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There are many offshoots of a CRAT, such as a Charitable Remainder Uniform Trust (CRUT). In contrast to a CRAT, the payout provided to the noncharitable beneficiary from a CRUT can be either a fixed amount or a percentage of the FMV of the trust ...

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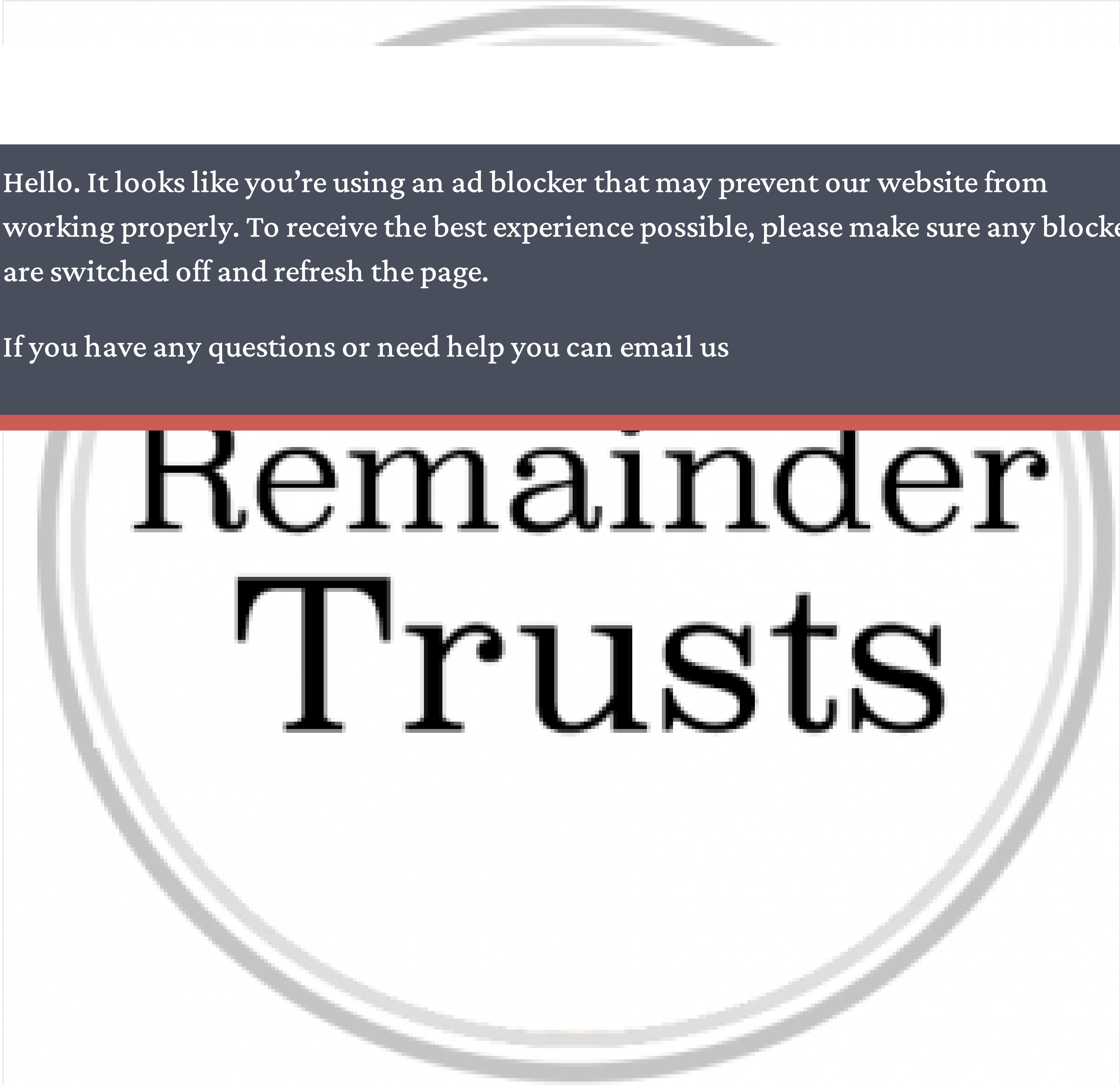

I have a client that is a doctor. He is looking for a way to pay for his kid's private school and make it tax deductible. Tax planning for the ultra-wealthy has some challenges but can be very rewarding for the client. Charitable Remainder Annuity Trusts (CRATs) are very useful financial arrangements for individuals who hold highly appreciated assets.

