PLANNED GIVING ROUND TABLE OF ARIZONA SUMMER FORUM

NUTS AND BOLTS OF CHARITABLE SPLIT INTEREST PLANNING

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Shari A. Levitan, Esq.*
Holland & Knight LLP

Direct Dial Telephone: 617-854-1405
Email Address: shari.levitan@hklaw.com

*admitted to practice in Arizona and Massachusetts

Contributions For Partial Consideration

A bargain sale occurs when property is sold to charity for less than its value or when property subject to an indebtedness is given to charity, which is treated as if there were a sale for the amount of the indebtedness. Note that this latter situation occurs even where there is non-recourse indebtedness and even if the charity does not assume the debt. Rev. Rul. 81-163.

Bargain sales are treated as part gift and part sale. The taxpayer gets a charitable contribution for the gift portion, but the sale portion has the same tax treatment as a regular sale.

- The gift portion is equal to the value of the property, less the consideration the charity paid to get it. The sales portion consists of the balance.
- The donor's basis in the property is apportioned prorata to the gift and sales portions.

Ex. T contributes land worth $72,000, which is subject to indebtedness of $9,000 to a public charity. T's basis in the land at the time of the contribution is $32,000. This will be treated as a bargain sale to the charity, with the sale and gift portions determined as follows:

	Total	Sale	Gift
Value	$72,000	$9,000	$63,000
Basis	$32,000	-$4,000	-$28,000
Gain		$5,000	

Again, the gift portion of a bargain sale is treated like any other charitable contribution, so:

- If T had held the land for a year or less, it would be ordinary income property and the amount of the charitable deduction would be reduced to the $28,000 portion of the basis allocated to the gift portion.
- If T had held the property for more than a year, the $63,000 allocated to the gift portion would be 30 percent capital gain property unless the election to reduce the value to basis was made by T.

And, the sale portion is treated like any other sale of property. Thus, on the above facts, T will have to recognize the $5,000 gain realized on the sale portion of the transaction.

Of course, bargain sale can occur just if the charity pays a reduced consideration for the property, where it is not subject to indebtedness. The concept of how to treat the consideration, however, remain the same.

Charitable gift annuities

This is a fairly easy means of making remainder gifts to larger organizations that have annuity programs in place. Indeed, it is something that can result in significant tax and cash flow benefits to your client, particularly when dealing with smaller gifts. Thus, clients can contribute cash or appreciated property in exchange for a lifetime annuity, pending a charitable contribution deduction and generally increasing their cash flow. A portion of the cash flow will be a tax-free return of investment, and another portion may well be entitled to capital gains treatment. The amount of the annuity is generally determined based upon tables published by the American Council on Gift Annuities (ACGA), which assume no more than 1% for expenses of administration **.** Generally, the charity will have an annuity contract form, so there is little need to get involved in any particular drafting (other than reviewing the contract), and because it is a contract, most of the rules that would place restrictions on split-interest trusts that we will go through in a while don't apply to the charitable gift annuity.

As noted, the donor gets two benefits – a charitable deduction and an increased cash flow. The charitable deduction equals the excess of the purchase price over the donor's "investment in the contract," which is determined using the §7520 rate for the valuation month, or, at the election of the donor, either of the two preceding months.

An election to use the month with the highest interest rate will result a larger charitable deduction

For a single cash payment of $100,000 in exchange for a $6,300 a year life annuity, where the highest §7520 rate is 5.4%, the value of the annuity is $67,452, so the charitable contribution is the difference between that and $100,000, or $32,548. The deduction could be increased by reducing the value of the annuity, which can be accomplished by deferring its start date. Whether that is appropriate will involve some number crunching, as well as some good old guessing about the likelihood that T will outlive his or her expected life expectancy.

The amount of the deduction is obviously impacted by the §7520 rate. It also will be affected by how often the annuity is to be paid, and whether the payments are at the beginning or at the end of the payment intervals.

So much for the contribution. As noted, the second benefit is that T receives $6,300 a year, which will trigger some tax consequences, which are computed the same as with any annuity, thus a portion of each payment will be tax free (as a return of the donor's investment in the contract) and a portion will be ordinary income (representing interest).

> ***Ex.*** In 2006, T (age 63) purchases an annuity of $6,300 per year for T's life from Charity for a single cash payment of $100,000. The annuity is payable annually at the end of the year. The highest IRC § 7520 interest rate for the month of the gift and the two preceding months is 5.4 percent. On these facts, the value of T's annuity right is $67,452. Accordingly, T makes a charitable contribution of $32,548 ($100,000 minus $67,452).

The tax-free portion of each payment is determined by calculating an "exclusion ratio."

- Determined by dividing the value of the donor's annuity right – the investment in the contract ($56,669) by the contract's "expected return."
- The expected return is the annual annuity amount ($6,300) times the donor's life expectancy (21.1 years), so the exclusion ratio in Ex is:

$$\frac{\$67{,}452}{(\$6{,}300 \times 21.1)} = .507425$$

So, over half of each payment ($3,197) is received tax-free.

The balance is ordinary income.

COMMENTS

- If the donor lives beyond his life expectancy, the entire payment will be ordinary income, because the donor will have excluded his entire investment in the contract.
- Where the annuity is for the life of the donor only, a deduction of the entire remaining investment in the contract (total investment, less the sum of all previously excluded amounts), is available in the donor's final taxable year if the donor dies before his full life expectancy.

If appreciated property is transferred in exchange for the annuity, the contribution aspects are computed the same, but the annuity taxation is somewhat different, for it is treated as a bargain sale. Thus, where there is basis of $20,000 in $100,000 worth of property, the ordinary income portion will be the same, but what otherwise was the excluded portion will now be the bargain sale, for which a portion will have to be treated as capital gain. The example results in a capital gain of just over $54,000, which generally can be reported over the life expectancy of the annuitant. Should the taxpayer not live for the life expectancy, no further gain need be reported.

> ***Ex.*** Same except T acquires the annuity in exchange for investment property worth $100,000 in which T has a basis of $20,000. The allocation would be as follows:

	Total	Sale	Gift
Value	$100,000	$67,452	$32,548
Basis	$20,000	-$13,490	-$6,510
Gain		$53,962	

The sale portion of the bargain sale results in capital gain of $53,962.

- As long as the annuity contract is nonassignable (or is assignable only to the issuing charity), this gain may be reported ratably over the donor's life expectancy. Hence the donor will report capital gains of $2,557 ($53,962 divided by 21.1) each year.
- This amount is treated as if it was paid out of the excluded portion described above. Accordingly, the actual amount of each annual payment that is actually excluded from the donor's income is $640 ($3,197 - $2,557).

Recap

Ordinary income	$3,103
Capital gain	2,557
Return of basis	640
Total	$6,300

Charitable split-interest trusts provide that the charity's interest is either at the end of the trust (Charitable Remainder Trusts) or at the beginning (Charitable Lead Trust). The rules that apply to each will apply whether the trust is created during lifetime or at death.

