

Charitable Remainder Trust Agreements Approved by the IRS

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We are winning the war against cancer. But there is still a great need for additional scientific research on the cause, prevention and treatment of cancer. As we learn more about the role of nutrition in the cause and prevention of cancer, our educational programs become more and more important and rewarding.

Millions of Americans provide financial support to our programs – often through tax-planned gifts, trusts and bequests. To encourage, facilitate and recognize this very important financial support, the Institute has created the League of Willful Cancer Fighters. We will be pleased to enroll in the League any client who has made, or intends to make, a bequest to the Institute or name the Institute as the beneficiary of a trust, life insurance policy, retirement death benefit or other form of estate gift. We invite you or your client to call us at your convenience.

We have prepared this booklet to help attorneys and other financial advisers understand all the important tax and financial rewards Congress has provided. Our staff can provide the exact tax and financial consequences of any gift, trust or bequest your clients may want to consider. Because we are so active in this specialized field, we can provide whatever technical and practical information you may request for planning and drafting a charitable gift arrangement that will provide your clients both the greatest personal satisfaction and the greatest tax and financial rewards.

Please feel free to call the Office of Gift Planning at any time. Our toll-free telephone number is 800-843-8114 or contact us by email at gifts@aicr.org. And please . . . if the opportunity presents itself, inform your clients about how a gift, trust or bequest to the American Institute for Cancer Research can help in the fight against cancer, while also enhancing their personal tax, investment, retirement and estate plans.

SAFE HARBOR FORMS OF CHARITABLE REMAINDER TRUSTS

In 2003, the IRS released eight specimen “safe harbor” forms for charitable remainder annuity trusts, updating earlier annuity trust documents and taking into account various revisions in the Internal Revenue Code and Regulations since 1989. On August 22, 2005, the Service issued eight redesigned forms for charitable remainder unitrusts, which parallel in many respects the annuity trust documents but contain special provisions unique to unitrusts.

Suggestions are made in this booklet for modifying the safe harbor forms to reflect additional developments that affect the drafting of a charitable remainder trust and for clauses that are not included in the safe harbor forms.

Citations: The IRS safe harbor forms are reproduced from these sources: Rev. Procs. 2003-53 through 2003-60 (annuity trusts) and 2005-52 through 2005-59 (unitrusts).

Purpose of the Sample Forms

The sample forms are essentially safe harbors for drafting a charitable remainder trust. The Revenue Procedures assure taxpayers that a trust agreement which is “substantially similar” to one of the sample forms will be recognized as meeting all the requirements of a charitable remainder trust . . . provided the trust operates in a manner consistent with the terms of the instrument creating the trust and provided it is a valid trust under applicable state law.

It will not be necessary in such cases to request a private ruling from the IRS approving the form of the trust to be assured that charity’s remainder interest is deductible. (However, the IRS later said that it will continue to issue rulings on charitable remainder trusts that are not “substantially similar” to the safe harbor documents. Rev. Proc. 2003-53 through 2003-60 and 2005-52 through 2005-59.)

The ruling request does not have to be in any standard format. The IRS has prescribed the con-

tents of the request letter, and the procedure for making the request. See Rev. Proc. 93-4, 1993-1 C.B. 382.

A trust instrument will still be considered “substantially similar” to the sample forms even though the wording is varied to comply with local law and practices as necessary to create trusts, define legal relationships, pass property by bequest, provide for the appointment of alternative and successor trustees or designate alternative charitable remaindermen.

All Charitable Remainder Trusts Benefit Individuals and Charity

Every charitable remainder trust must name one or more qualified charitable organizations – such as the American Institute for Cancer Research – as the remainder beneficiaries. And every charitable remainder trust must provide for specific annual payments to one or more individuals for the life or lives of the individuals or for a specified period of years.

Example: A charitable remainder annuity trust might direct the trustee to pay the donor a specific dollar amount each year for his or her life. At the death of the donor, the trustee would be directed to pay the then-principal of the trust to the designated charity.

Every charitable remainder trust must meet all the requirements of the applicable statutes. These requirements are both technical and specific: (1) no amounts of income or principal can be paid out other than the specified annuity or unitrust amounts; (2) the trust cannot engage in self-dealing or other specifically prohibited transactions; (3) the trust must be irrevocable; (4) additional contributions must be prohibited or, with a unitrust, subject to very specific requirements; (5) the trust must use the calendar year as its taxable year; and (6) the trustee must be reasonably free to determine investments.

If the trust is qualified, the tax law provides several important tax benefits. The present value of the charitable remainder can be immediately deducted as a charitable contribution for income, gift and estate tax purposes. The trust itself is exempt from paying taxes unless it has unrelated business income. And distributions to individuals are taxed under a special and generally favorable provision of the law.

If the trust is not qualified, the client gains no income tax charitable contribution deduction and the value of the charitable remainder interest is a taxable gift for federal gift and estate tax purposes.

In addition, the trust will not be exempt from income taxation and distributions to income beneficiaries will be taxed under a different set of rules.

Clearly, it is essential that every charitable remainder trust meet the qualification requirements of the tax law. And that, of course, is the purpose of the IRS sample forms. If they are followed, qualification is practically ensured.

Sample Forms Are Minimalist

Generally speaking, the IRS forms provide only the minimal compliance provisions. For example the forms do not include any gift-specific provisions, such as restrictions on the eventual use of the property by the charitable remainderman.

A trust draftsman may be surprised by the language used in the IRS sample forms. It is, in many cases, much different from the language generally used in a trust instrument.

The IRS safe harbor forms do not contain clauses enumerating trustees' powers, leaving that drafting task to the practitioner.

The specimen trust forms issued by the IRS do not restrict, as a "default position," the charitable remainder beneficiaries to public charities. The result of using the IRS standard clause will be to limit the donor's income tax charitable deduction to the deduction ceilings and adverse capital gains rules that apply to gifts to private foundations. Practitioners should choose the alternative provision – restricting the charitable remainderman to a public charity – for inter vivos trusts, unless the donor clearly intends to benefit a private foundation. Both the annuity trust and unitrust forms set out in this booklet employ the alternative provision.

There is now a requirement that every charitable remainder trust have a remainder value equal to at least 10% of the initial value of the trust. This requirement does not change the drafting of inter vivos charitable remainder trusts but, because assumed interest rates can change dramatically, it is prudent to include a special provision in testamentary trusts.

The sample forms contain alternative provisions permitting the donor to revoke by will the interest of the designated individual beneficiary (and thus avoid a completed gift to the beneficiary). Alternative provisions also are provided that permit substitution of different charities as remaindermen.

SECTION ONE

CHARITABLE REMAINDER UNITRUST

General Nature of the Unitrust

Every charitable remainder unitrust must provide for the payment to an individual beneficiary, at least annually, of a specified percentage of the

value of the trust assets in that particular year. The payment must be at least 5% of the value of the trust assets and can be any higher percentage the donor may want to provide, up to 50%.

The trust instrument must state the date or dates on which assets are to be valued and, of course, it must state the date or dates on which payments are to be made. The specified percentage of value – known as the “unitrust amount” – must be paid from principal if income is not sufficient to make the payment.

The unitrust will provide increased payments to the individual beneficiaries if the value of the trust assets increases. In this way, it is a hedge against continued inflation and is often recommended when the individual beneficiary is relatively young.

The present value of the remainder interest given to the American Institute for Cancer Research, or to other qualified charitable organizations, qualifies as a charitable deduction for income tax, gift tax and estate tax purposes.