Basically, the taxpayer starts a CRAT and contributes their appreciating assets to the trust. For example, let's say your client has stocks, bonds, or mutual funds, and they have a basis of $1 million. When sold, they will be sold for $2 million. Your client contributes those assets to the CRAT for their basis. Once the assets are contributed, the CRAT sells them for $2 million. The taxpayer avoids the $1 million capital gain. The term of the CRAT can be anywhere between 10 to 20 years. In my client's case, we made the term 14 years, which was enough time to get his children through private school. The CRAT pays the beneficiaries (the children) an annuity of 5% per year,

assets each year. In the latter case[1], the trust is revalued annually and the pre-established percentage is distributed to the beneficiary. This will cause the amount paid to the recipient to fluctuate both up and down during the life of the trust. Additional contributions may be made to a CRUT (if it is not of the fixed amount variety) subsequent to the initial contribution, assuming the trust instrument includes a formula for incorporating the additional contributions into the unitrust calculations.

For example, I have another client that doesn't believe in investing in stocks. His assets are all in cash. He can make contributions to the CRUT every year, provided that the formula is recalculated annually.

In some years, the income generated by a CRUT may be insufficient to allow for the required payout to a donor without invading the trust's principle. To address this issue, Reg. 1.664-3 allows a modification to the CRUT. A net income with a makeup charitable remainder unitrust allows the payout to be limited to trust income in such "lean" years and provides a provision wherein the trustee can "makeup" the lean years' shortfalls from future years to the extent that trust income exceeds the required payout percentage in that subsequent year.[2] The regulation also allows for a net income without a makeup charitable remainder trust. With this, the annual payout is limited to the income generated by the trust from that current year. However, there is no feature allowing a makeup of the shortfall from excess income in future years.

Another important factor that requires careful consideration when selecting which type of CRT to establish, is that in certain circumstances the trustee may be forced to make a distribution in kind. A distribution in kind is treated like a sale of the property distributed, causing the recipient to recognize capital gains on the property in kind distributed.[3] For example, since the payout in both a CRAT and a fixed sum CRUT is fixed, the trustee will be forced to invade principal and make a distribution in kind in years when the income is insufficient to meet the fixed dollar payout required. If the assets to be placed in trust are primarily non-income producing, such as land, a

which the trust makes the required annual payments to the non-charitable beneficiary or beneficiaries), the remainder of the principal in the trust goes to the specified charity. Note that by law, the remainder portion must represent a minimum of 10% of the FMV of the property as determined at the time the donation was made and the trust established.[6]

The important thing about these plans is that you can't invade the corpus of the trust. Typically, when the money or assets are contributed to the Irrevocable Trust, in whatever form it takes, the assets are then sold and invested into financial instruments that produce enough cash to pay the annuity to the beneficiaries of the trust.

Just like with any good tax law, there are rules:

CRATs and CRUTs are subject to the following provisions:

1. These trusts are irrevocable and since they are governed by state laws, their structure will likely vary from state to state. Therefore, a competent attorney with experience establishing trusts in the relevant state should be consulted when setting up such a trust.
2. The trust must benefit a nonprofit charity recognized under the Code.
3. At least 10% of the initial FMV of the assets placed in trust must ultimately go to the charity.
4. The trust is free to sell the assets if it chooses, without being subject to capital gains taxes. It can then invest the proceeds in other (presumably income-producing) assets.
5. Payments must be made annually, at a minimum. However, a CRT will not fail the requirements of a CRT if the payment is not made within the tax year the income is earned, as long as payment is made within a reasonable time after the close of the taxable year.[7]

6. All amounts distributed to the noncharitable beneficiary are includable in that

over the assets. But, before the trust is closed, the grantor can put restrictions on how the money can be used. Then once the money is gone, it's gone.

Furthermore, careful consideration must be given to the income needs of the client and beneficiaries. Even in the case of the CRUT which is reevaluated each year, for example, if the value of the assets held in the trust decreases, the donor's income will also decrease.

In conclusion, CRATs and CRUTs can be powerful instruments that can used for a variety of circumstances. It is crucial, though, that you first consider all the angles before recommending them to your clients.

[1] Section 664(d)(2)(A).

[2] Reg. 1.664-3(a)(1)(i)(b)(2) and Section 664(d)(3).

[3] Reg. 1.664-1(d).

[4] Regs. 1.664-2(a)(5) and 1.664-3(a)(5).

[5] Section 664(d)(1)(A).

[6] It was 5% under the old law—raised to 10% per Sections 664(d)(1)(D) and 664(d)(2)(D).

[7] Regs.1.664-2(a)(1)(i)(a) and 1.664-3(a)(1)(i).

[8] Section 664(b)(1) and Reg. 1.664-1(d)(1)(i)(a)