Split-interest trusts have particular benefit where the client has property with a high asset value but a low basis, and particularly where there is a low yield. Inter Vivos Lead Trusts can be of benefit to those whose income is very cyclical, or where for all taxpayers in years in which there is a substantial income tax reduction for a future year.

Testamentary Lead Trusts are sometimes used to try to eliminate taxes or minimize them, by giving a lead interest to a charity in an amount designed to create a charitable deduction that approaches 100% of the property, with the obvious hoped for expectation that the appreciation in the property will exceed the AFR.

CRTs not only can have a benefit where there is the low basis high value asset with a low yield, but also for clients who want to actually realize this satisfaction of having made the gift but need to retain income.

Obviously, in all these situations, the charity benefits – although not as much as it would with an outright gift (except to the extent that the size of the gift is impacted by the retained interest – i.e., the charity will get more than it would have otherwise).

A contribution of a partial interest in property can not be the subject of a charitable contribution unless it meets very specific statutory requirements. Thus, as noted in some of the examples, a gift of stock in a closely held corporation in which the voting rights are retained doesn't create any deduction. Similarly, a gift into trust to provide for income or principal to an individual with the remainder to charity does not qualify for any deduction – even if the distributions are subject to an ascertainable standard.

On the other hand, an outright contribution of a partial interest, which constitutes the entire interest which carries with it the full bundle of rights – is deductible, as the example shows with respect to an undivided interest in real estate or in an art collection. In addition, there is a specific statutory authority that allows deductible interest of the remainder in a personal residence or farm, so long as this is a legal life estate to the individual – if the property is placed in trust, it will not qualify.

An offshoot of a charitable gift annuity – which is also covered by the Tax Code – are pooled income funds. Essentially, these are common trust funds maintained by a public charity, and rather than having the amount of the payout frozen at inception, it is based upon the return of the common trust fund.

Every split trust:

Has an income beneficiary

Split interest trusts are subdivided into two types:

1. Annuity Trusts, in which a fixed dollar amount is paid, and that is established at the outset of the trust.

2. Unitrust, which has a fixed percentage of the trust (fixed at the outset) that is distributed based upon the value of the trust with revaluation occurring annually. Thus, we can have CLATs or CLUTs or CRATs or CRUTs. Lets look at the latter two first.

Note that, in a remainder trust, the lead interest (the non-charitable interest) must be a minimum of 5%, whether expressed as a percentage or an annuity that is at least 5% of the initial value of the trust.

> A CRT must function exclusively as a CRT from the time of its inception. For this purpose, a CRT is treated as having been created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under the grantor trust rules applied by ignoring the fact that the grantor or the grantor's spouse is a recipient of the annuity or unitrust amount.

> ***Ex.*** T creates a revocable inter vivos trust naming BANK as trustee. At T's death, the trust terms meet the requirements of a CRT, with the specified distribution made in equal shares to A and B and the remainder after 10 years to go to Charity. This trust will be treated as having been created at T's death when T's power to revoke (and grantor trust status) end. Accordingly, the trust qualifies for the estate tax charitable deduction.

> ***Ex.*** T creates an irrevocable inter vivos trust with BANK as trustee. The instrument provides that the trustee shall pay the specified distribution to two life beneficiaries, one of whom is T. Upon the death of the survivor of the two beneficiaries, the trust will terminate and the trust assets will be distributed to charity. The fact that T is a recipient of the trust is ignored for purposes of determining whether this is a grantor trust. Accordingly, the trust is not treated as a grantor trust and the trust is a qualified CRT as of its inception.

> Next, a CRT must have at least one recipient who is not a charity, but a charity can have an income interest. Indeed, this is how to deal with the situation (which can occur) where someone doesn't want the individual to have an interest as large as 5% simply make the amount payable that is desired to the individual and pay to a charity the difference between that and the 5%.

> Also note that CRTs are not permitted to create interests for those who are not yet living, so that the class of recipients cannot be expanded to include afterborns or future spouses. On the other hand, the trustee may be given a power to allocate the specified payment among the class members, but only if the power itself does not turn the trust into a grantor trust. In effect, this requires an independent trustee.

> Anyone may serve as trustee of a CRT, provided only that the combination of the person and the trustee's powers does not turn the trust into a grantor trust.

> A CRT may last for the life or lives of one or more recipients or for a fixed term of 20 or fewer years.

- It is permissible to measure the duration of the trust by the shorter (or longer) of a designated recipient's life or a period not to exceed 20 years.
- It is not permissible to measure the duration of the trust by the life of one or more recipients plus a period not to exceed 20 years.

A CRT can terminate short of its natural termination if:

1. The grantor retains a testamentary power to revoke or terminate the interest of any recipient other than the charity,
2. The CRT is drafted to terminate upon the happening of a “qualified contingency” – any contingency that could cause termination no later than the normally scheduled termination.

The inclusion of either or both of these optional provisions will not affect the amount of the charitable deduction.

Like many tax rules regarding trusts, CRT payments must be paid annually or more frequently.

As noted earlier, the frequency of payment will affect the amount of the charitable deduction. Generally, the longer the non-charity waits to get the dollars, the greater the charitable deduction.

From a family standpoint, one of the major drawbacks of a CRT is that it may not make any distribution to a non-charitable recipient other than the specified payment. Thus, there is no flexibility to deal with emergencies.

This restriction creates two specific issues.

- For taxable years ending after April 18, 1997, the Regulations require CRATs and fixed income CRUTs to make their distribution no later than the close of the taxable year. This requirement does not apply to NIM-CRUTs.
- First, it prohibits payment of estate taxes at the death of the settlor of an inter vivos CRT.
- And, according to Rev. Proc. 2005-24, an inter vivos CRT can't satisfy the elective share claim of the donor’s surviving spouse, although the Service has now deferred application of the Procedure until further guidance is issued.

COMMENTS

Rev. Proc. 2005-24 creates a major planning problem for a married person who wants to create an inter vivos CRT Nominally, the problem exists only for residents of states which permit collection of an elective share right from the CRT.

> ***Ex.*** T transfers property to a trust which ostensibly meets the requirements of a CRT but that also provides that the property is to revert to T if the trust does not qualify for a charitable deduction. The trust does not qualify as a CRT because the reversion would be a payment of something other than the annuity or unitrust amount.

But, you can make additional distributions to charitable organizations, as noted, although:

- No additional charitable deduction will result from an additional distribution, and
- If the distribution is made in kind, the adjusted basis of the property distributed must be fairly representative of the adjusted basis of all property available for distribution.

A caution: The private foundation prescriptions and penalty taxes apply to CRTs, so either state law or your instrument must prohibit the trustee from:

1. Engaging in any act of self-dealing as defined under IRC § 4941(d);
2. Retaining any excess business holdings as defined in IRC § 4943(c) that would subject the trust to tax under IRC § 4943;
3. Making any investments that would subject the trust to tax under IRC § 4944; and
4. Making any taxable expenditures as defined in IRC § 4945(d).

