

Charitable Remainder Annuity Trust- Caution

Quick-Take: Treasury just provided helpful guidance when a charitable remainder annuity trust (CRAT) is funded with appreciated assets, and the CRAT turns around, sells the appreciated asset, and uses the net sales proceeds to purchase an annuity.

Background: Treasury released Final Regulations on July 8, 2026, regarding what it has identified as an abusive arrangement, thus identifying it as a 'listed transaction.' A participant in a 'listed transaction' (and their advisor using Form 8918) is required to file Form 8886 and disclose information on each reportable transaction in which they participate. Failure to file or disclose the relevant facts can lead to significant penalties, along with additional taxes and interest. The Final Regulations describe transactions in which the individual purports to eliminate his/her ordinary income and/or capital gains on the sale of property by a CRAT. These Final Regulations address the transfer of appreciated assets to a charitable remainder annuity trust (CRAT) and the subsequent sale by the CRAT of the appreciated asset with the concomitant purchase of a commercial annuity.

CRAT: The mechanics behind the 'listed transaction' CRAT is that property with a fair market value more than its basis, like an interest in a closely held business, or assets that are used in connection with a trade or business, is transferred to the CRAT. The CRAT then sells the appreciated property and uses some (or all) of the net sale proceeds to purchase a single premium immediate annuity (SPIA.) Allegedly by ignoring, or misconstruing, IRC 664 (CRAT distribution rules) and IRC 72 (annuity distribution rules) the CRAT beneficiary then claims that he/she is taxable *only* to the extent of the income portion of the SPIA payment. In effect, the position taken is that the Tax Code's normal trust distribution rules do not apply. Only a CRAT with this distinguishing feature would be treated as the 'listed transaction.'

Cannot Launder Capital Gains: This Final Regulation reflects the long-standing position of the IRS that a taxpayer cannot launder capital gain out of a charitable remainder annuity trust by routing it through a commercial annuity. Fortunately, under the Final Regulation, a charity that is named as the remainder beneficiary in the 'listed transaction' is not deemed to be a participant in that transaction simply by holding an interest in the CRAT.

Conclusion: Funding a charitable remainder annuity trust is a highly effective estate planning tool used to avoid taxes. That said, a CRAT only works when the normal trust distribution rules are followed and not ignored.