The following shows the approximate amount of the charitable deduction for a one-life unitrust.*

Age of Beneficiary	Percentage of Value Payable to Beneficiary		
	5%	6%	7%
55	32%	26%	22%
60	38%	32%	28%
65	45%	39%	34%
70	52%	47%	42%
75	60%	55%	50%
80	68%	63%	59%

* Deductions are based upon a 3% AFR. The rates change monthly. Please contact our Office of Gift Planning for the exact tax consequences.

Note: Our Office of Gift Planning will be pleased to provide the exact amount of the charitable deduction that will be available for any charitable remainder trust your clients may want to consider. There is no cost for the service. You can write to us – or call our Office of Gift Planning – at the address or toll-free telephone number on the back page of this booklet.

The Income-Only Unitrust. There is a variation of the unitrust that has been employed where the

trust is funded with property that may take time to sell and does not produce an income equal to the unitrust amount. This special form of trust is also used to defer payments to the donor or other individual beneficiaries and make large payments after retirement.

The income-only unitrust, as the name implies, directs that the individual beneficiaries be paid the lesser of income earned by the trust or the specified percentage of value. A provision can be added to direct that, if the individual is paid less than the specified percentage of value in any year, the deficit can be made up in a subsequent year by paying out income that is in excess of the specified percentage of value.

The changes required for this form are found on pages 12 and 13 of this booklet.

The Flip Unitrust. IRS Regulations also permit a trust drafted as an income-only unitrust to “flip” to a standard unitrust upon the happening of a specified triggering event. The changes required for this trust arrangement are found on pages 13 – 16 of this booklet.

Term of Years Annuity Trust or Unitrust. A unitrust may be for a term of up to 20 years or it may be for the life of the beneficiary or a term of years, whichever is the greater. The safe harbor forms provide approved language for this trust arrangement.

Inter Vivos Unitrust Form for One Life

On this _____ day of _____, 20 _____, I, _____ (hereinafter “the Donor”), desiring to establish a charitable remainder unitrust within the meaning of Rev. Proc. 2005-52 and §664(d)(2) of the Internal Revenue Code (hereinafter “the Code”), hereby enter into this trust agreement with _____ as the initial trustee (hereinafter “the Trustee”). This trust shall be known as the _____ Charitable Remainder Unitrust.

1. Funding of Trust. The Donor hereby transfers and irrevocably assigns, on the above date, to the Trustee the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage and distribute the property, and any property subsequently transferred, under the terms set forth in this trust instrument.

2. Payment of Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Recipient’s death. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

3. Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 2 or, if an additional contribution is made to the trust, the unitrust amount described in paragraph 5.

4. Distribution to Charity. At the termination of the unitrust period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Recipient under the terms of this trust) to [designated remainderman] (hereinafter “the Charitable Organization”). If the Charitable Organization is not an organization described in §§170(b)(1)(A), 170(c), 2055(a) and 2522(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in §§170(b)(1)(A), 170(c), 2055(a) and 2522(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion.

5. Additional Contributions. If any additional contributions are made to the trust after the initial contribution, the unitrust amount for the year in which any additional contribution is made shall be [same percentage used in paragraph 2] percent of the sum of (a) the net fair market value of the trust assets as of the valuation date (excluding the assets so added and any post-contribution income from, and appreciation on, such assets during that year) and (b) for each additional contribution during the year, the fair market value of the assets so added as of the valuation date (including any post-contribution income from, and appreciation on, such assets through the valuation date) multiplied by a fraction the numerator of which is the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the last day of the unitrust period and the denominator of which is the number of days in the period that begins with the first day of such taxable year and ends with the earlier of the last day in such taxable year or the last day of the unitrust period. In a taxable year in which an additional contribution is made on or after the valuation date, the assets so added shall be valued as of the date of contribution, without regard to any post-contribution income or appreciation, rather than as of the valuation date.

6. Deferral of the Unitrust Payment Allocable to Testamentary Transfer. All property passing to the trust by reason of the death of the Donor (hereinafter “the testamentary transfer”) shall be considered to be a single contribution that is made on the date of the Donor’s death. Notwithstanding the provisions of paragraphs 2 and 5 above, the obligation to pay the unitrust amount with respect to the testamentary transfer shall commence with the date of the Donor’s death. Nevertheless, payment of the unitrust amount with respect to the testamentary transfer may be deferred from the date of the Donor’s death until the end of the taxable year in which the funding of the testamentary transfer is completed. Within a reasonable time after the end of the taxable year in which the testamentary transfer is completed, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between any unitrust amounts allocable to the testamentary transfer that were actually paid, plus interest, and the unitrust amounts allocable to the testamentary transfer that were payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under §664 of the Code prescribe for this computation.

7. Unmarketable Assets. Whenever the value of a trust asset must be determined, the Trustee shall determine the value of any assets that are not cash, cash equivalents or other assets that can be readily sold or exchanged for cash or cash equivalents (hereinafter “unmarketable assets”), by either (a) obtaining a current “qualified appraisal” from a “qualified appraiser,” as defined in §1.170A-13(c)(3) and §1.170A-13(c)(5) of the Income Tax Regulations, respectively, or (b) ensuring the valuation of these unmarketable assets is performed exclusively by an “independent trustee,” within the meaning of §1.664-1(a)(7)(iii) of the Income Tax Regulations.

8. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of §4941(d) of the Code, as modified by §4947(a)(2)(A) of the Code, and shall not make any taxable expenditures within the meaning of §4945(d) of the Code, as modified by §4947(a)(2)(A) of the Code.

9. Taxable Year. The taxable year of the trust shall be the calendar year.

10. Governing Law. The operation of the trust shall be governed by the laws of the State of _____. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the trust as a charitable remainder unitrust under §664(d)(2) of the Code and the corresponding regulations.

11. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of §664(d)(2) of the Code.

12. Investment of Trust Assets. Nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

13. Definition of Recipient. References to the Recipient in this trust instrument shall be deemed to include the estate of the Recipient with regard to all provisions in this trust instrument that describe amounts payable to and/or due from the Recipient. The prior sentence shall not apply to the determination of the last day of the unitrust period.

IN WITNESS WHEREOF _____ and _____

[TRUSTEE] by its duly authorized officer have signed this agreement the day and year first above written.

[DONOR]

[TRUSTEE]

By _____

[Acknowledgments, witnesses and other execution formalities required by local jurisdiction]

Drafting Comments

In General. This agreement provides for the creation of an inter vivos unitrust, with the unitrust amount payable to one beneficiary for life. Unitrust payments are quarterly. Alternative provisions allow for (1) net income, or net income with makeup pay-out arrangements, (2) a “combination of methods” payment arrangement, commonly known as a “flip” provision, (3) payment of part of the unitrust amount to a charity, (4) termination of the trust upon the happening of a qualified contingency, (5) proration of the last unitrust payment to the beneficiary’s date of death, rather than the last regular payment prior to death, (6) restricting the charitable remainderman to a public charity (employed in the above form), (7) retaining the right to substitute the charitable remainderman and (8) granting the unitrust beneficiary the power to designate the charitable remainderman.

The IRS will recognize a trust as a qualified charitable remainder unitrust meeting all of the requirements of Code §664(d)(2) if the trust operates in a manner consistent with the terms of the trust instrument, if the trust is a valid trust under applicable local law and if the trust instrument (i) is substantially similar to the sample or (ii) properly integrates one or more alternative provisions from this revenue procedure (Rev. Proc. 2005-52).

The IRS has provided detailed annotations for the unitrust sample forms (available online at <http://www.irs.gov/pub/irs-irbs/irb05-34.pdf>). The Revenue Procedure also sets out various alternative provisions.

