

Understanding Charitable Trusts: How CRTs and CLTs Accomplish Philanthropic and Estate Planning Goals Simultaneously

What Donors and Their Advisors Need to Know About Charitable Remainder Trusts and Charitable Lead Trusts

For families who want to make meaningful charitable contributions while also addressing income needs, estate tax exposure, or wealth transfer goals, charitable trusts offer a structure that accomplishes both objectives within a single vehicle. The donor can direct assets toward a charitable purpose while also generating income, reducing taxes, or transferring wealth to family members in a tax-efficient manner.

The two primary structures in this category are the Charitable Remainder Trust (CRT) and the Charitable Lead Trust (CLT). The order in which the charity and the family are paid, and who receives what, determines which structure is appropriate for a given client's goals and circumstances.

Understanding how each structure works, when each is most effective, and what the planning and administrative considerations are is essential for advisors, attorneys, and families for whom philanthropy is a meaningful component of the overall estate plan.

What Is a Charitable Trust?

A charitable trust is an irrevocable trust that names both a charitable organization and one or more non-charitable beneficiaries as recipients of trust distributions. The trust can be created during the donor's lifetime or established at death through a will or a revocable living trust. Once created, the trust holds assets contributed by the donor and makes distributions according to a defined schedule, with the remaining assets ultimately passing either to the charity or to the family beneficiaries depending on which structure is used.

The Charitable Remainder Trust is a structure in which the non-charitable beneficiaries receive income distributions during the trust term and the charity receives whatever remains at the end. The Charitable Lead Trust mandates that the charity receives income distributions during the trust term and the remaining assets pass to the family beneficiaries at the end.

Core Features of a Charitable Trust

The trust is irrevocable once established, and the donor cannot reclaim the contributed assets or modify the trust's charitable purpose after funding. Within each structure, distributions may be fixed in dollar amount as an annuity trust or calculated as a percentage of trust assets annually as a unitrust. Charitable deductions are available at the time of contribution, though the amount and type of deduction depend on the structure chosen and the present value of the charitable interest. The trust must meet IRS requirements for qualifying charitable organizations to receive the associated tax benefits.

Why Charitable Trusts Are Used

Charitable remainder trusts are most commonly used by donors who hold appreciated assets and want to accomplish several planning objectives at once. When a donor contributes appreciated property to a charitable remainder trust, the trust can sell that property without incurring an immediate capital gains tax. The full proceeds remain in the trust and are reinvested to generate the income stream that will be paid to the donor or other non-charitable beneficiaries over the trust term. At the end of the term, whatever assets

remain pass to the designated charity. The donor receives a partial charitable income tax deduction at the time of contribution based on the present value of the remainder interest that will eventually pass to the charity.

Charitable lead trusts serve a different primary purpose. Rather than generating income for the donor, the CLT is designed to transfer wealth to family members at a reduced gift or estate tax cost while also supporting a charitable cause during the trust term. The charity receives income distributions for a defined period, and the remaining assets pass to the family beneficiaries at the end of that term. The taxable value of the gift to family members is reduced by the present value of the charitable distributions made during the term, which can result in a meaningful reduction in gift or estate tax liability depending on the size of the charitable interest and the applicable Section 7520 rate.

Who Uses Charitable Trusts

Some common uses for charitable trusts include:

- Donors with highly appreciated, low-basis assets who want to diversify without triggering an immediate capital gains tax.
- Individuals approaching retirement who want to convert an illiquid or concentrated asset position into a diversified income stream while also making a meaningful charitable gift.
- Families for whom charitable giving is a core value and who want to integrate philanthropy into the estate plan in a tax-efficient manner.
- Business owners planning a liquidity event who wish to contribute a portion of their pre-sale equity to a charitable remainder trust, capturing the capital gains deferral benefit and generating retirement income.
- Donors seeking to reduce the taxable value of gifts to family members through a charitable lead trust structure, particularly in lower-interest-rate environments where the charitable interest discount is most favorable.
- Families using a charitable lead trust in coordination with a dynasty trust or other long-term structure to pass wealth to future generations at a reduced transfer tax cost.

Advantages of the Charitable Trust Structure

For the charitable remainder trust, the central advantage is that the capital gains deferral described above allows the donor to convert a concentrated, illiquid position into a diversified income-producing portfolio without the tax drag that would accompany an outright sale. The assets that ultimately pass to the charity are removed from the donor's taxable estate.

For the charitable lead trust, the discount on the family gift grows as the Section 7520 rate falls, so the structure works best when interest rates are low. Any appreciation on the trust assets during the term passes to the family beneficiaries free of additional gift or estate tax, compounding the planning benefit for assets with strong growth potential.

