Mayo Clinic
Office of Gift Planning

The Power of CRTs

Arizona Planned Giving Conference
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YOUR PRESENTERS

The Power of CRTs

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http://plannedgiving.mayoclinic.org/

OBJECTIVES

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CRT Structures

- Review CRT potential planning ideas

CRT Assets

- Assets to fund a CRT and their tax consequences

CRT Administration and Investment Strategies

- Overview of Administration process and investment strategies

Why establish a CRT?

- A tool in the fundraising toolbox
- No income tax due upon gifting asset into a CRT
- Charitable income tax deduction
- Income payments
- Accomplish charitable goals

CRT STRUCTURES

A Review of potential planning ideas

Types of Charitable Remainder Unitrusts

- Type I – Standard (straight)
- Type II – Net income with makeup
- Type III – Net income
- Type IV – Flip unitrust

Charitable Remainder Unitrust – Protocols & Options

- Variable income
- Income beneficiaries
- Payment percentage
- Term
- Applicable federal rate
- IRS qualification
- Four-tier taxation
- Additional gifts

Charitable Remainder Annuity Trusts – Protocols & Options

- Annual income payments never change
- 5% probability test; 10% termination alternative
  - Potential problem with testamentary CRATs
- Options – similar to a CRUT, but some variations
  - Income beneficiaries, payment percentages, term, AFR, 10% remainder rule and four-tier taxation
- Funding assets & additional gifts
- Fairly easy for grantors to understand, making it popular
- Fairly easy for administration, so less likely to run into IRS issues

CRT ASSETS

Potential Assets and Their Tax Consequences

Assets to Consider: Good and Bad

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- Cash
- Appreciated Securities
- IRAs
- Real Estate and Income Producing Properties
- Business Interests
- Tangible Personal Property
- Farm equipment, crops, etc. (Green Unitrust)
- S Corp Stock
- Crypto Currency

Funding Asset Tax Consideration

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- Income tax deduction limits
- Appreciated assets can be great options
- Qualified appraisals for appreciated assets

CRT ADMINISTRATION AND INVESTMENT STRATEGIES

Overview of Administration Process and Investments

Trust Administration Process at Mayo

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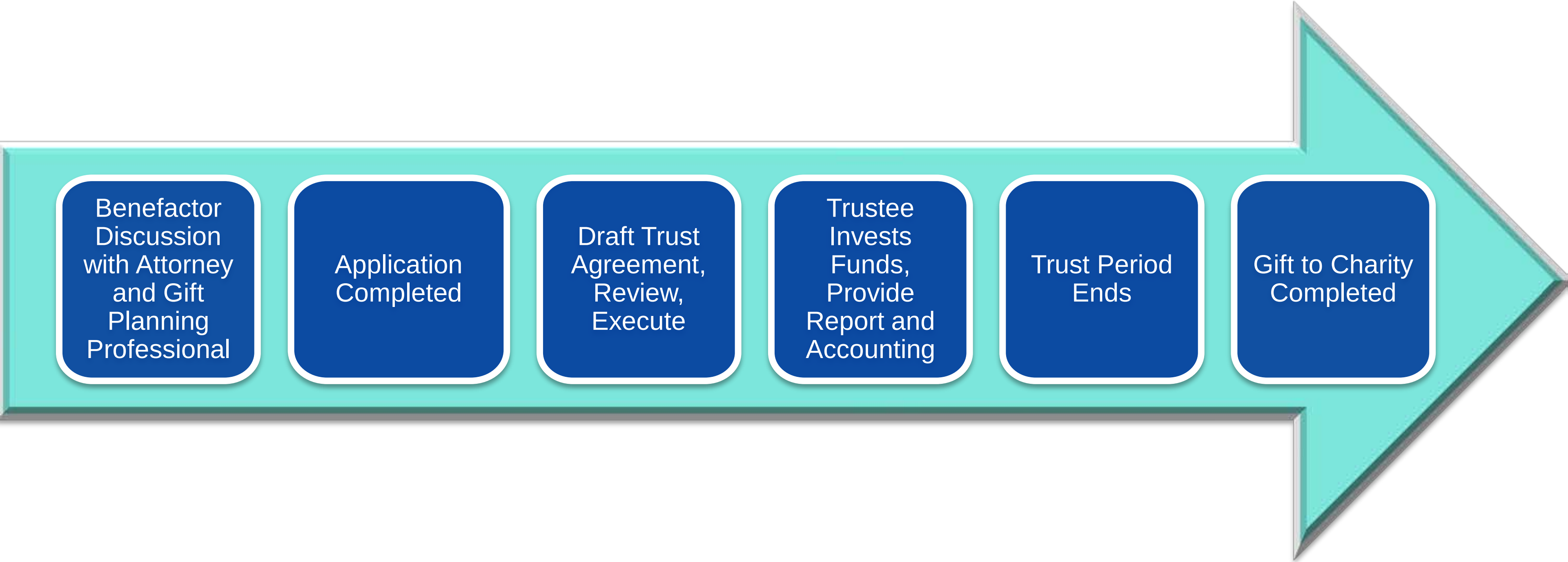