Opening Paragraph. The opening paragraph of each sample charitable remainder unitrust form refers to the specific Revenue Procedure which published the form and states the donor’s intention of creating a charitable remainder trust. Obviously, this should be included in any trust agreement that follows the sample form.

The trust agreement can name an individual or a corporation as trustee. The American Institute for Cancer Research may agree to serve as trustee, or as co-trustee with the donor, if it is designated as a remainder beneficiary. The Institute, which is experienced at trust administration, accounting and tax return preparation, acts as trustee or co-trustee without cost to either the trust or the donor.

Paragraph 1 – Funding the Trust. Almost any form of property can be transferred to a charitable remainder unitrust. Stocks, bonds, mutual fund shares and real property that has appreciated in value are the properties most commonly transferred to the trust.

Certain properties (e.g., short-term capital gain properties, life insurance, inventory and tangible personal property) may produce a small charitable deduction or even no deduction. Other properties (e.g., mortgaged real property or an active business interest) may cause the disqualification of the trust or the loss of tax exemption.

Paragraph 2 – Payment of Unitrust Amount. The trust agreement must require the trustee to determine the fair market value of the trust assets every year and must direct that a specified percentage of the fair market value of the trust assets be paid to a designated beneficiary or beneficiaries each year for a specified period of time. This percentage cannot be changed over the term of the trust.

This form provides that the unitrust amount is to be paid for the life of the designated beneficiary. If the unitrust amount is to be paid for a specified term of years, see page 10. Provision also can be made for a portion of the unitrust amount to be paid to a qualified charity.

The trust agreement should state whether the payments are to be made monthly, quarterly, semiannually or annually. (They must be made at least annually.) In most situations, the draftsman should add language to the effect that the unitrust amount is to be paid on the last day of each specified period (as provided in the IRS form). Otherwise, payments must be made on the first day of each specified period and the allowable charitable deduction will be reduced.

The trust agreement must also state the date on which trust assets are to be valued. The trust agreement can provide averaging for the trust asset values on several different dates but this can be both cumbersome and confusing. Most trusts provide for valuing trust assets on the first day of the year.

The unitrust amount must be payable from principal if income is not sufficient and a direct statement to this effect should be included in the trust agreement.

The IRS sample form provides that any income in excess of the unitrust amount must be added to principal. Alternatively, the trust agreement can provide that income in excess of the unitrust amount is to be distributed to the American Institute for Cancer Research (or other qualified charitable remainderman).

The sentence concerning the results of an incorrect determination of value is mandatory in every form of charitable remainder unitrust.

If the payment to the individual beneficiary is to be limited to the lesser of the specified percentage of value or trust income, see the drafting changes and comments starting on page 12. Or if the payment is to flip from income only to a payment from both income and principal, see the drafting suggestions on page 13.

Paragraph 3 – Proration of the Unitrust Amount. It is mandatory to provide that the unitrust amount is to be prorated for a short taxable year. The trust agreement can provide that payments of the unitrust amount are to terminate with the last regular payment preceding the death of the beneficiary. In the absence of this provision, the full clause in the IRS sample agreement is mandatory.

Paragraph 4 – Distribution to Charity. The trust agreement can name one or more charitable beneficiaries or it can direct that the trust continue for the charitable beneficiary or beneficiaries. The last sentence of this paragraph is mandatory in all events.

The value of the remainder interest, as determined under IRC §7520, is required to be at least 10% of the initial fair market value of all property placed in the trust.

This paragraph has been modified by the editors to require that the charitable remainderman be qualified under IRC §170(b)(1)(A).

If the trust names the Institute as the remainder beneficiary, it is important to use our correct legal name: the American Institute for Cancer Research, a not-for-profit corporation located in Washington, DC.

The American Institute for Cancer Research is a fully qualified charitable institution for income tax, gift tax and estate tax purposes.

Paragraph 5 – Additional Contributions. The trust instrument must specifically prohibit or specifically permit additional contributions. If they are permitted, this rather cumbersome provision is manda-

tory. The sample form for a testamentary unitrust contains a prohibition against additional contributions. The first sentence of this paragraph can be used to prohibit additional contributions (see page 16).

Paragraph 8 – Prohibited Transactions. This paragraph of the IRS sample trust form prohibits the violation of all the private foundation excise rules. The Regulations, however, seem to require only the prohibition of self-dealing and taxable expenditures in a charitable remainder trust that directs an outright distribution to the charitable remainderman. (If the trust is to continue for the charity, the trust instrument must prohibit jeopardizing investments and excess business holdings as in the sample form.)

Paragraph 9 – Taxable Year. This is a mandatory provision.

Paragraph 10 – Governing Law. It is mandatory to specifically provide that the trustee cannot exercise any state law power that would cause a disqualification of the trust.

Paragraph 11 – Limited Power of Amendment. This clause is generally included in every charitable trust agreement. The draftsman may also want to add a clause that directs the trustee – in carrying out the provisions of the trust agreement – to seek to give effect to the intent of the donor, which is to create a tax-exempt charitable remainder unitrust as defined in IRC §664.

Paragraph 12 – Investment of Trust Assets. A mandatory paragraph.

Optional Provisions. Most practitioners will want to include additional provisions in the unitrust agreement. Typically, a provision will be included to facilitate the payment of the unitrust amount to the beneficiary in the event he or she becomes legally incapacitated. The powers and responsibilities of the trustee are often set forth in detail.

In most cases, the trustee should be given broad investment discretion and the right to make distributions in kind. Other provisions, common in general trust agreements, can be included in a charitable remainder unitrust agreement, but a clause should be added to the effect that any power or authority given to the trustee by state law or the terms of the agreement shall be ineffective and invalid if it could result in the disqualification of the trust as a charitable remainder unitrust.

Inter Vivos Unitrust for Term of Years

This trust form follows generally the provisions of an inter vivos unitrust for one life, with the following substitutions:

Opening Paragraph. Substitute Rev. Proc. 2005-53 for Rev. Proc. 2005-52.

2. Payment of Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). The unitrust period shall be a period of [a number not more than 20] years. The first day of the

unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the day preceding the [ordinal number corresponding to the length of the unitrust period] anniversary of that date. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

Special Provisions for Inter Vivos Unitrust for Two Lives

A charitable remainder unitrust can provide for the payment of a unitrust amount to two individuals for as long as either one may live. The individual beneficiaries can be given consecutive interests (to A for life then to B for life) or concurrent interests (equally to A and B for as long as they both shall live and then to the survivor for his or her life).

The IRS sample trust instruments for two lives are very similar to the standard one-life trust agreement. The biggest difference is the required paragraph relating to the payment of any estate or death taxes.

The IRS has provided sample inter vivos trust forms for both consecutive life interests and concurrent life interests. These follow the standard one-life trust form with the following exceptions:

Opening Paragraph. For consecutive individual interests, substitute “Rev. Proc. 2005-54” for “Rev. Proc. 2005-52.”

For concurrent and survivor interests, substitute “Rev. Proc. 2005-55” for “Rev. Proc. 2005-52.”