Additionally, the trustee may not make any distributions in such a manner as to subject the trust to tax under IRC § 4942.

There are additional limitations on Trust investments and administration, so

1. CRT investments may not be subjected to the control of someone other than the trustee.
2. A CRT may not be a shareholder of Subchapter S stock. [Check this to see if it wasn't changed by legislation on Subchapter S a little while ago.]
3. CRT property must be debt-free; otherwise this would make the trust a grantor trust.
4. Can't charge any portion of the trustee's commission to the annuity or unitrust amount.

COMMENTS

Also, the regulations require non-independent trustees t rely on a current qualified appraisal by a qualified appraiser to value unmarketable assets.

The annuity must be stated as a fixed sum or a percentage of the initial value of trust assets (5% minimum, and it cannot exceed 50% of the initial value) with respect to transfers in the last nine years. Although the amount is to be fixed, it may be reduced proportionately if a distribution of principal is made at the death of a noncharitable recipient or at the expiration of a term of years.

Moreover, the annuity when funded cannot have greater than a 5% probability that the trust will be exhausted before the death of the non-charitable beneficiary. This can only be an issue where the annuity amount exceeds the AFR rate and the annuity extends for a number of years.

As another restraint that was added in 1997, along with the maximum 50% payout, the actuarial value of the charities interest must be at least 10%. This creates a situation where you really have to be careful when a young income beneficiary is involved.

COMMENTS

This minimum interest requirement is particularly troublesome for testamentary transfers, because it often will be difficult to predict with accuracy at the time a will is drafted what combination of annuity and trust term will be necessary to satisfy the requirement at the time of the decedent's death. Some relief is provided by IRC § 2055(e)(3)(J), however, which allows noncomplying trusts to be declared void ab initio or (alternatively) to be reformed to meet the ten percent requirement.

The last aspect peculiar to CRATs is that no additional contributions are permitted after the CRAT is initially funded, although, all property passing to a CRAT by reason of the death of its grantor is treated as a single contribution.

There are also special rules for CRUTs, but they have a little more flexibility:

- focusing on the 5% rule, the unitrust amount must be at least 5% of the value of the trust, determined annually. Again, since 1997, it cannot exceed 50%. Your instrument can provide for corrective repayment or distribution if there is an error in valuing the trust assets which causes a mispayment. As with a CRAT, the percentage can be reduced proportionately if a distribution of principal is made at the death of a noncharitable recipient or at the expiration of a term of years.

There is another exception, which is permitted if the trust provides that only income is to be used, which prevents the necessity of selling principal. Another variation of this option will allow an income only unitrust to have a makeup provision, so that if income later exceeds the payout amount, any underpayments can be "made up."

The NIM-CRUT is particularly useful as a retirement vehicle. Before the donor retires, the trust invests in highly appreciating, low yield investments and pays only the income to the donor. After retirement when the donor is in a lower tax bracket, the trusts shifts to high income investments and pays out the shortfall of prior years as a form of retirement benefit. It is also useful when highly appreciated property is contributed to the NIM-CRUT with the expectation of its sale in the relatively near future.

There is another alternative, for the regulations now permit so-called FLIP unitrusts, which start out as a NIM-CRUT and later convert to a fixed income unitrust. To qualify as a FLIP-CRUT:

(a) The governing instrument must require that the conversion occur upon on a specific date or upon the happening of a single event such as the sale of unmarketable assets or the marriage, divorce, death, or birth of a child;

(b) The conversion must be nondiscretionary, permanent and effective as of the first taxable year following the year in which it is required to convert; and

(c) Any makeup amount owing to the noncharitable recipient at the time of the conversion must be forfeited.

Also like the CRAT, since July 28, 1997, the charity's interest must equal at least 10 percent of the value of all property in the CRUT as of the time of the transfer.

Finally, unlike a CRAT, a CRUT may permit additional contributions. If additional contributions are permitted, however:

- The governing instrument must contain special provisions dealing with them; and
- The ten percent minimum charitable interest requirement must be met with respect to each additional contribution to the trust.
- The remainder interest in a CRT qualifies for a gift, estate, or income tax deduction.
- An income and gift tax deduction to the donor who creates an inter vivos CRT, and
- An estate tax deduction for CRTs that are created or are included in the donor's gross estate.

  The charity's interest CRT is valued by the IRC § 7520 rate for the month, on at the option of the donor, the rate for either of the two months preceding the month of the transfer.

COMMENTS

A CRAT will yield a larger charitable deduction when the annuity or unitrust amount is less than the IRC § 7520 rate used to value the remainder. The converse is true when the annuity or unitrust amount exceeds the section 7520 rate. For example, with an seven percent annuity or unitrust amount and a section 7520 rate of 5.4 percent, the charitable deduction for a CRAT and CRUT would be $45,922 and $49,588, respectively.

Percentage limitations and valuation reduction rules

For income tax purposes, contributions to a CRT are subject to the normal percentage limitations and valuation reduction rules Sarah discussed.

Thus, a transfer to a CRT is a transfer "to" (not "for the use of") the charity, unless the property remains in trust at the expiration of the annuity or unitrust interest.

With respect to the valuation reduction rules:

- Where the subject of the transfer is tangible personal property, the use to which the trust puts the property is considered an unrelated use if the same use would have been unrelated had the gift been made directly to the charity, and
- The valuation reductions rules are applied after the charitable contribution portion of the transfer is determined. In measuring the appropriate reduction, the donor's basis in the property is apportioned pro-rata to the income and remainder interests.

There is no limitation on a charitable deduction for the value of the charity's remainder interest. But this will not equal the full value of the property transferred to the CRT, so there is a possibility the donor can make a taxable gift.

If the income interest is in someone other than the donor /or the donor's US citizen spouse. Note that:

- A gift tax marital deduction is available only if the donor and the donor's spouse are the only noncharitable beneficiaries of the CRT.
- The spouse's interest need not be an interest for life. It may be for a term of 20 or fewer years.

- No QTIP election may be made with respect to the spouse's interest in a CRT.
- The deduction is allowable even though the transfer is conditioned on the spouse's payment of state death taxes attributable to the CRT.

Moreover, no gift will occur if the donor retains a testamentary power to revoke or terminate the annuity or unitrust interest of any recipient. Such a power would render the gift incomplete, although only at the cost of estate tax exposure should the donor die during the CRT period.

In the absence of such a power, a gift would occur, although it could qualify for the $13,000 annual exclusion if it consists of a present interest in property, if the annuity or unitrust interest must commence immediately after the transfer.

Additionally, it must be limited in favor of a single person or a group of persons in fixed shares.

If the donor dies during the term of a CRT, some or all of it may be includible in the gross estate. When this occurs, the donor will receive an estate tax charitable deduction for the value of the remainder interest in the CRT.

