

## **Why Size Matters**

A primary objective in establishing and operating any CRT is to ensure the CRT will have enough money to make the required payments to its life income beneficiary(ies) each year throughout the trust term. Even with a low payout rate, in any given year trust income may fall short of the amount that needs to be paid. Unless the CRT is a charitable remainder unitrust (CRUT) with a net-income limitation, the CRT will have to make up the difference by drawing on principal.

Too many years of significant encroachment on principal can cause a trust to waste away. This process is often exacerbated in the case of a charitable remainder annuity trust (CRAT) because the amount it pays out each year is fixed. By contrast, with a CRUT the amount paid declines as trust principal declines. In any event, the less principal the trust has available for investment, the less diversification will be possible. This lack of diversification will lead either to more modest returns or to the assumption of greater risk in the quest for higher returns.

Important, as well, is ensuring that when the trust ends there will be a meaningful amount left for charity. This amount will be a function not only of how much the trust earns and how much it must pay to life income beneficiary(ies), but also of trustee fees and other expenses associated with managing the trust from year to year. Particularly if a CRT is small, these costs can sometimes total almost as much as the amount that must be paid to the life income beneficiary(ies).

## **In Search of Feasible Fees**

When it comes to funding a CRT, how much is enough will depend in great measure on who the trustee is. Financial services firms will likely charge the highest fees. For example, while a bank might feature a 1-percent annual fee, it might also have a minimum fee of \$5,000 each year. This would be a mere 1 percent of a \$500,000 CRT, but it would be a full 5 percent of a \$100,000 trust.

A charity willing and able to serve as trustee may well charge something less. This can end up being so even if the charity engages a financial services firm as a co-trustee or as an agent, provided the firm charges fees that take into account all

CRTs to which such an arrangement applies. Thus, if a bank already serves with a charity as co-trustee of 30 CRTs with a total of \$10 million in assets and charges fees that in the aggregate are a little over 1 percent, the fee associated with a new \$100,000 CRT might realistically be expected to come to around 2 percent (taking into account that certain fixed costs, such as those for preparing trust tax returns, will apply to each trust regardless of its size). Such fee arrangements may also be possible if a charity does not serve as trustee but merely encourages donors to use the services of a particular firm.

Another option is for the donor or a family member (or someone else the donor knows, trusts, and thinks will do a good job) to serve as trustee, possibly for little or no fee. Nevertheless, this approach to minimizing costs could have significant negative consequences if the person selected is not conscientious or lacks the necessary expertise. To a certain extent, investment and accounting expertise can be obtained at a reasonable cost to the trust, but the trustee must still coordinate and oversee whatever work is done by others.

### **Time for Plan B?**

In short, what is tolerable is going to depend on a variety of considerations. A CRT funded with \$100,000 might not fly if there are several relatively young beneficiaries, a 7-percent payout rate, and an institutional trustee. It might take wings, though, if there is only one life income beneficiary who is well on in years, the payout rate is 5 percent, and the donor's nephew the CPA is willing as a favor to serve as trustee for half his normal hourly rate. Yet if a donor wants to establish a CRT such as this latter one but can only manage to fund it with \$75,000, the gift plan may end up serving no one's needs.

True, if the CRT is a CRUT, it's possible to make subsequent contributions to the trust, but only if the donor ends up having the financial wherewithal to do so. Some small CRUTs - set up in the hope that better times lie ahead - languish when a longed-for affluence fails to materialize. Of course, if the CRT is a CRAT, no subsequent contribution can be made.

If a charity offers CGAs, a donor with his or her heart set on a CRT may be delighted to learn of this. Especially if the donor was contemplating a CRAT, the fixed-payment aspect should please the donor, along with the security of the payments, the favorable taxation of those payments, and the simplicity of the process. If the

donor was instead focused on a CRUT due to the potential for payments to increase over time, a CGA may be perceived as a consolation prize. In the case of a small CRUT, however, the increases would likewise be small, plus the payments might also decrease from one year to the next. Accordingly, when afforded some perspective, a CRUT donor might conclude that a CGA would be an acceptable fit, if not a perfect one.

A charity that does not offer CGAs – or even one that does – could also suggest something in the nature of a “poor man’s” gift annuity. A donor thinking of using \$80,000 to establish a CRAT might opt for using \$50,000 to purchase a commercial annuity and making a \$30,000 outright gift to the charity. To the extent the donor was thinking of using long-term appreciated securities, those with the most appreciation could be used to make the gift, in order to minimize the need to recognize capital gain in coming up with \$50,000 cash to pay the insurance company. The charity could even be named as the beneficiary of any value that might remain in the annuity contract upon death. Additional testamentary gifts to the charity might also be appropriate.

### **One Middle, Many Paths**

Quite often a donor intrigued by the notion of establishing a CGA will discover there’s a catch:

- only one charity can be a beneficiary
- payments can be made to no more than two persons
- long term capital gain in appreciated assets will be recognized up front if payments will be made initially to someone other than the donor
- payments must be for life, with no option for a term of years

In such situations, if the amount is realistic then the donor might welcome learning more about how a CRT could help fulfill his or her objectives.

Similarly, even a charity might have some reservations if the donor is thinking of contributing real estate (or some other illiquid asset) or if the donor has in mind a large contribution that would create a correspondingly large payment liability for the charity. To some extent, reinsuring some or all of the CGA would be one approach in this latter scenario, but a CRT might hold more appeal to the donor.

## Conclusion

Sometimes a donor's gift vehicle of choice just isn't going to be the right choice. In such an instance, a wise and skillful gift planner will use the occasion to clarify objectives and guide the donor through an examination of other possibilities. Of course, it may be that nothing else will work either. If indeed the donor is **stuck** in the middle, the integrity of our profession depends on acknowledging this and confirming for the donor that the best gift may be no gift at all – at least for the time being. If in the months or years to come the situation improves, the conversation can always be resumed.

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