The Charitable Trust: Do Good and Get Tax Breaks

Give to charity and get a tax benefit.

A charitable trust lets you donate generously to charity, and it gives you and your heirs a big tax break. However, if you just want to make a few small charitable gifts, then a charitable trust probably isn't worth the bother.

You need to do some serious thinking before you set up a charitable trust. Charitable trusts require that that you give up legal control of your property, and charitable trusts are *irrevocable* -- once the trust becomes operational, you cannot change your mind and regain legal control of the trust property.

How It Works

The most common type of charitable trust is called a charitable remainder trust. Here's how it usually works.

First, you set up a trust and transfer to it the property you want to donate to a charity. The charity must be approved by the IRS, which usually means it has tax-exempt status under the Internal Revenue Code.

The charity serves as trustee of the trust, and manages or invests the property so it will produce income for you. The charity pays you (or someone you name) a portion of the income generated by the trust property for a certain number of years, or for your whole life -- you specify the payment period in the trust document. Then, at your death or the end of the period you set, the property goes to the charity.

What's in It for You -- Tax Advantages

In addition to helping out your favorite charity, you get several big tax advantages from this arrangement.

Income Tax

You can take an income tax deduction, spread over five years, for the value of your gift to the charity. Where things get tricky is determining the amount of your deduction. The value of your gift is not simply the value of the property; the IRS deducts from that value the amount of income you're likely to receive from the property. For example, if you donate $100,000 but can expect to get $25,000 in income back (based on your life expectancy, interest rates and how the trust document is set up), the value of your gift is $75,000.

Estate Tax

When the trust property eventually goes to the charity outright (at your death or the end of the payment period you specified), it's no longer in your estate -- so it isn't subject to federal estate tax. (Most people don't need to worry about estate tax, however, because it is assessed only on large estates.)

Capital Gains Tax

With a charitable trust you can turn appreciated property (property that has gone up significantly in value since you acquired it) into cash without paying capital gains tax on the profit.

A charity usually sells any non-income-producing asset in a charitable trust and uses the proceeds to buy property that will produce income for you. Because charities, unlike individuals, don't have to pay capital gains tax, if the charity sells your property, the proceeds stay in the trust and aren't taxed.

Example

> Toni owns stock worth $300,000. She paid $20,000 for it 20 years ago. She creates a charitable trust, naming Greenpeace as the charity beneficiary, and funds her trust with her stock. Greenpeace sells the stock for $300,000 and invests the money in a mutual fund. Toni will receive income from this $300,000 for her life.
>
> Had Toni sold the stock herself, she would have had to pay capital gains tax on her $280,000 profit. But no capital gains tax is assessed against the charity