Payment of Unitrust Amount. For consecutive individual interests substitute the following:

2. Payment of the Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient]

(hereinafter “the Initial Recipient”) until the Initial Recipient’s death, and thereafter to [permissible recipient] (hereinafter “the Successor Recipient”), a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the death of the survivor of the Initial Recipient and the Successor Recipient. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Initial Recipient and/or the Successor Recipient (in the case of an undervaluation) or receive from the Initial Recipient and/or the Successor Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

For concurrent and consecutive individual interests substitute the following:

2. Payment of the Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] and to [permissible recipient] (hereinafter “the Recipients”) in equal shares during their joint lives, a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”) and, upon the death of one (hereinafter “the Predeceasing Recipient”), the Trustee shall pay the entire unitrust amount to the survivor (hereinafter “the Survivor Recipient”). The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Survivor Recipient’s death. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Predeceasing Recipient and/or the Survivor Recipient (in the case of an undervaluation) or receive from the Predeceasing Recipient and/or the Survivor Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

New Paragraph 3 – For consecutive interests, add the following new paragraph 3 and renumber succeeding paragraphs accordingly:

3. Payment of Federal Estate Taxes and State Death Taxes. The lifetime unitrust interest of the Successor Recipient will take effect upon the death of the Initial Recipient only if the Successor Recipient furnishes the funds for payment of any federal estate taxes and state death taxes for which the Trustee may be liable upon the death of the Initial Recipient. If the funds are not furnished by the Successor Recipient, the unitrust period shall terminate on the death of the Initial Recipient, notwithstanding any other provision in this instrument to the contrary.

For concurrent and survivor interests add the following new paragraph 3, and renumber succeeding paragraphs:

3. Payment of Federal Estate Taxes and State Death Taxes. The lifetime unitrust interest of the Survivor Recipient will take effect upon the death of the Predeceasing Recipient only if the Survivor Recipient furnishes the funds for payment of any federal estate taxes and state death taxes for which the Trustee may be liable upon the death of the Predeceasing Recipient. If the funds are not furnished by the Survivor Recipient, the unitrust period shall terminate on the death of the Predeceasing Recipient, notwithstanding any other provision in this instrument to the contrary.

Proration of Unitrust Amount. For consecutive interests, substitute the following: “For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 2, or, if an additional contribution is made to the trust, the unitrust amount described in paragraph 6. If the Successor Recipient survives the Initial Recipient, the Trustee shall prorate on a daily basis the next regular unitrust payment due after the death of the Initial Recipient between the estate of the Initial Recipient and the Successor Recipient.”

For concurrent and consecutive interests, substitute “Predeceasing Recipient” for “Initial Recipient” and “Survivor” for “Successor.”

Distribution to Charity. For consecutive interests substitute “Initial Recipient and/or the Successor Recipient” for “Recipient.” For concurrent and consecutive interests, substitute “Predeceasing Recipient and/or the Survivor Recipient” for “Recipient.”

Deferral of the Unitrust Payment Allocable to Testamentary Transfer. For consecutive interests substitute “Initial Recipient and/or the Successor Recipient” for “Recipient.” For concurrent and consecutive interests, substitute “Predeceasing Recipient and/or the Survivor Recipient” for “Recipient.”

Add the following clause for consecutive interests:

“Definition of Initial Recipient and Successor Recipient. References to the Initial Recipient and/or the Successor Recipient in this trust instrument shall be deemed to include the estate of the Initial Recipient and/or the Successor Recipient with regard to all provisions in this trust instrument that

describe amounts payable to and/or due from the Initial Recipient and/or the Successor Recipient. The prior sentence shall not apply to the determination of the last day of the unitrust period.”

For concurrent and consecutive interests, add the foregoing clause but substitute “Predeceasing” and “Survivor” for “Initial” and “Successor” wherever they appear.

Drafting Comment. Many draftsmen prefer to provide language similar to the following rather than the

safe harbor provision of new Paragraph 3: *No federal estate taxes, generation skipping taxes, state death taxes or other estate, death or inheritance taxes (hereinafter called death taxes) with respect to any party to this trust shall be allocated to or recoverable from this trust. Nevertheless, if for any reason this trust shall become liable for the payment of death taxes, the lifetime interest of the second Recipient shall take effect upon the death of the first Recipient to die only if the second Recipient furnishes the funds for the payment of any death taxes for which the Trust may be liable.*

Special Provisions for Inter Vivos Income-Only Unitrust

A charitable remainder unitrust can provide that the specified percentage of value payable to individual beneficiaries is to be paid only to the extent of the trust income for the taxable year. The trust agreement can also provide that deficits resulting from the income-only limitation are to be paid in a subsequent year to the extent trust income in that year exceeds the specified percentage of value for the year.

This form of unitrust is often preferred where it is uncertain whether the trust will have the cash to make the required payments to the individual beneficiaries. With the income-only limitation, payments are required only to the extent of trust income. This permits the trustee to take the time to sell property and invest the proceeds without raising immediate cash to pay the unitrust amounts.

The IRS has provided several sample forms for this unitrust arrangement. These follow the standard unitrust form for a one-life payment (set forth on page 6) with the following exceptions.

■ The trustee is instructed to pay to the recipient a unitrust amount equal to the lesser of (a) a fixed percentage amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the valuation date or (b) the trust income for the taxable year as defined in § 643(b) of the Code and the applicable regulations.

■ The paragraph addressing proration of the unitrust amount for a short taxable year, or the taxable year during which the unitrust period ends, is adapted to accommodate the income-only provision.

■ Direction is provided for how to calculate payments from a net-income unitrust if any additional contributions are made to the trust after the initial contribution, including the method for pro-rating the unitrust amount attributed to the additional contribution.

The sample forms also permit a charitable remainder unitrust to flip from an income-only unitrust to a standard unitrust in the year following the happening of a specified triggering event.

Net-Income with Make up Unitrust

The following are the IRS instructions for adding a net-income with make up provision to an inter vivos unitrust for one life. Language for two-life situations and the net-income unitrust without a make up provision can be found in Rev. Procs. 2005-52 through 2005-59.

(1) Each and every time a reference to §664(d)(2)

appears in the sample trust, replace it with a reference to §664(d)(2) and (d)(3).

(2) Replace the first four sentences of paragraph 2, Payment of Unitrust Amount, of the sample trust with the following:

In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient]

(hereinafter “the Recipient”) a unitrust amount equal to the lesser of (a) a fixed percentage amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the valuation date (hereinafter “the fixed percentage amount described in (a) of paragraph 2” or (b) the trust income for the taxable year as defined in §643(b) of the Code and the applicable regulations. The unitrust amount for a taxable year shall also include any amount of trust income for the year that is in excess of [the fixed percentage amount determined under (a) of this paragraph for the year], but only to the extent that the aggregate of the amounts paid to the Recipient in prior years was less than the aggregate of the amounts determined for all prior years under (a) of this paragraph and (a) of paragraph 5. The valuation date is the first day of each taxable year of the trust. The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Recipient’s death. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal.

(3) Replace paragraph 3, Proration of Unitrust Amount, of the sample trust with the following paragraph:

Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the fixed percentage amount described in (a) of paragraph 2, or, if an additional contribution is made to the trust, the fixed percentage amount described in (a) of paragraph 5. In such a year, this prorated fixed percentage amount shall be used in place of the fixed percentage amount described in (a) of paragraph 2 or in (a) of paragraph 5 to determine the unitrust amount payable for that year.

