Case Study

# CHARITABLE REMAINDER TRUSTS

Charitable Planned Giving

STATE STREET GLOBAL ADVISORS

# Contributing to the Nonprofit Organization of Your Choice

With a charitable remainder trust, you place assets in a trust, are able to receive regular distributions from the trust, and identify a nonprofit organization to receive the assets at the end of the trust term. You may transfer assets such as cash, securities, or real property into a charitable remainder trust. The assets are then invested, and a distribution is intended to be paid to you, other non-charitable beneficiaries, or both, for life or a specified term of up to 20 years. At the end of this period, the trust's assets are transferred to the nonprofit organization.

## Profile of a Charitable Remainder Trust Donor

A charitable remainder trust (CRT) is an excellent way to fulfill your desire to support a favorite nonprofit organization with the goal of also supplementing your current income. Charitable remainder trusts may be appropriate for donors who want to:

- Defer capital gains taxes on highly appreciated assets
- Reduce the size of their taxable estate
- Benefit from income-tax deductions
- Earn an income stream

A charitable remainder trust is appropriate if you are confident that you will not need these assets during your lifetime and have already considered provisions for your family and heirs.

### Potential Benefits

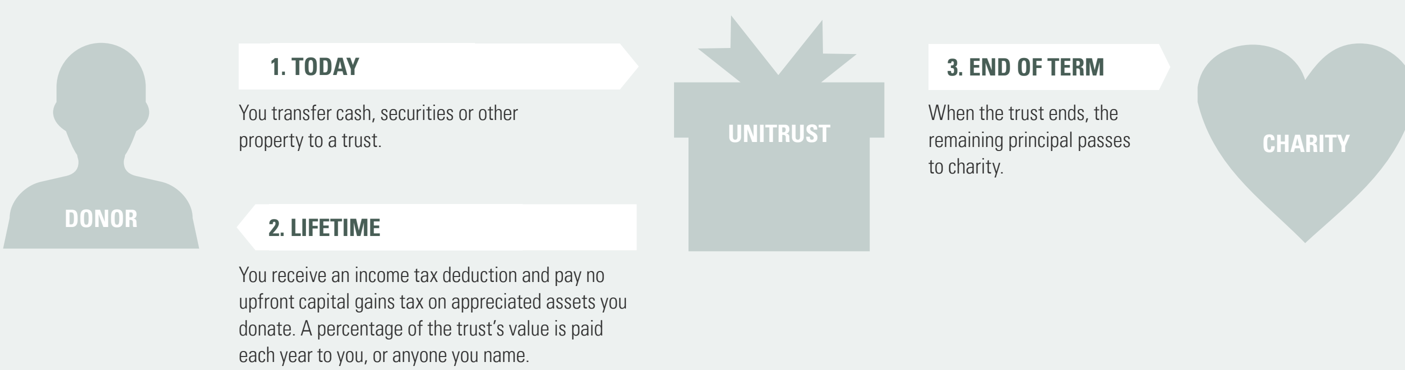
- Make a gift to charity
- Enjoy income based on trust value
- Enjoy lower capital gains taxes
- Receive an immediate tax deduction
- Realize estate tax savings
- Diversify your investment portfolio
- Benefit from professional investment of funds
- Defer income until retirement

**Immediate**
Income tax deduction and no upfront capital gains tax on appreciated assets.

**Annual**
Income will vary year by year based on market performance.

**Future**
Charity receives the remaining principal.

## How It Works




Diversification does not ensure a profit or guarantee against loss.

# Type of Charitable Remainder Trusts

You may choose from among several types of charitable remainder trusts, depending on your income and tax planning circumstances. In all cases, the trust can be established to run for the beneficiary's life expectancy or for a predetermined period of years.

## Straight Payout Unitrust

*Fixed percentage payments of at least 5%; principal can be used.*

A straight payout charitable remainder unitrust (CRUT) makes a payment each year to the individual or non-charitable beneficiary based on a fixed percentage (5% or greater) of the net fair market value of the trust's assets. The assets are valued once a year. If the net asset value of the trust increases, the annual payout also increases. Conversely, if the value of the trust declines, the annual payout also decreases.

If the annual income earned is insufficient to meet the CRUT's payout obligation, the principal of the trust is used to meet the difference. If more than the required income is earned, the excess income reverts to principal. The payout percentage cannot be changed once the trust is established, although you may donate additional assets to the trust at any time.

A straight payout trust is well suited for a donor who is looking for potential growth in both distributions and the remainder market value. The percentage payout also provides a simple format for expected payments.

## Net-Income-Only Unitrust

*Fixed percentage payments of at least 5% or actual income earned; principal cannot be used.*

With a net -income- only unitrust, the trust pays out either a fixed percentage of the net asset value of the trust or the actual net income earned, whichever is lower. In most cases, income is limited to interest and dividends earned. The principal of the trust will never be invaded to make payments to beneficiaries.

## Net Income with Make-Up Unitrust

*Fixed percentage payments of at least 5% or actual income earned; principal cannot be used; income shortfalls potentially reimbursed.*

This trust is similar to the net -income- only unitrust in that it pays out either a fixed percentage of the net asset value of the trust or the actual net income earned, whichever is lower. However, in years when the income is less than the fixed payout, this shortfall is "accumulated." If the net income is ever greater than the fixed payout, the shortfall may be "made up" and paid to the beneficiary in that year to the extent of the additional income.