(1) This will occur only if the donor was a present or future recipient of the annuity or unitrust amount, or the donor had the testamentary power to revoke such interests held by others.

(2) If the donor is the only noncharitable beneficiary, any estate tax exposure will be offset by a charitable deduction for the value of the remainder interest passing to charity.

(3) If the donor's US citizen spouse holds the only noncharitable interest in a CRT after the donor's death, there will be no estate tax exposure, because the spouse's interest in the trust will qualify for the estate tax marital deduction and the remainder will qualify for the charitable deduction.

Generally, a CRT is exempt from income taxes, unless it has unrelated business taxable income. Thus, its income is taxed only when distributed to a non-charitable beneficiary. Note, however, that if there is any unrelated business taxable income for the year, the CRT is taxable on all of its income for the year. As a result, there must be a lot of care taken to avoid investments in partnerships or pass-through entities because generally they can create UBIT.

> ***Ex.*** This year, in satisfaction of a $10,000 annuity or unitrust payment due T, a CRT distributes property worth $10,000 in which the trust had a basis of $2,000. The CRT has a realized gain from the sale of property of $8,000. This gain is tax exempt to the trust but may result in taxation to T in this or some subsequent year. T takes a fair market value basis in the distributed asset.

COMMENTS

With a CRUT (but not a CRAT), the recognition of gain in this example may not be all bad because:

- The donor could generate an additional charitable deduction by retransferring the property to the CRUT; and
- Thereafter, the property could be "recycled" (i.e., used to fund another unitrust payment) with little or no gain recognized.

Income taxation of trust distributions

Distributions from a CRT to the noncharitable beneficiary each year are characterized according to a "worst in, first out" tier system that is unique to charitable remainder trusts.

Under this system, each distribution is deemed to consist of ordinary income, capital gain, tax exempt income or a return of corpus according to the following priority:

1. First, as ordinary income to the extent of ordinary income for the current year and undistributed ordinary income for prior years.
2. Next, as capital gains to the extent of gains for the current year and undistributed gains from prior years. If there are both short-term and long-term gains, the distribution is treated first as having come from the short-term gains.

3. Next as other income (such as tax exempt income) to the extent of other income for the current year and undistributed income from prior years.

4. Lastly, from the corpus of the trust.

If different classes of income within a particular category are taxed at different rates, the distributions are deemed to be made in higher to lower rate order. Thus, a distribution would be treated as coming from interest income before it was deemed to consist of qualified dividends in distribution years when the latter are taxed at a lower rate than interest income. Likewise, a distribution from the capital gains category would be treated as coming first from short-term capital gains and then from each class of long-terms capital gain, beginning with the class subject to the highest Federal rate and ending with the class subject to the lowest rate.

With respect to losses, capital losses are offset against capital gains starting with the gains taxed at the highest rate. Thus, a net loss in the short term class is offset against long-term gains starting with the gains taxed at the highest rate. A net loss for all long-term classes is offset against net short-term gains.

Before talking about planning ideas, lets briefly review two kinds of trusts and their basic advantages and disadvantages:

With respect to CRTs:

ADVANTAGES:

- There is a certainty of the amount received
- Helpful where bonds are the funding vehicle
- Provides the greatest protection and loss of value principal.

DISADVANTAGES:

- No protection against inflation
- No further contribution permitted; must create separate trust
- 5% exhaustion problem.

UNITRUST:

ADVANTAGES:

- Provides best hedge against inflation
- Flexible, for it can receive additional transfers
- Also flexible because distribution can be limited to trust income, and there can be a makeup provision.

DISADVANTAGES:

- There is an uncertainly about the amount of the payment
- There is a necessity to value the assets annually.

Turning this to specifics, there are several ideas that may be considered to create benefits for taxpayers who wish to use the CRT. What might be characterized as a temporary tax shelter involves the transfer of highly appreciated property to a CRT for the life of the grantor, with a rate higher than could be earned were the grantor to have sold the property himself and invested the after tax dollars.

- The transfer to the CRT will generate an income and gift tax charitable deduction at the creation of the trust and an estate tax deduction at the grantor's death.
- The CRT then sells the property at a gain, but no taxes payable on the sale.
- So pre-tax dollars are available to fund the generous annuity or unitrust amount retained by the grantor.

- The grantor may use some or all of the payments to purchase life insurance, the proceeds of which will replace the inheritance the grantor's family loses by virtue of the fact that the remainder passes to charity at the grantor's death.

A similar example might be to create a scholarship fund or supplemental income for children, to use the same approach as a way to fund it in the future at a minimum gift tax cost.

A NIM-CRUT makes a useful supplement to a donor's retirement plan.

- The donor transfers property to a NIM-CRUT, taking an income tax deduction for the remainder interest.
- In the period prior to the donor's retirement, the NIM-CRUT invests in low yield, high appreciation assets, so the income is less than the unitrust amount.
- After the donor reaches retirement, the investment strategy changes to high income assets and the distributions to the grantor under the make-up provision increase.

A donor who wishes to contribute property during life for the benefit of a US citizen spouse with a remainder passing to Charity has two choices.

1. The donor could create a QTIP trust with remainder passing to charity; or
2. The donor could create a CRT with the spouse as the noncharitable beneficiary of the annuity or unitrust payment.

If the surviving spouse will not need access to all of the trust property, the CRT approach may be the better choice.

- The CRT will give the donor a current income tax deduction; and
- The property in the CRT will not be in the spouse's estate at death. This latter may be important if the size of the spouse's estate is important, because the spouse is on the threshold of qualification for benefits under IRC §§ 303, 2032A, 6166.

Essentially, the CLT is the reverse of the CRT, so that the annual or more frequent distribution is to one or more charitable organizations for the life of designated individuals or for a term of years, with a reversion or remainder interest in the grantor or one or more other noncharitable persons.

The value of the lead interest in a CLT is fully deductible for estate and gift tax purposes, income tax deduction only if the trust is a grantor trust. Otherwise,

- The grantor receives no income tax deduction for the value of the charitable lead interest;
- The trust, rather than the grantor, is taxed on subsequent income earned by the trust.
- But the trust will receive a charitable deduction under IRC § 642(c) for amounts of gross income paid to the charitable organization or organizations.

Of course, if a CLT is a grantor trust, the grantor will receive an income tax deduction in the year the trust is created for the value of the charitable lead interest, but be taxed on the trust income subsequently.

COMMENTS
If the grantor dies (or the trust ceases to be a grantor trust) during the term of the lead interest, some or all of the income tax deduction is recaptured.

Many of the requirements for charitable lead trusts directly parallel those for charitable remainder trusts. There are, however, some differences, reflecting the fact that the charity receives the income interest in a CLT, which may either be an annuity trust (CLAT) or unitrust (CLUT).