(4) Replace paragraph 5, Additional Contributions, of the sample trust with the following paragraph:

Additional Contributions. Notwithstanding paragraph 2, if any additional contributions are made to the trust after the initial contribution, the unitrust amount for the year in which any additional contribution is made shall be equal to the lesser of (a) a fixed percentage amount equal to [same percentage used in (a) of paragraph 2] percent of the sum of (1) the net fair market value of the trust assets as of the valuation date (excluding the assets so added and

any post-contribution income from, and appreciation on, such assets during that year) and (2) for each additional contribution during the year, the fair market value of the assets so added as of the valuation date (including any post-contribution income from, and appreciation on, such assets through the valuation date) multiplied by a fraction the numerator of which is the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the last day of the unitrust period and the denominator of which is the number of days in the period that begins with the first day of such taxable year and ends with the earlier of the last day in such taxable year or the last day of the unitrust period (hereinafter “the fixed percentage amount described in (a) of paragraph 5”) or (b) the trust income for the taxable year as defined in §643(b) of the Code and the applicable regulations. The unitrust amount for that year shall also include any amount of trust income for the year that is in excess of [the fixed percentage amount determined under (a) of this paragraph for the year], but only to the extent that the aggregate of the amounts paid to the Recipient in prior years was less than the aggregate of the amounts determined for all prior years under (a) of paragraph 2 and (a) of this paragraph. In a taxable year in which an additional contribution is made on or after the valuation date, the assets so added shall be valued as of the date of contribution, without regard to any post-contribution income or appreciation, rather than as of the valuation date.

Drafting Comment on Defining Capital Gains as Income. Regulations under IRC §643(b) allow post-contribution capital gain to be allocated to income, under the terms of a net-income unitrust instrument, if not prohibited under local law. Trustees may be granted discretionary power to allocate post-contribution gain to income, but only if permitted under state law. Reg. §1.664-3 has been amended to prevent net income unitrusts from determining trust income by reference to a fixed percentage of the annual fair market value of the trust property, even where state law would allow.

Combination of Methods (“Flip”) Unitrust Provisions

“Flip” unitrusts are the latest development in charitable remainder trust design [Reg. §1.664-3(a)(1)(i)(c)]. Donors who fund trusts with real estate, closely held stock and other nonliquid assets histori-

cally have used a net income or net income with make up unitrust, which permitted the trustee to avoid or postpone income payments prior to the sale of the trust assets. Once property is sold, however, most donors prefer the fixed percentage payments offered by a straight unitrust. Unitrusts created after December 9, 1998, may contain provisions allowing them to “flip” from a net-income trust to a standard unitrust upon the occurrence of a specific date or triggering event, which must be outside the control of the trustees or any other persons. Examples of permissible triggering events include a beneficiary achieving a particular age, marriage, divorce, death, birth of a child and sale of unmarketable assets, such as real estate. Conversion must occur at the start of the taxable year immediately following the year in which the triggering date or event occurs, and any make up amounts are forfeited. Unmarketable assets are defined as anything other than cash, cash equivalents or assets that can be readily converted to cash. Here are the IRS instructions for combining the net income with make up and fixed percentage methods (a so-called flip unitrust). (See Rev. Proc. 2005-52 regarding a flip provision for a net income unitrust without make up.)

To convert from the net income with make up method for calculating the unitrust amount to the fixed percentage method after a permissible triggering event:

(1) Each and every time a reference to “§664(d)(2)” appears in the sample trust, replace it with a reference to “§664(d)(2) and (d)(3).”

(2) Replace paragraph 2, Payment of Unitrust Amount, of the sample trust with the following paragraph:

Payment of Unitrust Amount

(i) Unitrust amount determined by net income with make up method. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) a unitrust amount equal to the lesser of (a) a fixed percentage amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the valuation date (hereinafter “the fixed percentage amount described in (a) of paragraph 2(i)”) or (b) the trust income for the taxable year as defined in §643(b) of the Code and the applicable regulations. The unitrust amount for a taxable year shall

also include any amount of trust income for the year that is in excess of [the fixed percentage amount determined under (a) of paragraph 2(i) for the year], but only to the extent that the aggregate of the amounts paid to the Recipient in prior years was less than the aggregate of the amounts determined for all prior years under (a) of paragraph 2(i) and (a) of paragraph 5(i). The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal.

(ii) Conversion to fixed percentage method of determining unitrust amount. Notwithstanding paragraph 2(i), upon the occurrence of [permissible triggering event as described in §1.664-3(a)(1)(i)(c) and (d) of the Income Tax Regulations] (hereinafter “the triggering event”) and effective as of the first day of the taxable year that immediately follows the triggering event (hereinafter “the effective date of the triggering event”), the Trustee shall pay to the Recipient in each remaining taxable year of the trust during the unitrust period a unitrust amount equal to [same percentage used in (a) of paragraph 2(i)] percent of the net fair market value of the trust assets as of the valuation date. Beginning on the effective date of the triggering event, the Trustee shall no longer pay the amount equal to the lesser of (a) or (b) in paragraph 2(i) and shall not pay any amount of trust income described in the second sentence of paragraph 2(i). The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal.

(iii) In general. The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Recipient’s death. The valuation date is the first day of each taxable year of the trust. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable

and the unitrust amount(s) actually paid.

(3) Replace paragraph 3, Proration of Unitrust Amount, of the sample trust with the following paragraph:

Proration of Unitrust Amount

(i) Proration in years preceding the effective date of triggering event. For a short taxable year before the effective date of the triggering event, which may include the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the fixed percentage amount described in (a) of paragraph 2(i) or, if an additional contribution is made to the trust, the fixed percentage amount described in (a) of paragraph 5(i). In such a year, this prorated fixed percentage amount shall be used in place of the fixed percentage amount described in (a) of paragraph 2(i) or in (a) of paragraph 5(i) to determine the unitrust amount payable for that year.

(ii) Proration on and after effective date of triggering event. For a short taxable year beginning on or after the effective date of the triggering event, which may include the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 2(ii) or, if an additional contribution is made to the trust, the unitrust amount described in paragraph 5(ii).

(4) Replace paragraph 5, Additional Contributions, of the sample trust with the following paragraph:

Additional Contributions

(i) Additional contributions made before effective date of triggering event. Notwithstanding paragraph 2(i), if any additional contributions are made to the trust after the initial contribution and before the effective date of the triggering event, the unitrust amount for the year in which the additional contribution is made shall be equal to the lesser of:

(a) a fixed percentage amount equal to [same percentage used in (a) of paragraph 2(i)] percent of the sum of: (1) the net fair market value of the trust assets as of the valuation date (excluding the assets so added and any post-contribution income from, and appreciation on, such assets during that year); and (2) for each additional contribution during the year, the fair market value of the assets so added as of the valuation date (including any post-contribution income from, and appreciation on, such assets

through the valuation date) multiplied by a fraction the numerator of which is the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the last day of the unitrust period and the denominator of which is the number of days in the period that begins with the first day of such taxable year and ends with the earlier of the last day in such taxable year or the last day of the unitrust period (hereinafter “the fixed percentage amount described in (a) of paragraph 5(i)”); or

(b) the trust income for the taxable year as defined in §643(b) of the Code and the applicable regulations. The unitrust amount for that year shall also include any amount of trust income for the year that is in excess of [the fixed percentage amount determined under (a) of paragraph 5(i) for the year], but only to the extent that the aggregate of the amounts paid to the Recipient in prior years was less than the aggregate of the amounts determined for all prior years under (a) of paragraph 2(i) and (a) of this paragraph. In a taxable year in which an additional contribution is made on or after the valuation date, the assets so added shall be valued as of the date of contribution, without regard to any post-contribution income or appreciation, rather than as of the valuation date.