## Flip Trust

*Starts as a net income trust and "flips" to a straight payout trust.*

This trust is a combination of a net income (or net income with make up) trust and a straight payout trust.

The trust starts as a net income trust and will, upon some triggering event, "flip" to become a straight payout in the next year. Flip trusts must always start as net income trusts and then flip to straight trusts; they cannot flip from a straight payout to a net income trust.

The triggering event can be any number of events such as a birthday, the death of a spouse or the sale of specific assets held by the trust, etc. The triggering event must be identified when the trust is created and can't be controlled by the trustee or any other person. For example, "retirement" is not a sufficient triggering event because a beneficiary can control the event. However, the beneficiary's 65th birthday is such an occurrence because it is a definitive event.

By combining the growth potential of a straight payout trust with a net income trust, the flip trust offers donors the flexibility for retirement planning and the ability to use illiquid assets, such as real estate, as a funding asset.

## Annuity Trust

*Fixed dollar payments (at least 5%); principal can be touched.*

As its name implies, the charitable remainder annuity trust (CRAT) each year pays the named beneficiaries a fixed dollar amount, or annuity. The amount must be specified in the trust instrument as either a dollar figure or a percentage of the initial fair market value of the assets used to fund the trust. This amount may not be less than five percent of the initial value. Once the annual payment of an annuity trust is specified, it is fixed and cannot vary during the life of the trust. The amount payable has no relation to the amount of income earned by the trust. Unlike the unitrust, no additional contributions may be made to an annuity trust after the initial contribution.

If the trust produces annual income greater than the amount of the required annuity, any excess will be added to the trust principal. Conversely, if the trust's investment income does not meet the required annuity amount, it must pay all or part of the annuity from principal. Thus, it is possible to eventually consume and terminate an annuity trust, depending on the size of the annuity, the term of the trust, and investment results. In this case, payments to the beneficiary would stop.

The trust will provide a fixed income stream each year.

# Important Issues

## Irrevocable Gift

When considering a charitable remainder trust, it's important to keep in mind that this arrangement irrevocably transfers your assets to the trust rather than to your family or heirs. Before making such a gift, it is important to consider the effect this irrevocable feature might have on your family's financial circumstances over the long term. Always consult with your legal and financial advisors before making a planned gift.

## Choosing a Beneficiary

There is no limit on the number of beneficiaries that can be named, but IRS regulations do require that a minimum of 10% of the original gift be left for charity. This can become an issue if several younger beneficiaries are named. Typically the donor and/or a spouse is named as the trust beneficiary; however, a brother, sister or a child can be named as well. It is important to note that the amount of the deduction will vary depending on the ages of the beneficiaries chosen. In addition, if the beneficiary is someone other than the donor or spouse, there may be gift tax issues. Beneficiaries can receive payments monthly, quarterly, semi-annually, or annually as specified in the trust document.

## Choosing a Payout Rate

The payout rate for a CRT will determine the amount the beneficiary will receive, the size of the charitable deduction, and ultimately the amount the charity will receive. Generally, the lower the payout rate, the higher the deduction and the greater amount for the charity.

### Taxes on Payments

The distribution received by the beneficiary is taxable income in the calendar year. The income is taxed based on a special method of accounting, and is based on the following tax tiers:

- Interest/dividends
- Short-term capital gains/long-term capital gains
- Tax-free income
- Return of capital

As the trust investments have earnings, the return is tracked in the appropriate tier and is accumulated. Each year the beneficiary payment is taxed based on how the income was earned. Because each tier accumulates on a year-to-year basis, the beneficiary must work through all of the accumulated earnings in each tier before moving to the next.

As an example, consider a trust funded with $100,000 cash, paying out $5,000 each year, and earning $3,000 of interest and dividends and $1,500 in realized long-term capital gains. The beneficiary's distribution would then be taxed in the following manner: $3,000 as ordinary income; $1,500 as long-term capital gains; $0 as tax-free income; and $500 as return of principal (no tax due).

# Financial Planning Considerations

**When you establish a CRT, you will receive a charitable income tax deduction in the year that the trust is established. The deduction is based on an actuarial calculation, which takes into account various factors including:**

- The fair market value of the assets when transferred
- The number and ages of the income beneficiaries (or term of years)
- The payout rate of the trust
- IRS discount ratio
- Timing of payments

You may carry forward any portion of the charitable deduction not used in that year for up to five additional years, within the limitations of the tax law.

In addition, if you transfer appreciated assets held for more than one year to a charitable remainder trust, you will defer capital gains tax that would have been due if you had sold these assets outside of the trust.

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* AUM reflects approximately $35.96 billion USD (as of June 30, 2019), with respect to which State Street Global Advisors Funds Distributors, LLC (SSGA FD) serves as marketing agent; SSGA FD and State Street Global Advisors are affiliated.

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[1] As of 06/30/2019.

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CAM@ssga.com | 800-635-9001

ssga.com/cam

**State Street Global Advisors** One Iron Street, Boston MA 02210.
T: +1 617 786 3000.

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