ADVISOR'S QUARTERLY

Are Charitable Remainder Unitrusts Making a Comeback?

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When a donor establishes a charitable remainder unitrust (CRUT), he typically achieves several objectives. First, he commits to a future gift to charity when the trust terminates. Second, he creates a stream of income from the trust, one that typically continues for his lifetime and might be higher than what his donated assets were earning. Finally, he can contribute appreciated assets to the trust which, when sold, can be fully invested, avoiding the immediate capital gains tax that would result from selling the appreciated assets outside of the trust. For many years after their introduction in the Tax Reform Act of 1969, CRTs were popular gift planning vehicles.

The bursting of the tech bubble in the early 2000s dampened the appeal of CRUTs because many individuals experienced significant declines in the value of their investments. There were simply fewer appreciated securities to transfer into CRUTs. At about the same time, in 2001, the federal tax rate on long-term capital gains was reduced from 20% to 15%. The lowering of the capital gains tax rate reduced the tax cost associated with the sale of appreciated assets, which further reduced the appeal of CRUTs. Still, CRUTs remained an attractive charitable planning tool for those who held appreciated assets. For example, most real estate retained its value through the mid-2000s and was often used as a funding asset for CRUTs. In these cases, a donor could transform a non-income-producing asset such as a vacation home into an income stream from a CRUT, while also making a significant future gift to a favorite charity.

As interest in CRUTs began to decline in the early 2000s, the popularity of charitable gift annuities (CGAs) started to increase. The predictability of the fixed payments from CGAs was appealing to donors, as were the relatively high CGA rates. The severe market declines and the recession in 2008 and 2009 produced an even greater headwind for CRUTs and indeed for fundraising in general. Donors who were interested in life income gifts typically pursued CGAs.

More recently, beginning in the second half of 2012, there has been a noticeable increase in CRUT activity among Kaspick & Company's clients. During that six-month period, the proportion of total new gift dollars going to trusts exceeded 50% for the first time since the 12-month period ending June 30, 2008. This is in stark contrast to the 12-month periods ending June 30, 2011 and June 30, 2012 when just 40% and 33% of new gift dollars, respectively, went to trusts. In the fourth quarter of 2012, nearly 60% of life income gift funding went to trusts.

A number of factors are likely contributing to the resurgence of CRUTs and might foretell a continuation of this trend:

- Investment markets have been strong since 2008, with returns from the S&P 500 index in positive territory each calendar year from 2009 through 2012 (and in double digits for three of those four years). More individuals now have appreciated securities that can be used to fund CRUTs.

- The capital gains tax rate has increased for higher earners. Under the American Taxpayer Relief Act of 2012, the long-term capital gains tax rate increased from 15% to 20% for individual taxpayers with taxable incomes greater than $400,000 and for joint filers with taxable incomes greater than $450,000. Also, the new 3.8% tax on net investment income that was included in the Affordable Care Act brings the total levy on capital gains for some individuals to 23.8% beginning in 2013 (ignoring state taxes on capital gains). This higher capital gains tax rate means that investors with appreciated assets can realize a larger benefit if those appreciated assets are used to fund a charitable gift (by avoiding or deferring the capital gains tax). Additionally, ordinary income tax rates are now higher for many taxpayers, resulting in a lower after-tax cost of making a charitable gift.

- More people are entering the stage of life, their mid-60s to early 70s, in which a CRUT is typically a better choice than a CGA for a life income gift. As a result, the prospect pool for CRUTs is growing for many institutions. According to the Department of Health and Human Services' Administration on Aging, Americans aged 65 and older represented 12% of the population in the year 2000, but are expected to grow to 19% of the population by 2030. Based on U.S. census data, the number of people aged 65-75 rose from 18.4 million in 2000 to 21.7 million in 2010, an increase of 18%.

- Life expectancies continue to increase. In 1950, the life expectancy of a 65-year-old male was 12.8 years. By 2010, it had increased to 17.5 years—more than 35% longer. This trend is expected to continue, which means that retirees need to have sources of income that have the potential to grow. The ability for CRUT payments to increase with rising investment markets means that they can better keep pace with inflation when compared to the fixed payments of a CGA.

- Improvements in the economy, the labor market, and real estate values in the U.S. could lead to more confidence among donors in their financial well-being, which when combined with the recent strong investment markets, might lead to a greater willingness on the part of donors to make both outright and planned gifts.

After a prolonged period in which few CRUTs were established, it is important for gift planners to brush up on the key opportunities and risks that they should discuss with prospective CRUT donors. The Resource Center on Kaspick & Company's website, Kaspick Connect, includes many helpful articles, including *Standard Charitable Remainder Unitrusts: Disclosure of Key Investment Risks*. The article describes issues such as payment volatility, inflation, and investment returns, and is designed to be shared with donors.

Gift planners should also revisit their institution's gift acceptance policies for CRUTs to be sure they know the following:

- *The minimum gift size for a CRUT*. Most institutions have a minimum funding amount for CRUTs that is much higher than for CGAs. The typical minimum funding amount for a CGA among Kaspick & Company clients is $10,000. For CRUTs, it is $100,000.

- *The payout rates that your institution will accept for a CRUT*. Most Kaspick & Company clients will serve as trustee of a CRUT if the payout rate is between 5% (the minimum allowable) and 7%. In today's low interest rate environment, however, some institutions are accepting only 5% trusts. For CRUTs that have long horizons, a lower payout rate typically produces a better outcome for both the donor and the charity remainder beneficiary. Our article entitled *Choosing a Payout Rate for Your Charitable Remainder Trust* can help gift planners and donors understand the issues related to the payout rate choice. Kaspick & Company's Gift Advisor software, also available on Kaspick Connect, enables gift planners to model possible outcomes for CRUTs with different payout rates. Gift planners should work with their finance counterparts to discuss what payout rates can be offered to CRUT donors.

- *The minimum percentage (or amount) of the remainder interest that must be designated to your institution in order for it to serve as trustee.* Serving as trustee carries with it costs and risks. A charitable institution should be sure that it is fairly compensated if it serves in this role. Most Kaspick & Company clients will serve as trustee if the donor irrevocably designates at least 50% or 51% of the remainder interest to the institution.

With the economy, the markets, and demographics trending toward an environment that is more conducive to donors establishing new CRUTs, gift planners should consider how they will renew their promotional efforts for CRUTs using brochures, newsletter articles, their planned gift websites, and other media. It might also be useful to revisit your trust instrument templates to make sure that they are current and include the proper provisions to protect the interests of the donor, the income beneficiary, and the charity as trustee and remainderman. See our website for an article entitled *Refreshing Your Charitable Remainder Trust Templates*.