(ii) Additional contributions made on or after effective date of triggering event. Notwithstanding paragraph 2(ii), if any additional contributions are made to the trust after the initial contribution and on or after the effective date of the triggering event, the unitrust amount described in paragraph 2(ii) for the year in which the additional contribution is made shall be [same percentage used in (a) of paragraph 2(i)] percent of the sum of: (a) the net fair market value of the trust assets as of the valuation date (excluding the assets so added and any post-contribution income from, and appreciation on, such assets during that year); and (b) for each additional contribution during the year, the fair market value of the assets so added as of the valuation date (including any post-contribution income from, and appreciation on, such assets through the valuation date) multiplied by a fraction the numerator of which is the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the last day of the unitrust period and the denominator of which is the number of days in the period that begins with the

first day of such taxable year and ends with the earlier of the last day in such taxable year or the last day of the unitrust period. In a taxable year in which an additional contribution is made on or after the valuation date, the assets so added shall be valued as of the date of contribution, without regard to any post-contribu-

tion income or appreciation, rather than as of the valuation date. Beginning on the effective date of the triggering event, the Trustee shall no longer pay the amount equal to the lesser of (a) or (b) in paragraph 5(i) and shall not pay any amount of income described in the second sentence of paragraph 5(i).

Testamentary Unitrust for One Life

I give, devise and bequeath [property bequeathed] to my Trustee in trust to be administered under this provision. I intend this bequest to establish a charitable remainder unitrust, within the meaning of Rev. Proc. 2005-56 and §664(d)(2) of the Internal Revenue Code (hereinafter “the Code”). The trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial trustee (hereinafter “the Trustee”).

1. Payment of Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). The first day of the unitrust period shall be the date of my death and the last day of the unitrust period shall be the date of the Recipient’s death. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

2. Deferral Provision. The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is completely funded, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between any unitrust amounts actually paid, plus interest, and the unitrust amounts payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under §664 of the Code prescribe for this computation.

3. Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 1.

4. Distribution to Charity. At the termination of the unitrust period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Recipient under the terms of this trust) to [designated remainderman] (hereinafter “the Charitable Organization”). If the Charitable Organization is not an organization described in §§170(c) and 2055(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in §§170(c) and 2055(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion.

5. Additional Contributions. No additional contributions shall be made to the trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the trust by reason of my death.

6. Unmarketable Assets. Whenever the value of a trust asset must be determined, the Trustee shall determine the value of any assets that are not cash, cash equivalents, or other assets that can be readily sold or exchanged for cash or cash equivalents (hereinafter “unmarketable assets”), by either (a) obtaining a current “qualified appraisal” from a “qualified appraiser,” as defined in §1.170A-13(c)(3) and §1.170A-13(c)(5) of the Income Tax Regulations, respectively, or (b) ensuring the valuation of these unmarketable assets is performed exclusively by an “independent trustee,” within the meaning of §1.664-1(a)(7)(iii) of the Income Tax Regulations.

7. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of §4941(d) of the Code, as modified by §4947(a)(2)(A) of the Code, and shall not make any taxable expenditures within the meaning of §4945(d) of the Code, as modified by §4947(a)(2)(A) of the Code.

8. Taxable Year. The taxable year of the trust shall be the calendar year.

9. Governing Law. The operation of the trust shall be governed by the laws of the State of _____ . However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the trust as a charitable remainder unitrust under §664(d)(2) of the Code and the corresponding regulations.

10. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of §664(d)(2) of the Code.

11. Investment of Trust Assets. Nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

12. Definition of Recipient. References to the Recipient in this trust instrument shall be deemed to include the estate of the Recipient with regard to all provisions in this trust instrument that describe amounts payable to and/or due from the Recipient. The prior sentence shall not apply to the determination of the last day of the unitrust period.

Drafting Comments

In General. The testamentary charitable remainder unitrust is very similar to the inter vivos trust set forth on pages 6 and 7. And most of the drafting suggestions for that trust are generally applicable to the testamentary trust.

The statement of the unitrust amount, the designation of a beneficiary, the fixing of the valuation date, and the statement of the duration of the trust is identical. The requirement for a clause prorating the unitrust amount, for making a distribution to the American Institute for Cancer Research (or other qualified charity) for prohibited transactions, for the taxable year, and for the investment of trust assets are all very similar to the sample form of the inter vivos unitrust.

The form obviously is based on a trust created by will but it also can be used to create a charitable remainder trust through a revocable living trust. It is important to provide very clearly in the will or revocable trust agreement for the payment of all debts, expenses and taxes of

the estate from properties other than those that are to pass to the charitable remainder trust.

Opening Paragraph. The will or revocable living trust agreement can provide that a specified sum of money, a specified property, a specified percentage of the value of the trust or estate or all or part of the residue of the trust or estate is to be distributed to the charitable remainder trust.

Alternatively, the charitable remainder trust can be left unfunded by the will or revocable trust and be named as the death beneficiary of an individual retirement account or other retirement plan. This designation, of course, is made by the client during his or her life. The trust will come into existence at the death of the decedent and will become the owner of the retirement fund or account at that time.

The trustee of the trust is designated in this opening paragraph of the safe harbor form. In most cases,

the trustee can be any person or entity permitted by state law, including the beneficiary of the trust. It may be prudent to name alternate and successor trustees in this opening paragraph.

The grantor may name himself or herself to act as trustee, or may retain the power to substitute any person as trustee, unless the trustee is given some power which, if held by the grantor, would disqualify the trust. For example, the IRS has ruled that a power to allocate, or “sprinkle,” the annuity or unitrust amount between two beneficiaries may be held only by an independent trustee who is not subservient to the grantor’s wishes.

Paragraph 1 – Payment of Unitrust Amount. See suggestions made on page 8 for the inter vivos unitrust. The requirements are the same whether the trust is created during the life or at the death of the donor.

Paragraph 2 – Deferral Provision. This clause is almost always included in a testamentary charitable remainder unitrust. In all events, the obligation to pay the unitrust amount must start at the date of death. Thus, if a quarterly payment is required, it would have to be made three months after the death. This paragraph permits the payment to be postponed until after the complete funding of the trust.

Note that the interest to be paid on the deferred unitrust amount payments will vary with the rate set forth in the Regulations.

Paragraph 4 – Distributions to Charity. In naming the Institute as the remainder beneficiary, it is important to use our correct legal name, *The American Institute for Cancer Research, a not-for-profit corporation located in Washington, DC.*

The Institute welcomes restricted trust funds but we recommend that the specific restrictions be discussed with us in advance.

Paragraph 5 – Additional Contributions. The trust instrument could permit additional contributions although this is not generally done with a testamentary trust. For a clause permitting additional contributions, see the inter vivos unitrust form on pages 6 and 7.

Minimum remainder requirement. Paragraph 1 should be drafted to assure compliance with the minimum remainder interest (10%) requirements of IRC §664(d)(2)(D). For example:

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [permissible recipient] (hereinafter referred to as “the Recipient”) during the Recipient’s life a unitrust amount equal to 7 percent [or any percent at least 5 but not exceeding 50 percent] of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the “valuation date”), or the highest percent that will result in a qualifying remainder interest under section 664(d)(2)(D), but in no case shall the unitrust amount exceed 7 percent of the net fair market value of the trust assets. If the unitrust amount required to satisfy the minimum remainder interest requirements falls below 5 percent, then the Trustee shall pay to the Recipient for a term of 20 years following the date of my death a unitrust amount equal to the highest percent that will result in a qualifying remainder interest. (Add here additional payout language from IRS sample forms as adapted for a potential term-of-years arrangement.)

Testamentary Unitrust for Two Lives

A charitable remainder trust created by will can provide for the payment of a unitrust amount to two individuals for as long as they may live. The individual beneficiaries can be given consecutive interests (to A for life and then to B for life) or concurrent interests (equally to A and B for as long as they both shall live and then to the survivor for life).

The terms of the testamentary trust for two lives is very similar to the terms of the standard one-life testamentary trust instrument.

