pdf); Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2003-2004, “Split-Interest Trusts, 2001,” Washington D.C. [www.irs.gov/pub/irs-soi/01trust.pdf](http://www.irs.gov/pub/irs-soi/01trust.pdf); Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2004-2005, “Split-Interest Trusts, 2002,” Washington D.C. [www.irs.gov/pub/irs-soi/02eorust.pdf](http://www.irs.gov/pub/irs-soi/02eorust.pdf); Internal Revenue Service, *Statistics of Income Bulletin*, Spring 2006, “Split-Interest Trusts, Filing Year 2004,” Washington D.C. [www.irs.gov/pub/irs-soi/04spintr.pdf](http://www.irs.gov/pub/irs-soi/04spintr.pdf); Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2006-2007, “Split-Interest Trusts, Filing Year 2005,” Washington D.C. [www.irs.gov/pub/irs-soi/05spintr.pdf](http://www.irs.gov/pub/irs-soi/05spintr.pdf); and Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2008, “Split-Interest Trusts, Filing Year 2006,” Washington D.C. [www.irs.gov/pub/irs-soi/06spstrust.pdf](http://www.irs.gov/pub/irs-soi/06spstrust.pdf); Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2009, “Split-Interest Trusts, Filing Year 2007,” Washington D.C. [www.irs.gov/pub/irs-soi/09winbultrusts.pdf](http://www.irs.gov/pub/irs-soi/09winbultrusts.pdf); and Internal Revenue Service, *Statistics of Income Bulletin*, Winter 2010, “Changing Times: An Analysis of the 2007 Revision of the Split-Interest Trust Information Return,” Washington D.C. [www.irs.gov/pub/irs-soi/10winbulchangingtimes.pdf](http://www.irs.gov/pub/irs-soi/10winbulchangingtimes.pdf).

**IRS CRT Statistics** (for Tax Years 2004 through 2007)<sup>16</sup>

*Money amounts are in thousands of dollars*

	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Book Value of CRATs	\$8,931,574	\$9,080,252	\$9,041,175	\$9,540,935
Percentage of Total Number	16.66%	17.44%	18.35%	18.61%
<b>TOTAL NUMBER OF CRTs</b>	115,489	115,754	116,063	116,446
Total Book Value of CRTs	\$106,974,054	\$95,821,558	\$90,163,124	\$89,386,645

**IRS CRT Statistics** (for Tax Years 2000 through 2003)

*Money amounts are in thousands of dollars*

	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Number of CRUTs (all types)</b>	93,329	91,371	89,874	84,201
Market Value of CRUTs	\$89,573,997	\$84,697,749	\$100,268,578	\$88,462,299
Book Value of CRUTs	\$77,368,620	\$81,564,412	\$84,282,040	\$71,008,793
Percentage of Total Number	80.49%	80.04%	79.65%	78.79%
<b>Number of CRATs</b>	22,626	22,783	22,958	22,669
Book Value of CRATs	\$9,464,536	\$9,596,835	\$10,177,555	\$10,547,242
Percentage of Total Number	19.51%	19.96%	20.35%	21.21%
<b>TOTAL NUMBER OF CRTs</b>	115,955	114,154	112,832	106,870
Total Book Value of CRTs	\$86,833,156	\$91,161,247	\$94,459,595	\$81,556,035

**B. How CRTs Work**

In its most basic form, a charitable remainder trust consists of an arrangement between four parties: 1) a donor; 2) a trustee; 3) an income beneficiary; and 4) a charitable remainder beneficiary. While all four parties can be separate entities, it is possible for the donor, trustee and income beneficiary to be the same person. It is also possible for the charitable remainder beneficiary to serve as the trustee. The donor enters into a trust agreement with the trustee to transfer certain assets to be managed and maintained by the trustee. In accepting the assets, the trustee agrees to pay from the trust's assets an income stream to one or more designated income beneficiaries for a specified period of time. At the expiration of the trust term, the trustee delivers the remaining trust assets to the charitable remainder beneficiary. From 1969 through December 31, 2006, the CRT's tax-exempt status was preserved so long as the CRT did not produce "unrelated business taxable income."<sup>17</sup> As discussed elsewhere in this paper, the interplay between UBI and CRTs changed on January 1, 2007.