The terms of either may be for the life or lives of one or more individuals, or for a fixed term, or for a combination of both.

a) Like a CRT, the individuals must be alive at the creation of the trust.

b) Unlike a CRT:

- The fixed term of a CLT is not limited to 20 years.
- It is permissible to measure the duration of the trust by the life of one or more individuals plus a specified term of years.
- The grantor of an inter vivos CLT may not have a testamentary power to revoke the lead interest.
- A CLT may not provide for termination of the lead interest upon the happening of a qualified contingency.

Generally, the provisions for the annuity or unitrust interest in a CLT are the same as for a CRT, with the following differences:

With a CLAT:

- No requirement for the annuity to be at least 5 percent.
- No upper limit on the percentage payout to charity.
- No requirement for the value of the lead interest to be at least 10 percent of the initial value.
- Although the annuity must be guaranteed and determinable as of the creation of the trust, it may be redetermined at the expiration of a term (a fixed period of years or the death of a measuring life), but only if the mechanism for calculating the redetermined amount is fixed and ascertainable at the creation of the trust.

With a CLUT:

- No 5 percent floor.
- No upper limit on percentage payout.
- No requirement for the value of the lead interest to be at least 10 percent of the initial value.
- A CLUT may not provide that the trust is to pay the lesser of the unitrust amount or the trust's current fiduciary accounting income for the year. If the income is insufficient to fund the unitrust amount, principal must be used for that purpose.

Obviously, a CLT must have one or more charitable income beneficiaries, but they need not be designated by name, but can be chosen by the trustee. Indeed, the trustee of a CLT should have the authority to select alternate charitable organizations in the event the initial organizations lose eligibility.

CAUTION:

COMMENTS

If the grantor of an inter vivos CLT serves as trustee, and the trustee has the power to select the charitable beneficiaries:

- The lead interest will not qualify for a charitable deduction because the transfer will be an incomplete gift; but
- The grantor will get a charitable deduction each year when the gift to the charity becomes complete by virtue of a distribution in satisfaction of the lead interest.

In addition, if the grantor dies during the term of the lead interest, some or all of the trust property will be included in the grantor's gross estate.

As with CRTs, a CLT is a split interest trust to which the private foundation rules apply. Therefore, the governing instrument (or state law) must have the same 5 prohibitions from::

a) Engaging in any act of self-dealing as defined under IRC § 4941(d);

b) Retaining any excess business holdings as defined in IRC § 4943(c) that would subject the trust to tax under IRC § 4943;

c) Making any investments that would subject the trust to tax under IRC § 4944; and

d) Making any taxable expenditures as defined in IRC § 4945(d).

e) Making any distributions in such a manner as to subject the trust to tax under IRC § 4942.

Although the restrictions against excess business holdings (IRC § 4943) and jeopardy investments (IRC § 4944) can be avoided if:

a) The entire income interest (and none of the remainder) is devoted to a charitable purpose, and

b) The present value of all charitable lead interests does not exceed 60 percent of the net value of all assets in the trust.

During the lead term, there is a prohibition against distributions to noncharitable beneficiaries; except where the noncharitable distribution is made from a separate trust share.

In addition, one can have a lead interest in a noncharitable beneficiary if it precedes the charitable income interest.

- The value of the reversion must be greater than 5 percent of the value of the property transferred to the trust.
- And this means that some or all of the trust property will be subject to estate tax at the grantor's death.

If avoiding estate tax is desirable, the remainder interest could be given to the grantor's spouse.

Alternatively, the grantor could retain the power to reacquire trust property by substituting property of equivalent value, which might also help provide flexibility for future operations. This is not without risk.

- The trustee can designate which of several charitable organizations is to receive the lead income interest and the donor is either the trustee or has the power to replace the trustee with a nonindependent successor; or
- The CLT directs payments of the lead interest to a private foundation with which the donor has a continuing relationship.

Unlike a CRT, a CLT is not a tax exempt entity. Accordingly, the trust will be taxed like a complex trust.

- Although no trust may claim a distribution deduction for distributions to charity, a trust is entitled to a charitable deduction for items of gross income paid to the charity.
- But income not distributed currently will be taxed to the trust.

COMMENTS

- The trust may elect to deduct amounts paid to charity after the close of the current taxable year and before the end of the next taxable year.
- Accumulation of income in the trust is generally expensive because the trust will pay taxes at the rate of 35 percent for interest income over $8,350 (only 15% for dividend income).
- On the other hand, distribution of excess income to the charity will not result in any taxes being paid because the charity is exempt.

Several Cautions: Amounts paid to charity by a nongrantor CLT are not deductible to the extent the trust has tax exempt income.

COMMENTS

Consideration should be given to including a direction in the instrument that the lead interest is not to consist of tax exempt income unless no other income is available to fund the distribution. Although it is not clear that such a direction will be given effect, there is no harm in trying.

A nongrantor CLT will lose a deduction for the distribution to charity to the extent it has unrelated business taxable income.

Note, however, that the otherwise disallowed portion is deductible up to 30 or 50 percent of the CLTs unrelated business taxable income, depending on whether the amounts allocable to that income are paid to a private or public charity.

If a CLT must distribute trust principal to fund the full annuity or unitrust amount, and uses appreciated property for this purpose, the trust will recognize gain from the sale of a trust asset.

Finally, a CLT generally will not have income tax consequences for either its charitable or noncharitable beneficiaries. The former are tax exempt and the latter will not be receiving distributions from the trust until the trust terminates at the expiration of the lead interest.

I. Drafting Considerations

A. Charitable remainder trusts

1. Model and sample IRS forms

2. Mandatory instrument requirements

There are numerous **mandatory** requirements for a CRAT or CRUT. The failure to include one of these mandatory provisions will disqualify the trust. These have all been included in the sample CRAT and CRUT forms provided by the IRS and reproduced in the appendices.

a) CRAT basics

The regulations describe a CRAT as follows.

1. A CRAT must provide for the payment of a sum certain at least annually.
2. To one or more persons at least one of whom is not a IRC § 170(c) charitable organization.
3. For a period measured by the life or lives of one or more named individuals or for a term certain of no more than 20 years.
4. Which annuity amount must be at least 5% of the initial net FMV of the assets placed in trust.

b) CRUT basics

The Regulations describe a CRUT as follows.