The IRS has provided sample forms for both a testamentary unitrust that provides consecutive interests and a testamentary unitrust that provides concurrent and survivor interests. These forms are identical to the one-life form with the following exceptions:

For consecutive individual interests, substitute the following:

Opening Paragraph. Substitute Rev. Proc. 2005-58 for 2005-56.

1. Payment of Unitrust Amount. In each taxable

year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter “the Initial Recipient”) until the Initial Recipient’s death, and thereafter to [permissible recipient] (hereinafter “the Successor Recipient”), a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). The first day of the unitrust period shall be the date of my death and the last day of the unitrust period shall be the date of the death of the survivor of the Initial Recipient and the Successor Recipient. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Initial Recipient and/or the Successor Recipient (in the case of an undervaluation) or receive from the Initial Recipient and/or the Successor Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

2. Deferral Provision. The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is completely funded, the Trustee must pay to the Initial Recipient and/or the Successor Recipient (in the case of an underpayment) or receive from the Initial Recipient and/or the Successor Recipient (in the case of an overpayment) the difference between any unitrust amounts actually paid, plus interest, and the unitrust amounts payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under §664 of the Code prescribe for this computation.

3. Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in para-

graph 1. If the Successor Recipient survives the Initial Recipient, the Trustee shall prorate on a daily basis the next regular unitrust payment due after the death of the Initial Recipient between the estate of the Initial Recipient and the Successor Recipient.

4. Distribution to Charity. At the termination of the unitrust period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Initial Recipient and/or the Successor Recipient under the terms of this trust) to [designated remainderman] (hereinafter “the Charitable Organization”). If the Charitable Organization is not an organization described in §§170(c) and 2055(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in §§170(c) and 2055(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion.

The following additional clause is required:

12. Definition of Initial Recipient and Successor Recipient. References to the Initial Recipient and/or the Successor Recipient in this trust instrument shall be deemed to include the estate of the Initial Recipient and/or the Successor Recipient with regard to all provisions in this trust instrument that describe amounts payable to and/or due from the Initial Recipient and/or the Successor Recipient. The prior sentence shall not apply to the determination of the last day of the unitrust period.

For concurrent and consecutive interests, replace Rev. Proc. 2005-56 with 2005-59 in the opening paragraph and substitute the following:

1. Payment of Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] and to [permissible recipient] (hereinafter “the Recipients”) in equal shares during their joint lives, a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”) and, upon the death of one (hereinafter “the Predeceasing Recipient”), the Trustee shall pay the entire unitrust amount to the survivor (hereinafter “the Survivor Recipient”). The first day of the unitrust period shall be the date of my death and

the last day of the unitrust period shall be the date of the Survivor Recipient's death. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined, then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Predeceasing Recipient and/or the Survivor Recipient (in the case of an undervaluation) or receive from the Predeceasing Recipient and/or the Survivor Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

2. Deferral Provision. The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is completely funded, the Trustee must pay to the Predeceasing Recipient and/or the Survivor Recipient (in the case of an underpayment) or receive from the Predeceasing Recipient and/or the Survivor Recipient (in the case of an overpayment) the difference between any unitrust amounts actually paid, plus interest, and the unitrust amounts payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under §664 of the Code prescribe for this computation.

3. Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 1. Upon the death of the Predeceasing Recipient, the Trustee shall prorate on a daily basis the next regular unitrust payment due after the death of the Predeceasing Recipient between the estate of the Predeceasing Recipient and the Survivor Recipient.

4. Distribution to Charity. At the termination of the unitrust period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Predeceasing Recipient and/or the Survivor Recipient under the terms of this trust) to [designated remainderman] (hereinafter "the

Charitable Organization"). If the Charitable Organization is not an organization described in §§170(c) and 2055(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in §§170(c) and 2055(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee's sole discretion.

For concurrent and consecutive interests, add the additional clause:

12. Definition of Predeceasing Recipient and Survivor Recipient. References to the Predeceasing Recipient and/or the Survivor Recipient in this trust instrument shall be deemed to include the estate of the Predeceasing Recipient and/or the Survivor Recipient with regard to all provisions in this trust instrument that describe amounts payable to and/or due from the Predeceasing Recipient and/or the Survivor Recipient. The prior sentence shall not apply to the determination of the last day of the unitrust period.

Testamentary Unitrust for a Term of Years

This trust form follows generally the provisions of a testamentary unitrust for one life, with the following substitutions:

Opening Paragraph. Substitute Rev. Proc. 2005-57 for Rev. Proc. 2005-56.

1. Payment of Unitrust Amount. In each taxable year of the trust during the unitrust period, the Trustee shall pay to [permissible recipient] (hereinafter "the Recipient") a unitrust amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter "the valuation date"). The unitrust period shall be a period of [a number not more than 20] years. The first day of the unitrust period shall be the date of my death and the last day of the unitrust period shall be the day preceding the [ordinal number corresponding to the length of the unitrust period] anniversary of that date. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust

assets is incorrectly determined, then within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid.

2. Deferral Provision. The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which

the trust is completely funded, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between any unitrust amounts actually paid, plus interest, and the unitrust amounts payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under §664 of the Code prescribe for this computation.

3. Proration of Unitrust Amount. For a short taxable year and for the taxable year during which the unitrust period ends, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 1.

SECTION TWO

CHARITABLE REMAINDER ANNUITY TRUST

General Nature of the Annuity Trust

The charitable remainder annuity trust provides for the payment to the individual beneficiary or beneficiaries, at least annually, of a specified dollar amount. This fixed annuity amount must be at least 5% of the initial value of the gift to the trust and generally should not exceed the assumed interest rate used in computing the charitable deduction.

Example: Patrick and Anne C. transfer stock worth \$100,000 to a trust for the eventual benefit of the American Institute for Cancer Research. The trust agreement must direct the trustee to pay them (or other designated beneficiaries) a specific dollar amount that must be at least \$5,000 a year and, depending on their ages and the assumed interest rate, should not be more than \$5,000 or perhaps \$6,000 a year. The safe harbor forms define the annuity as a specified percentage of the initial fair market value of the trust, with alternative language for a fixed dollar amount.

The amount of the annuity does not change and is always payable from principal if income is not sufficient. Payments can be made on a monthly, quarterly, semiannual or annual basis. In all events, the annuity amount must be paid at least annually.

The following table shows the approximate amount of the charitable deduction that will be allowed for a gift to an annuity trust.

Rates are based on a 3.0% AFR. The rates change monthly. Please call our Office of Gift Planning at 800-843-8114 for the exact tax consequences of any charitable remainder trust that is of interest to your clients.

Age of Beneficiary	Percentage of Initial Value Payable		
	5%	6%	7%
70	45%	No	No
75	55%	46%	No
80	65%	57%	50%
85	73%	67%	62%

We should note that additional contributions cannot be made to an annuity trust.

The annuity trust is certainly easier to administer than a unitrust (which requires annual valuations), and the fixed dollar annuity payments can be especially attractive to your older clients.

Note: The Office of Gift Planning can provide the exact amount of the charitable deduction that will be allowable for any specific trust arrangement your clients may want to consider. This service is available without cost or other obligation.

Term of Years Alternative

One challenge with creating charitable remainder annuity trusts during times of low §7520 interest rates (applicable federal rates) is that the trust may fail to pass the so-called 5% probability test and/or meet the 10% minimum charitable remainder requirement. The 5% probability test applies only to trusts established for the lifetimes of individuals, which suggests an alternative: a term of years annuity trust, which can last up to 20 years

and benefit any number of beneficiaries, regardless of age. In some cases, a 20-year trust term may exceed the actuarial life expectancies of the income beneficiaries.