Both structures also carry significant non-financial advantages for families who value philanthropy as part of their legacy. The charitable trust provides a formal, durable vehicle for charitable giving that reflects the donor's values, supports specific organizations over a defined period, and involves the family in a meaningful way in decisions about the charitable purpose the trust will serve.

Risks and Structural Considerations

Charitable remainder trusts carry a valuation risk that is built into the structure from the outset. At the time the trust is funded, the IRS requires that the present value of the remainder interest passing to the charity must equal at least ten percent of the initial contribution. If the trust is funded with assets that are expected to generate significant income over a long term, or if the payout rate is set too high, the trust may fail this ten percent remainder test, disqualifying it as a charitable remainder trust entirely. Careful actuarial analysis at the time of funding is essential to ensure the structure meets the IRS requirements.

Charitable remainder annuity trusts offer less flexibility than unitrusts because the distribution amount is fixed at the time of funding and cannot be adjusted for inflation or changes in the donor's circumstances. For donors who are uncertain about their income needs over time, the annuity trust's fixed distribution may prove to be either too much or too little as circumstances change. The unitrust form is generally more flexible, since distributions rise and fall with the trust's investment performance.

Charitable lead trusts involve a different set of tradeoffs. The donor does not receive an income tax deduction for contributing to a non-grantor charitable lead trust, though the contribution reduces the taxable estate over time. For donors who are primarily motivated by current income tax savings, the CLT may not serve that objective, and a charitable remainder trust or direct charitable contribution may be more appropriate. Additionally, if the trust assets underperform during the term of a charitable lead annuity trust, the fixed charitable distributions may consume a larger portion of the trust than anticipated, leaving less for the family beneficiaries at the end.

Finally, both structures require careful ongoing administration. The trustee must make the required distributions accurately and on time, maintain detailed records of trust income and charitable payments, and file the appropriate annual information returns with the IRS. A charitable trust that is not properly administered can lose its tax-exempt status or its qualification as a split-interest trust, with significant tax consequences for the donor and the beneficiaries. Coordination among the estate planning attorney, tax advisor, and trust administrator is essential from the time of drafting through the full term of the trust.

The Role of Jurisdiction in Trust Planning

Charitable trusts, by their nature, are designed to operate over defined terms that can span many years or decades. The administrative environment in which the trust is administered affects the quality and consistency of that long-term administration in ways that compound over time. A jurisdiction with modern trust statutes, experienced trust officers, and a stable legal framework provides a more durable foundation for a trust designed to serve both charitable and family objectives across an extended period.

South Dakota is the leading trust jurisdiction in the United States, and its advantages are directly relevant to charitable trust administration. South Dakota imposes no state income tax on trust assets. For a charitable remainder trust designed to generate income over a twenty-year period, that allows the portfolio to compound more efficiently and produce more income for the non-charitable beneficiaries over the trust's life.

South Dakota's advanced directed trust statute also benefits charitable trusts that are coordinated with broader family wealth structures. In a directed trust arrangement, the family's existing investment advisor can continue managing the trust assets while Sterling Trustees handles the fiduciary administration, tax reporting, distribution processing, and regulatory recordkeeping. South Dakota's perpetual trust duration and robust privacy protections further support charitable lead trusts that are designed to transfer wealth across multiple generations, providing the statutory flexibility and confidentiality that complex family planning requires.

Summary: Charitable Trusts at a Glance

Feature	Details
Trust Type	Irrevocable split-interest trust distributing income to charitable and non-charitable beneficiaries in a defined sequence
Tax Treatment	Charitable deductions available at funding; CRTs defer capital gains on appreciated asset sales; CLTs reduce the taxable value of gifts to family beneficiaries
Primary Objective	Integrate charitable giving with income generation, capital gains planning, or wealth transfer to family members in a tax-efficient structure
Two Primary Structures	Charitable Remainder Trust: family receives income, charity receives remainder; Charitable Lead Trust: charity receives income, family receives remainder
Ideal Candidate	Donors with appreciated assets, retirement income needs, philanthropic goals, or estate planning objectives that benefit from combining charitable and family interests in a single structure
Key Risk	CRT remainder interest must meet the IRS ten percent minimum at funding; CLT distributions must be funded precisely throughout the term; improper administration can disqualify the trust

Learn More

Sterling Trustees works with advisors, attorneys, and families to administer sophisticated trust structures designed to support long-term wealth preservation and transfer planning. As an independent South Dakota trust company focused exclusively on trust administration, we collaborate closely with advisory teams to implement and manage complex trusts with the precision, transparency, and responsiveness that clients expect.

To learn more about charitable trusts and other estate planning strategies, [contact Antony Joffe](#) or [schedule a call](#).

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