1. A CRUT must provide for a payment to be made at least annually that is based on a fixed percentage of the net FMV of the trust assets, determined annually.
2. To one or more persons at least one of whom is not a IRC § 170(c) charitable organization.
3. For a period measured by the life or lives of one or more named individuals or for a term certain of no more than 20 years.
4. Which fixed percentage is at least 5 percent.

c) Irrevocable transfer to or for charity

The governing instrument of a CRAT or CRUT must irrevocably transfer the entire trust corpus to or for the benefit of a IRC § 170(c) organization, or retain it for such use upon the termination of all non-charitable interests.

d) Alternate charitable organization

The governing instrument must provide a means by which an alternative IRC § 170(c) organization can receive the trust corpus in the event the designated organization does not qualify as such at the time the corpus transfer is to occur.

e) Adjustment for incorrect valuation

The governing instrument of a CRUT must provide that in the case where the net FMV of the trust assets is incorrectly determined by the fiduciary, the difference between what the beneficiary received and should have received is to be paid to the beneficiary or refunded to the trust by the beneficiary.

f) Deferral during administration of decedent's estate

A deduction under IRC §§ 2055 or 2106 is not allowable unless the obligation to pay the annuity with respect to property passing in trust at the date of death begins as of the date of death of the decedent, although the governing instrument (will or trust) can provide for deferral of the requirement until the end of the first tax year of the trust in which funding of the trust is completed, provided such deferral is permitted by local law. Accordingly, the governing instrument of a testamentary CRAT or CRUT must provide that the obligation to pay the annuity or unitrust amount begins at the on the date of death and that payment of any annuity or unitrust amount that is deferred during administration will be made within a reasonable time after the completion of funding. Additionally, the governing instrument should provide that interest, compounded annually at the rate established according to the Regulations under IRC § 664, is to be included as part of the corrective payment.

g) Proration for short taxable years

The governing instrument of a CRAT and CRUT must provide that the payable annuity or unitrust amount be prorated daily for short taxable years and for years involving the termination of a non-charitable interest.

h) Additional contributions

(1) CRAT

The governing instrument of a CRAT must provide that no additional contributions can be made to the trust after the initial contribution, although all property passing by reason of death is considered as one contribution.

(2) CRUT

The governing instrument of a CRUT must provide either that no additional contributions be made to the trust after the initial contribution or that if additional contributions are permitted, the unitrust amount for the year of contribution be computed by multiplying the fixed percentage by the sum of:

i. The net FMV of trust assets without regard to any contributed property and

ii. The proportionate net FMV of the contributed property based on the beginning period of the trust's tax year, the contribution date of the property, and the ending period of the trust's tax year or termination of the unitrust interest, whichever is earlier.

Additionally, where the instrument provides no valuation date for the contributed property, that date is deemed to be the date of contribution.

i) Prohibitions applicable to private foundations

IRC §§ 4941, 4943, 4944, and 4945 are applicable to CRATs and CRUTs. Therefore, the governing instrument must provide that the trustee is prohibited: from any self-dealing as defined in IRC § 4941(d); from retaining any excess business holdings that would subject the trust to tax under IRC § 4943; from making any investments which would subject the trust to tax under IRC § 4944; and from making any taxable expenditures as defined in IRC § 4945(d). Additionally, the instrument must provide that the trustee shall make distributions in a manner so as not to subject the trust to tax under IRC § 4942.

j) Reasonable rate of return

The Regulations provide that a CRAT or CRUT must not restrict the trustee from investing trust assets in a manner that could result in a reasonable annual realization of income or gain. The IRS sample forms in Rev. Rul. 72-395 include the following language relating to this requirement. The provision is listed as optional but it should be considered **mandatory**.

3. Optional provisions

There are numerous optional drafting provisions that can be incorporated into CRATs and CRUTs.

a) Annuity stated as fraction or percentage

In the case of a CRAT, the annuity amount may be expressed as a percentage of the initial net FMV of the trust property if the governing instrument also provides that in the event such value is incorrectly determined by the fiduciary, the difference between what the beneficiary received and should have received is to be paid to the beneficiary or refunded to the trust by the beneficiary.

b) Income only CRUT

The governing instrument of a CRUT can allow for the trust to pay, instead of the regular unitrust amount, only the amount of trust income when it is less than that required to pay the regular unitrust amount, or the amount of trust income in excess of the regular unitrust amount to the extent that in previous years less than the regular unitrust amount was paid.

c) Power to allocate among a class

A trust is not a valid CRAT or CRUT if any person has the power to alter the amount to be paid to any named beneficiary other than a IRC § 170(c) organization. Nevertheless, the Regulations state that the governing instrument of either can provide that the trustee has the power to allocate the annuity or unitrust amount among members of a class of beneficiaries.

d) Reduction of payment at death of noncharitable beneficiary

In the case of a CRAT, the annuity amount must be the same either as to each recipient or as to the total amount payable for each year of the term of years or the lives of the recipients. A similar requirement applies to the percentages payable in the case of a CRUT. Nonetheless, the stated annuity amount (CRAT) or fixed percentage (CRUT) may be reduced at the death of a recipient or upon the expiration of a term of years if:

1. The reduced amount (or percentage) is the same either as to each recipient or as to the total amount payable each year for the balance of the period during which the annuity (or unitrust amount) is to be paid,
2. There is a distribution to a IRC § 170(c) organization at the death of the recipient or upon the expiration of the terms of years, and
    a. In the case of a CRAT, the total annuity amounts payable each year thereafter are not less than an amount that bears the same ratio to 5% of the initial net FMV

of the trust assets as the net FMV of the trust assets immediately after such distribution bears to the net FMV of the trust assets immediately before such distribution and

b. In the case if a CRUT, the total of the percentages payable each year after such distribution is not less than 5 percent.

e) Advancements to charity

A CRAT or CRUT may permit amounts other than the annuity or unitrust amount to be paid to a IRC § 170(c) organization, provided that, in cases of distributions in kind, the adjusted basis of the property distributed is fairly representative of the adjusted basis of the property available for payment on the date of payment.

f) Optional termination clause

A CRAT or CRUT can require that the payment of the annuity or unitrust amount terminate upon the regular payment next preceding the termination of all non-charitable interests.

g) Testamentary power to revoke

The grantor of a CRAT or CRUT may retain a testamentary power to revoke the interest of any non- IRC § 170(c) beneficiary.

h) Revocable inter vivos trusts

The Regulations provide that a CRAT or a CRUT must function as a CRAT or CRUT from its creation. Consequently, a revocable inter vivos trust that is used to administer the estate of a decedent can never qualify. Nonetheless, the governing instrument can permit that the CRAT or CRUT be funded by a distribution of assets from a revocable inter vivos trust used to administer the estate of the decedent.

4. Miscellaneous

a) Tax apportionment clause

1) A trust does not qualify as a charitable remainder trust and no charitable contribution deduction is allowable under IRC §§ 170 or 2522 if it is possible that federal or state death taxes may be payable from the trust assets upon the grantor's death.

2) This might be the case with a CRAT or CRUT for the life of the grantor and another person. Although the remainder will escape taxation because of the charitable deduction, the secondary life interest won't.

3) If state law apportions taxes to that interest, the trust will not qualify for a charitable deduction.

