



Secondary Planning for CRTs

Charitable remainder trusts (CRTs) can be powerful tax-planning tools, particularly for clients with strong charitable intent.

Clients who set up CRTs have the ability to generate an up-front income tax deduction, defer capital gains, diversify concentrated positions, and convert an appreciated asset (or assets) into a lifetime income stream.

On the other hand, CRTs are highly inflexible assets. A CRT is “irrevocable” by law, meaning that its payout rate, income beneficiaries, and trust structure cannot change post-inception. Because CRTs are typically tied to a client’s lifetime, they can be in place for decades. For example, a CRT that’s set up for a client who is 50 years old might last forty years (or more). Because CRTs are irrevocable and life circumstances change, CRTs tend to fall out of alignment with a client’s needs and goals over time.

Most clients with CRTs don’t understand their full range of secondary planning options; they naturally assume that because their CRT is irrevocable, they’re stuck with it for life (or until the end of the trust term). It’s therefore becoming increasingly important for advisors to inform their clients with CRTs of all the

available secondary planning options, so that clients are in a position to make changes if the need arises.

CRT Income Interest Sale

If a client is looking to exit their CRT and/or get the most income possible, the best option is often to sell their income interest on the secondary market to a third-party buyer. By selling, most clients can get a premium to the present value of their income interest.

Clients can exit a CRT in a couple of ways in addition to selling — they can simply gift the income interest to charity (and receive a tax deduction in the process), or they can terminate the CRT, splitting the trust according to an IRS Formula — the so-called 7520 rules — between the income beneficiary(ies) and the remainder beneficiary(ies).

Because third-party buyers are not bound by the IRS 7520 rules, they are generally willing to pay more than a client would receive by terminating. Also, a termination can be a costly, time-consuming process to complete (6–9 months or more in some cases), while a sale can be finalized in 2–4 weeks.

Selling a CRT income interest tends to make the most sense for clients who:

- Need cash for an investment opportunity, a business or charity

- Desire increased flexibility
- Want to maximize the value of their CRT interest (sale proceeds > value of income stream)
- Wish to simplify their financial affairs
- Are going through a divorce
- Have a spouse that's passed away
- Are tired of waiting/paying for CRT tax returns
- Need cash for other reasons (e.g., grandchildren's college tuition)

CRT Rollover

Many clients would rather change something about their CRTs than exit their trusts entirely. By using their CRT income interest to fund a new CRT — an innovative new technique called a “CRT Rollover” — clients can, in effect, alter the terms and conditions of their trusts.

CRT Rollovers make the most sense for clients seeking to:

- Add children as income beneficiaries
- Add a spouse as income beneficiary
- Defer (highly) taxable income forced out by Standard CRUTs (SCRUTs)
- Increase total trust income
- Fix underperforming NIMCRUTs

Case Study 1: SCRUT to NIMCRUT, Add Daughters as Beneficiaries

Problem: A 63-year-old client was the sole lifetime beneficiary of a \$2,185,000 SCRUT with a 5% payout. She had plenty of income sources outside the CRT and did not like how the CRT was forcing income to her. She was even more dissatisfied about the related tax, which in some years approached 50%. In addition, she had two daughters she would rather see benefit from the trust, but neither was listed as a beneficiary of the CRT. As it stood, everything in the trust was set to be distributed to charity upon her death, and her daughters would receive nothing.

Solution: Her advisors rolled her SCRUT income interest into a new NIMCRUT and added her two daughters as contingent income beneficiaries. Her attorney added structure to the NIMCRUT that allows her to decide whether to draw income from the trust. She can defer the distributions in full year after year (as she expects to do), and the trust will grow those deferred distributions tax-free over that time. If for some reason she needs income, in any year she can elect to take the accrued gain the trust has built up. At her death, her daughters will split the future distributions for their joint lifetimes. And because she plans to defer distributions tax-free over a 19-year period, her daughters will be receiving distributions from a much larger trust (her financial advisors estimate between \$3.5 and \$4 million).

Case Study 2: SCRUT to NIMCRUT, Add Daughters as Beneficiaries

Problem: A 75-year-old client was the sole beneficiary of a \$5,000,000 SCRUT with a 5% payout. He had set up the SCRUT shortly after divorcing his first wife, while he was still single. Several years later, he married a woman 10-years his junior. The client and his new wife relied on the distributions from the SCRUT, which constituted a large percentage of their overall income. As time passed, the client became increasingly concerned that his new wife would suffer a cut in living standards if he predeceases her, which is likely given their difference in age. As it stood, everything in the trust was set to be distributed to charity upon his death. The client needed to provide not only for himself and his wife during his lifetime, but also for his wife after he passes.

Solution: The client's advisors rolled his 5% SCRUT to a new 10% SCRUT and added the client's wife as an income beneficiary. Because the payout rate on the new SCRUT is higher, the couple expects to receive more income up front, during the husband's lifetime. By the time the husband is expected to pass away, the SCRUT will be distributing less income (unless the CRT can earn 10% each year). However, at that point, less income will be needed, since only his wife will be dependent on the SCRUT distributions. More importantly, the client can rest assured knowing that his wife will be taken care of after he passes.

For clients who have CRTs that are no longer a fit for their circumstances, a Rollover or sale of the income interest can be attractive options. Because CRTs are irrevocable assets that are typically tied to clients' lifetimes, most CRTs become misaligned with clients' situations at one point or another. Advisors should inform their clients of their ability to sell a CRT income interest or do a Rollover, should the need arise down the road.

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