CRT Administration

- You have options!
  - Charity Trustee
  - Outside Professional Trustee

- Nuances of Charity serving as the Trustee
  - Charities have specific internal rules

- Investment Considerations
  - Balance income needs and charity residuary protection
  - Payout percentage and trust length can impact allocation decisions
  - Impact of low interest rates

Trust Investment at Mayo

- Investment Allocations (Equity/Fixed Income Split)
  - Aggressive Growth (84% / 16%)
  - Growth (71% / 29%)
  - Growth/Income (57% / 43%)
  - Income/Growth (39% / 61%)
  - Income (16% / 84%)

- Long Term Investment Strategy

- Taking Fees and Payment Optimization into consideration

Trust Taxation Considerations

- Tax accounting overview

- When funding trust with appreciated assets, avoid capital gains taxes by placing full value of asset in trust

- Trust distributions are taxed under four-tier tax system
  - Ordinary Income
  - Capital Gain
  - Exempt Income
  - Distribution from Principal

EXAMPLES

Real World Trust Situations

CRUT Funded with Appreciated Securities

- Benefactor leaving estate gifts to adult children, but wants to assist them now financially
  - Adult child #1 – three children
  - Adult child #2 – one child
  - Adult child #3 – not married; no children
- Desire to support Mayo Clinic in the future
- Securities with significant capital gain (long-term)
- Mayo's 30/30 rule for serving as trustee
- Unitrust term, income percentage & unique payment structure
- Gift tax

CRUT Funded with Income Producing Real Estate

- Sale of highly appreciated rental real estate: looking for tax reduction ideas
- Benefactor researched and suggested a charitable lead trust to also support Mayo
- Learned of second highly appreciated real estate property
- Moved from CLT to CRUT
- Bypass capital gains tax, offset tax on sale of 1st property & provide retirement income
- Depreciation impact: straight-line vs. accelerated methods
- Charitable income tax deduction - reduction rules
- Tax implications upon sale of property by trustee and held within CRUT

CRUT Funded with Income Producing Real Estate (con't.)

Property Information	
Appraised Value	$1,750,000
Original Cost Basis	$170,000
Total Depreciation	$110,000
Book value on 12/29/2021	$60,000
Straight-Line Depreciation	$103,000
Accelerated Depreciation	$7,000
Funding the CRT	
Trust Funding	$1,750,000
Value used to determine the charitable income tax deduction	$1,743,000

CRUT Funded with Income Producing Real Estate (con't.)

Four-Tier Accounting Initial Values (inside the CRT)					
Ordinary income	$0				
Capital Gain (detailed per below)	$1,690,000				
Accelerated Depreciation Recapture		$7,000	Taxed as ordinary income		
Capital Gain attributable to Straight-Line Depreciation		$103,000	Taxed as capital gain at 25%		
Long-term Capital Gain		$1,580,000	Taxed as capital gain		
Principal	$60,000				

CRUT Funded with Commerical Building

Fact Scenario:

- Commercial Building – Box Store
- Triple Net Lease
- Benefactor Used Property to Fund a 5% CRUT

CRUT Funded with Farm Equipment

Lessons Learned

- Unmarketable properties
- Providing Benefactor flexibility where possible
- Communication is key!

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REFERENCES
AND ADDITIONAL MATERIAL

Gift Tax – Completed Gift to a Non-Spouse

- A gift to fund a unitrust which provides an income payment for a non-spouse creates a "completed gift" to that non-spouse, resulting in possible gift tax implications to the benefactor funding this gift vehicle
- The gift is "completed" upon funding the gift vehicle; the gift amount would be equal to the present value of the stream of income payments owed to that non-spouse over the life of the funding vehicle
- The gift amount to the non-spouse would first be reduced by the annual exclusion of $16,000 (if not already used), and then the remaining balance would reduce the gift/estate tax exemption amount provided to all individuals, which is $12.06 million in 2022; the exemption amount for a married couple is $24.12 million

Gift Tax – Completed Gift to a Non-Spouse (con’t)

- If the annual exclusion and/or the exemption amount are available to absorb the completed gift, no gift tax is due
- If both the annual exclusion and exemption amount have been used up prior to the completed gift being created, gift tax would be due
- Since the entire gift to the non-spouse would have been recognized by the benefactor at the time the gift vehicle was funded, there would be no estate tax issues for the benefactor