4) The problem can be remedied by:

- A provision making the secondary interest contingent on the taker furnishing the funds necessary for the payment of the federal or state death taxes, or
- A provision preventing apportionment of taxes to the CRAT or CRUT.

b) Probability of exhaustion savings clause

No gift or estate tax charitable deduction is available in the case of a CRAT if there is a greater then 5 percent probability that the trust property will be exhausted before the death of the noncharitable recipient. One of the IRS model forms for a testamentary CRAT appended the following language to the paragraph detailing the requirement to pay the annuity. The language would have to be modified as appropriate for an inter vivos CRAT.

5. Advance rulings and determination letters

Prior to 1990, the Service was open to requests for advance rulings and determination letters for the purpose of passing judgment on the validity of charitable remainder documents and contributions made thereunder. In the aftermath of issuing the sample IRS forms, the Service has stated that ordinarily, advance rulings and determination letters on these matters will no longer be issued.

B. Charitable lead trusts

1. Charitable remainder annuity trust (CLAT)

Taking into consideration the mandatory and optional provisions already covered under the discussion on charitable remainder trusts, there are numerous recommended drafting provisions that should be included in CLAT document.

a. Statement of the annuity amount to be paid to the charity, indicating that it be paid at least annually.

b. Statement indicating that the annuity payment is to be prorated on a daily basis in the case of a short taxable year and in the case of the taxable year in which the annuity terminates.

c. Statement authorizing the trustee to make the annuity payment to another IRC § 170(c) organization in the event the designated charity no longer qualifies under IRC § 170(c).

d. Statement indicating the trust is irrevocable and non-amending, except for the sole purpose of complying with the qualification requirements for charitable lead annuity trusts.

e. Statement prohibiting the trustee from engaging in any act of self-dealing as defined under IRC § 4941(d); from retaining any excess business holdings as defined in IRC § 4943(c) that would subject the trust to tax under IRC § 4943; from making any investments that would subject the trust to tax under IRC § 4944; and from making any taxable expenditures as defined in IRC § 4945(d). Additionally, the trustee may not make any distributions in such a manner as to subject the trust to tax under IRC § 4942.

f. Statement indicating no additional contributions may be made to the trust after the initial contribution.

g. Statement indicating the trustee is not restricted from selling or investing the trust assets in a manner that would result in a reasonable amount of income or gain.

h. Statement indicating the extent of the trustee's administrative powers, although this statement should be followed by one indicating that the trustee's power is limited to those that are consistent with the trust's status as a charitable lead annuity trust.

i. Statement indicating that the donor has no authority to control the trustee or trust assets.

j. Statement indicating that no part of any federal or state estate or inheritance tax imposed by reason of the donor's death is to be paid from trust assets.

k. Statement indicating the state law that governs the trust document.

2. Charitable lead unitrust (CLUT)

Again, taking into consideration the mandatory and optional provisions already covered under the discussion on charitable remainder trusts, there are numerous recommended drafting provisions that should be included in CLUT document.

a. Statement indicating additional contributions can be made to the trust.

b. Statement indicating the trust is irrevocable and non-amending, except for the purpose of meeting the qualification requirements for charitable lead unitrusts.

c. Statement indicating the donor has no control over the trustee or the trust assets.

d. Statement indicating the term of the trust, which can either be lifetime or a term of years, but not more than 20.

e. Statement indicating the unitrust payment amount is to be a fixed percentage of the net FMV of the trust assets valued each year.

f. If the lead interest is not to a specified charity, but may be distributed to a class of organizations at the trustee's discretion, statement indicating that no unitrust payment can be made to any person other than a IRC § 170(c) organization.

g. Statement indicating that, in a short taxable year, the unitrust payment is to be prorated on a daily basis.

h. Statement indicating that, in years in which additional contributions are made, the fixed percentage unitrust amount is to be applied to the non-contributed net FMV of trust assets plus the prorated net FMV of the contributed assets.

i. Statement indicating that, in the event the additional contribution is testamentary, the obligation to pay the

j. Statement indicating that the unitrust amount begins on the date of death, but such obligation can be deferred until complete funding of the trust. The statement should include that the trustee pay or receive the difference of unitrust amounts actually paid and what should have been paid, together with interest, compounded annually on such amounts.

k. Statement indicating that if the annual net FMV of trust assets is incorrectly determined by the trustee, the trustee shall pay the beneficiary or receive therefrom, the difference of the unitrust payment made and the unitrust payment that should have been paid.

l. Statement indicating that the adjusted basis of property the trustee may distribute in kind to a IRC § 170(c) organization is to be fairly representative of the adjusted basis of all trust property available for distribution on the date of distribution.

m. Statement indicating the trust is intended to qualify as a charitable lead unitrust, so that the value of the interest passing to IRC § 170(c) organizations is deductible and so that the distributions will be deductible from trust gross income.

n. Statement indicating that no estate, inheritance or other death taxes imposed against the donor's estate are to be recoverable from the trust.

o. Statement prohibiting the trustee from engaging in any act of self-dealing as defined under IRC § 4941(d); from retaining any excess business holdings as defined in IRC § 4943(c) that would subject the trust to tax under IRC § 4943; from making any investments that would subject the trust to tax under IRC § 4944; and from making any taxable expenditures as defined in IRC § 4945(d). Additionally, the trustee may not make any distributions in such a manner as to subject the trust to tax under IRC § 4942.

p. Statement indicating that any provisions made within the trust are to be ignored to the extent they would prevent the trust from qualifying as a charitable lead unitrust.

q. Statement indicating the state law that governs the trust document.

Holland & Knight

Nuts and Bolts of Split Interest Gift Structures

Planned Giving Round Table of Arizona Summer Forum Presentation June 13, 2012

CHARITABLE GIVING VEHICLES

By Shari A. Levitan, Esq.*
Holland & Knight LLP

Direct Dial Telephone: 617-854-1405
Email Address: shari.levitan@hklaw.com

*admitted to practice in Arizona and Massachusetts

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I. TAX ISSUES

A. Income Tax
   1. Adjusted Gross Income Limitations
      a) Cash
      b) Appreciated Property
   2. Public Charity vs. Private Foundation
   3. 5 Year Carry Forward Rule

B. Estate Tax
   1. Qualified Charitable Dispositions
   2. Unlimited Deduction

C. Gift Tax
   1. Qualified Charitable Dispositions
   2. Unlimited Deduction

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II. TECHNIQUES

A. Outright Lifetime Gift (cash, securities, property)
   1. Entire interest
   2. Partial interest
      a) real estate
      b) tangibles (art, etc.)
      c) part gift/part sale transactions
         i. income tax issues
         ii. allocation of basis

B. Testamentary Gift
   1. Under Will
   2. Disposition under Revocable Trust
   3. Beneficiary Designation
   4. Retirement Plan or Life Insurance Beneficiary Designation

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E. Charitable Gift Annuity

1. Provides Guaranteed Fixed Income for Life of Annuitant

2. Types of Annuities:
   a) Current Annuity
   b) Deferred Annuity
      (1) Use as a form of retirement plan
      (2) Higher payout rates due to deferred annuity structure
      (3) Can select variable data, keyed to retirement

