

How Unitrusts Distribute Income

A charitable remainder unitrust pays an amount each year equal to a fixed percentage of its value for that year. The percentage payout rate, which is stated in the trust document, must be at least 5% and can be no more than 50%.

Each year, the trust is valued with that amount multiplied by the payout rate. The resulting unitrust amount is distributed to the income recipients that year, subject to the exceptions discussed below. Payments can be made once per year, or in equal monthly, quarterly, or semi-annual installments.

Payout Options

There are four different payout formats available to charitable remainder unitrusts:

Standard Unitrust. As described above, a standard unitrust pays a fixed percentage of the annual value of the trust assets. If the trust does not have sufficient cash to distribute to satisfy its payout obligation, it must distribute assets. Because standard unitrusts always make the required payment, they are typically funded with liquid assets such as cash or marketable assets such as publicly traded securities.

Net Income Unitrust. Even though a unitrust is supposed to distribute a fixed percentage of its annual value each year, it can include a net income provision that permits it to pay the lesser of the full unitrust amount and actual trust income. This provision protects the trustee from having to distribute illiquid assets to satisfy its payout obligation during times when it lacks sufficient cash.

Net Income with Make-Up Unitrust. In the event the trust includes a net income provision, it can also provide that to the extent trust income in the current year exceeds the required unitrust amount, the trust can distribute any excess income to make up for income deficiencies from prior years. This type of trust is known as a "net income with make-up" unitrust and is designed to balance out income distributions over time.

Flip Unitrust. The fourth and final form of unitrust is known as a "flip" unitrust. It begins life as a net income or net income with make-up unitrust and converts or "flips" to a standard unitrust in the year following the happening of a "triggering" event as described in the trust document (such as the sale of the contributed asset). A flip unitrust can offer the best of both worlds in that it protects trust principal during times when the trust holds non-income producing assets, and then maximizes distributable income and simplifies investment management and administration after the asset is sold. The only potential negative is that any unpaid make-up amount is reduced to zero in the year following the triggering event.

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