Gift Tax – Incomplete Gift to a Non-Spouse

- A gift to a non-spouse can be made an “incomplete gift” when the benefactor funding the gift vehicle keeps a testamentary power of revocation over the non-spouse’s income interest; this power can only be exercised by providing for this revocation in the benefactor’s will
- Since this revocation power makes the gift incomplete, there is no gift tax due upon the funding of the gift vehicle
- Taxable gifts to the non-spouse, which are completed gifts, are the income payments to the non-spouse each year for the amount that exceeds the annual exclusion
- The remaining balance of the annual completed gift would reduce the gift/estate tax exemption amount provided to all individuals, which is $12.06 million in 2022; the exemption amount for a married couple is $24.12 million

Gift Tax – Incomplete Gift to a Non-Spouse (con't.)

- If the annual exclusion and exemption amount have been used up prior to the completed gift being created, gift tax would be due
- If the revocation power is not used, the value of the gift vehicle would be included in the estate of the benefactor at the benefactor's death
  - The present value of the future stream of income payments due the non-spouse at the benefactor's death would be included in the benefactor's estate for estate tax calculation purposes
  - The charitable portion of the unitrust would reduce the benefactor's estate for estate tax calculation purposes

Gift Tax – Incomplete Gift to a Non-Spouse (con’t.)

- If the revocation power is exercised, the value of the gift vehicle would be included in the estate of the benefactor at the benefactor’s death
  - There would be no more income payments to the non-spouse
  - Since no more payments, the trust would be distributed to the charity at the benefactor’s death
  - There is no estate tax due, as the entire amount included in the estate is offset by the charitable deduction provided by the gift to charity at the benefactor’s death

CRUTs vs. CGAs: CGAs

- Gift to fund a CGA is made directly to the charity
  - Minimums are low, such as $5,000 or $10,000
- Cannot add gifts to a CGA; simply create new CGA
- One or two lives are only term options
- When low AFR, income tax deduction lower than for a similar unitrust
- Payments usually determined by the American Council on Gift Annuities (ACGA); payment amount never changes
- CGA with annuity payments for non-spouse funded with appreciated securities (long-term) generates immediate capital gain for grantor on annuity portion; capital gain on charitable portion is bypassed

CRUTs vs. CGAs: CGAs (con't.)

- Invested with other CGAs, but tracked separately
- Residual value at end of all annuitants' lives then used by charity
  - No additional charitable organization beneficiaries allowed
- Annuity payments are backed by full financial faith of the charity
- Simple legal agreement between benefactor and charity
- If management fees, would not affect determination of annuity payment amount
- 1099-R tax form – all income status for life known at creation of CGA

CRUTs vs. CGAs: CRUTs

- Gift to fund the CRUT is made directly to the CRUT (a separate entity)
  - Minimums are often $100,000 or higher
- Can add gifts to a CRUT
- Numerous income beneficiaries are possible
- When low AFR, income tax deduction higher than for a similar CGA
- Numerous term options – life or up to 20 years, plus variations
- Payment percentage options; impacts remainder interest
- Payment amounts change each year based on CRUT year-end value
- CRUT with income for non-spouse funded with appreciated securities (long-term) bypasses entire capital gain for grantor when asset transferred into trust

CRUTs vs. CGAs: CRUTs (con't.)

- Invested separately from other trusts
- Residual value at end of trust term distributed to one or more charities
- Charitable beneficiary changes may be made during term of trust
- Payments are backed only by the assets held in the trust
- Complex legal agreement
  - must have a trustee - charity may/may not serve
- Management fees likely – various trustee options available
- K-1 tax reporting – income status of payments varies each year

Helpful Code References

- Standard CRUT – Rev. Proc. 2005-53 and § 664(d)(2) of the Internal Revenue Code
- Flip CRUT – Rev. Proc. 2005-54 and § 664(d)(2) and (d)(3) of the Internal Revenue Code
- A CRUT is a trust that provides for a specified distribution to one or more beneficiaries, for life or for a term of years (not to exceed 20 years), with an irrevocable remainder interest paid to charity. [Treas. Reg. 1.664-1(a)(1)(i)]
- Treasury Regulation Sec. 1.664-3(a)(1)(i)(d) and (e), and the IRS provide guidance as to what constitutes a permissible triggering event for a Flip CRUT
    - Among the specific possibilities listed are “the sale of unmarketable assets as defined in § 1.664-1(a)(7)(ii), or the marriage, divorce, death, or birth of a child with respect to any individual.”

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THANK YOU

QUESTIONS AND DISCUSSION