3. Advantages to Donor
   a) Guaranteed payments
   b) A portion of payment is tax-free
   c) A portion of transaction qualifies for income tax charitable deduction
   d) Annuity passes to charity estate tax-free upon annuitant's death

4. Disadvantages to Donor
   a) Payment stream fixed for life
   b) A portion of transaction may result in capital gains taxes

5. Advantages to Charity
   a) Can accommodate small gifts
   b) Proper management of funds can result in growth which exceeds annual payout
   c) Certainty of being named beneficiary

6. Disadvantages to Charity
   a) Payment obligation is a general liability
   b) Poorly managed funds can cannibalize gift

F. Split Interest Charitable Trusts
1. Charitable Remainder Trust ("CRT")
2. Charitable Lead Trust ("CLT")

G. Charitable Remainder Trusts

A. Example:

Client owns stock in a publicly traded company, which she acquired for $100,000 and which is now worth $1,000,000. The stock generates annual dividends of $10,000, representing a yield of 1%. The stock has grown at an average annual rate of 5% since Client acquired it. Client is 65 years old and her husband is 63 years old. Client would like to diversify her portfolio by selling the appreciated stock and replacing it with higher yielding securities or bonds.

She is concerned, however, that capital gains taxes would erode her base for reinvesting by over $100,000. Capital gains tax, imposed at 20%, would result in taxes of $180,000, leaving $820,000 available for reinvestment. Client has determined that if she sells the securities and uses the after-tax proceeds to invest in assets yielding 4%, she will increase her annual income from $10,000 to $41,000.

Alternatively, Client could establish a CRUT, of which Client and her husband are the trustees and the terms of which provide that she and her husband are to receive an annual interest of 5% for their joint lives and the life of the survivor. Upon the expiration of the income interest, the property in the trust will be distributed to charities that Client has designated.

When Client transfers the appreciated stock to the CRUT, an income tax charitable deduction is generated based upon the full value of the property transferred, reduced by the actuarial value of her and her husband's income interest, or approximately $320,000. Additionally, when the trustees elect to sell the stock, there will be no current capital gains taxes on the entire sale proceeds since the remainder interest passes to charity.

Client and her husband will receive a distribution in the amount of $50,000, representing 5% of the value of the trust property. In each subsequent year, a distribution of 5% of the fair market value of the trust property will occur regardless of the actual income generated by the Trust property.

B. Types of CRTs
   1. Charitable Remainder Annuity Trust (CRAT)
   2. Charitable Remainder Unitrust (CRUT)

C. Common Characteristics of CRATs and CRUTs
   1. Trust must function exclusively as CRT from its inception
   2. CRT must have at least one recipient who is not a charity
   3. Anyone may serve as trustee, provided the trust does not qualify as a Grantor Trust for income tax purposes
   4. Duration of Trust life or up to 20 years
   5. No commutation
   6. Early termination permitted
   7. Payment intervals and timing
   8. Private Foundation rules
   9. Trust investments and Administration
   10. Can use Private Foundation or Donor-advised fund as Charitable remainder payee
   11. Requires filing of split interest tax return

D. CRATs – Unique Features
   1. Annuity Amount – Fixed sum or a percentage of initial value, must be at least 5%
   2. Potential exhaustion of assets if annuity amount exceeds §7520 rate
   3. 10% minimum charitable interest based upon actuarial tables
   4. No additional contributions permitted

E. CRUTs – Unique Features
   1. Unitrust amount based upon a fixed percentage of value of trust determined annually (must be at least 5%)
   2. Different types of unitrust provisions:
      a) Net Income Only CRUT (NICRUT)
         - Trust pays lesser of unitrust amount or actual fiduciary accounting income for the year
      b) Net Income Only with Make-up Provision CRUT (NIMCRUT)
         - Trust includes a provision that permits distributions of income in excess of unitrust amount to the extent the full unitrust amount has been underfunded in prior years

c) FLIPCRUT
- CRUT that starts as a NIMCRUT and changes to a NICRUT
- FLIP event must be outside a trustee or beneficiary's control such as marriage, divorce, death, birth of child, sale, or turning a certain age

3. 10% minimum charitable interest rule (actuarial value of charitable remainder interest)
4. Additional contributions permitted

F. Planning with Charitable Remainder Trusts
1. Appreciated Assets
   a) Take entire gain in year 1
   b) Taxation of gain based upon time of distributions
   c) Diversification of concentrated position
2. Ultimate Charitable remainder uncertain

H. Charitable Lead Trust ("CLT")

A. Example:

Grantor wishes to transfer 100,000 shares of stock to a trust for future generations. The company that will go public later this year and is currently valued at $10 per share. If Grantor simply makes a gift of this stock to a Dynasty Trust, a large taxable gift would be made.

Alternatively, Grantor could establish a Non-Grantor CLT, which provides that named charities will receive annual distributions equal to 6% of the value of the Trust assets over the next 15 years and thereafter, will be held for future generations.

The value of this gift, based upon current IRS rates is about $400,600 (the income interest passing to charity generates a gift tax charitable deduction of ~ $599,400). After application of Grantor's gift tax and GST exemptions, no transfer taxes are due.

If the trust property grows at an annual rate of 8%, at the end of the 15-year term, the trust assets are projected to be worth nearly $1,345,900.

B. Types of CLTs
   1. Charitable Lead Annuity Trust (CLAT)
   2. Charitable Lead Unitrust (CLUT)

2. Duration of Trusts – for life or lives of one or more individuals, or for a fixed term, or a combination of both
   1. Like a CRT – may use individuals as measuring life
   2. Unlike a CRT
      a) Fixed term not limited to 20 years
      b) Duration of trust may be for combination of individual's life plus term of years
      c) Donor may not retain testamentary power or revoke lead interest in intervivos CLT
      d) No FLIPs allowed
      e) Can be created as a grantor trust or non-grantor trust

D. CLATs
1. No requirement that annuity amount be at least 5%
2. No upper limit on payout to charity
3. No 10% valuation rule
4. Flexibility in redetermining the annuity amount
5. No additional contributions permitted
6. GST exemption allocated at end of annuity term

E. CLUTs
1. No 5% floor on unitrust percentage
2. No upper limit on payout to charity
3. No 10% valuation rule
4. No provision similar to NICRUT (lesser of unitrust amount or actual income) permitted
5. Additional contributions permitted
6. GST exemption allocated upon initial transfer to CLUT

F. Planning Ideas

1. Leverage of Unified Credit and GST Exemption
2. With care, can use private foundation or Donor-advised fund as charitable payee
3. Can address deduction % limitation problems for large gifts
4. Like a GRAT that performs well, further upside passes gift-tax free to remainder beneficiaries
5. If charitable interest <60% at outset, private foundation rules for excess business holdings and jeopardizing investments N/A
6. Grantors vs. Non-grantor trust?