**The Donor.** Any individual, corporation, partnership, LLC or trust can be a donor. An individual donor can create a CRT during life or at death. Transfers to a CRT

<sup>17</sup> See IRC §664(c) and §§511 through 514.

may qualify for a charitable deduction for income, gift, estate and generation-skipping transfer (GST) taxes.

**The Trustee.** The CRT trustee may be an individual or an institution such as a bank or charity. The donor may serve as trustee<sup>18</sup> so long as the donor-trustee cannot exercise a grantor trust power such as a power to sprinkle income. The option of the donor to serve as trustee unbundles traditional trustee services (fiduciary decision-making, investment management and CRT administration), permitting the donor to hire best-in-class service providers for those services. Charities and banks can utilize this same outsourcing approach for investment management and CRT administration.

**The Income Beneficiary.** At least one CRT income beneficiary must be a person<sup>19</sup>, which includes individuals, corporations, partnerships, LLCs or trusts. Typically, the donor and the donor's spouse will be named as the only income beneficiaries for their joint lifetimes. In this case, the transfer to the CRT effectively removes the contributed asset and all growth in value of the asset from each donor's taxable estate.

Alternatively, the donor may elect to include one or more charities as co-income beneficiaries.<sup>20, 21</sup> This solution may be desirable when the donor wishes to currently benefit the charity or lower the payout below the 5% minimum payout rate permitted.

Occasionally, CRTs are established for a beneficiary other than the donor and the donor's spouse. Designing such a CRT creates significant gift, estate and/or GST tax ramifications that are discussed more fully below.

**The Charitable Remainder Beneficiary.** The charitable remainder interest in a CRT may benefit a public charity (e.g., alma mater, a religious institution, United Way, etc.) or a privately-controlled charity (e.g., a private foundation). A third possibility is to split the remainder interest among several charities such as "2/3 to my alma mater and 1/3 to my private foundation." In many CRTs, donors retain the power to change the charitable remainder beneficiaries. Naming the initial charitable remainder beneficiaries and retaining the power to change the charitable remainder beneficiaries should be guided by the donor's charitable goals.

**The Heirs.** Often the seemingly neglected fifth party to a CRT transaction is the donor's heirs. Because most CRTs are created for the benefit of the donor and the donor's spouse, heirs are left out of the equation without additional planning. This neglect can be, and often is, easily remedied by purchasing life insurance within an Irrevocable Life Insurance Trust (ILIT) to replace the assets transferred to the CRT.

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<sup>18</sup> See Rev. Rul. 77-285.

<sup>19</sup> See IRC §7701(a)(1).

<sup>20</sup> See PLR 200108035 for a discussion of the issues surrounding naming a charity as a CRT income beneficiary.

<sup>21</sup> If a charity is named as an income beneficiary, then the application of IRC §§4943 (excess business holdings) and 4944 (jeopardizing investments) must be required by either the trust's governing instrument or state law. IRC §4947(b)(3).

### C. Benefits to Donors

CRTs are flexible enough to solve a myriad of donor charitable, financial and non-financial problems. A best practice is to use a CRT to accomplish multiple donor goals. For example, CRTs can:

- Increase cash flow
- Avoid capital gain taxes
- Reduce income, gift and/or estate taxes
- Plan the donor's estate
- Transfer money to heirs
- Maximize charitable giving
- Diversify concentrated stock or other illiquid assets
- Preserve wealth for the family

Much of the power behind the CRT is based on its tax-exempt status and irrevocable nature. CRTs can be funded with a variety of assets including stocks, bonds, mutual funds, restricted securities, exchange funds, real estate in various forms, partnership interests, limited liability companies (LLCs), C-corporations, art and other tangible property. When combined with an ILIT, the CRT can solve many of your donor's noncharitable problems within a charitable context.

A CRT can enable donors to realize charitable goals that seem beyond their reach. For example, making a current gift to endow a chair in the donors' name at their *alma mater* may be infeasible, but by utilizing a CRT, this goal can be brought within the donors' grasp.

Often the same or multiple CRTs can be used again and again to address a donor's charitable, financial and non-financial goals.

### D. Benefits to Charities

CRTs are a bread-and-butter workhorse of any full-service planned giving program. The most obvious benefit for the charity is the charitable remainder distribution after the noncharitable term expires. Other benefits include enhanced donor relations (with the prospect of other current gifts), possible income beneficiary opportunities, testimonials, creating opportunities to engage donors with new and exciting programs, etc.

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