The IRS has issued a sample term of years CRAT, Rev. Proc. 2003-54, that can be found at http://www.irs.gov/irb/2003-31_IRB/ar05.html. Donors who prefer annuity payouts might also consider charitable gift annuities, available from the American Institute for Cancer Research.

Inter Vivos Annuity Trust Form for One Life

On this ___ day of ___, 20___, I, ___ (hereinafter “the Donor”), desiring to establish a charitable remainder annuity trust, within the meaning of Rev. Proc. 2003-53 and section 664(d)(1) of the Internal Revenue Code (hereinafter “the Code”), hereby enter into this trust agreement with ___ as the initial trustee (hereinafter “the Trustee”). This trust shall be known as the ___ Charitable Remainder Annuity Trust.

1. Funding of Trust. The Donor hereby transfers and irrevocably assigns, on the above date, to the Trustee the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage and distribute the property under the terms set forth in this trust instrument.

2. Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) an annuity amount equal to [a number no less than 5 and no more than 50] percent of the initial net fair market value of all property transferred to the trust, valued as of the above date (that is, the date of the transfer). The first day of the annuity period shall be the date the property is transferred to the trust and the last day of the annuity period shall be the date of the Recipient’s death. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. Proration of Annuity Amount. The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year of the trust during which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. Distribution to Charity. At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Recipient or the Recipient’s estate under the provisions above) to [designated remainderman] (hereinafter “the Charitable Organization”). If the Charitable Organization is not an organization described in sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion.

5. Additional Contributions. No additional contributions shall be made to the trust after the initial contribution.

6. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of

section 4941(d) of the Code, as modified by section 4947(a)(2)(A) of the Code, and shall not make any taxable expenditures within the meaning of section 4945(d) of the Code, as modified by section 4947(a)(2)(A) of the Code.

7. Taxable Year. The taxable year of the trust shall be the calendar year.

8. Governing Law. The operation of the trust shall be governed by the laws of the State of _____. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the trust as a charitable remainder annuity trust under section 664(d)(1) of the Code and the corresponding regulations.

9. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

10. Investment of Trust Assets. Nothing in this trust instrument shall be construed to restrict the Trustee investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

IN WITNESS WHEREOF _____ and _____

[TRUSTEE] by its duly authorized officer have signed this agreement the day and year first above written.

[DONOR]

[TRUSTEE]

By _____

[Acknowledgments, Witnesses, etc.]

Drafting Comments

In General. This agreement provides for the creation of an inter vivos annuity trust, with the annuity amount payable to one beneficiary for life. Annuity payments are quarterly and are expressed as a percentage of the initial value of the trust assets. Alternative provisions allow for (1) the annuity amount to be stated as a specific dollar amount, (2) payment of part of the annuity to a charity, (3) termination of the trust upon the happening of a qualified contingency, (4) proration of the last annuity payment to the beneficiary's date of death, rather than the last regular payment prior to death, (5) restricting the charitable remainderman to a public charity (employed in the above form), (6) retaining the right to substitute the charitable remainderman and (7) granting the annuity beneficiary the power to designate the charitable remainderman.

The IRS will recognize a trust as a qualified charitable remainder annuity trust meeting all of the requirements of Code §664(d)(1) if the trust oper-

ates in a manner consistent with the terms of the trust instrument, if the trust is a valid trust under applicable local law and if the trust instrument (i) is substantially similar to the sample or (ii) properly integrates one or more alternative provisions from this revenue procedure (Rev. Proc. 2003-53).

The IRS has provided detailed annotations for the annuity trust sample forms (available online at <http://www.irs.gov/pub/irs-irbs/irb03-31.pdf>). The IRS also sets out several alternative provisions that may be desirable to achieve client objectives.

Opening Paragraph. The opening paragraph of each sample annuity form refers to the specific Revenue Procedure that contains the form. Additionally, alternative or successor trustees may be designated in the trust instrument, along with other administrative powers relating to the trustee's duties and powers, as long as the provisions do not

conflict with the rules set forth in IRC §664 and associated regulations.

There are situations (e.g., where the annuity can be sprinkled among a class of beneficiaries) where the donor should not reserve the power to substitute trustees but it is generally a desirable provision to include in a charitable remainder trust agreement.

A common choice for trustee is a bank or trust company. Such organizations are experienced in managing trusts generally, and many of them have experience with charitable remainder trusts. They often can offer investment opportunities (such as common trust funds) that cannot be provided by individuals.

Paragraph 1 – Funding the Trust. It is common practice to list the properties transferred to the trust in a separate schedule, but properties can be listed in the trust agreement.

IRS annotations note that an independent trustee or “qualified appraiser” must determine the initial value of the trust assets where “unmarketable assets” are transferred.

Paragraph 2 – Payment of Annuity Amount. The annuity amount must be at least 5 percent and not more than 50% of the initial net fair market value of the assets placed in trust. But no deductions will be allowed if the probability that the trust corpus will be exhausted before the death of the recipient exceeds 5 percent (Rev. Rul. 77-374). Annotations to this form note that payments can be made in installments other than quarterly and that generally the annuity amount must be paid before the close of the taxable year for which it is due. The trust also may provide for distributions to charity before the termination of the trust and for payment of part (but not all) of the annuity amount to charity. Provision also can be made for payment to a trust for individuals who are “financially disabled.” The IRS Revenue Procedure provides alternative wording for stating the annuity amount as a specific dollar amount, rather than a percentage of the initial fair market value of the assets transferred. But note that such wording may run the risk of failing the minimum 5 percent payout requirement if the value of the trust assets should increase between the time of drafting and funding of the trust.

It is mandatory to provide that the annuity is payable out of principal if income is not sufficient.

Rather than the sample trust direction that excess income is to be added to principal, the trust instrument can direct that excess income is to be paid to the American Institute for Cancer Research (or other designated charitable beneficiary). It should be noted that no deduction is allowed for excess income paid to the Institute or other charitable beneficiary.

The trust agreement should specifically state the frequency sequence of annuity payments (annually, semiannually, quarterly, monthly, etc.). Note that the frequency of annuity payments does affect the amount of the charitable deduction. It is mandatory that the annuity be paid at least once a year after the date of the funding of the trust.

The last sentence of the sample form is not pertinent where the annuity amount is a specified dollar amount.

Paragraph 3 – Proration of the Annuity Amount. This is a mandatory provision for determining the amount of the annuity during the first taxable year of the trust and any other short taxable year.

Many charitable remainder annuity trust instruments provide that the annuity amount is to terminate with the last regular payment preceding the death of the beneficiary, which is an optional provision.

Paragraph 4 – Distribution to Charity. The trust agreement can name one or more charitable beneficiaries, or it can direct that the trust continue for the charitable beneficiary. The minimum value of the remainder interest must be at least 10% of the initial fair market value of all property placed in the trust.

As previously noted, it is recommended that both the designated and alternative charity must be one named in IRC section 170(b)(1)(a) as well as section 170(c). This seems to be a serious omission in the sample forms.

If the trust names the Institute as the remainder beneficiary, it is important to use our correct legal name . . . *the American Institute for Cancer Research, a not-for-profit corporation located in Washington, DC.*

The American Institute for Cancer Research is a fully qualified charitable organization for income, gift and estate tax purposes.

Paragraph 5 – Additional Contributions. This paragraph is mandatory. No additional contributions can be made to a charitable remainder annuity trust.

Paragraph 6 – Prohibited Transactions. This is a mandatory provision. However, the prohibitions against jeopardizing investments and excess business holdings are not generally required unless the trust is to continue after the termination of the annuity interests.

Paragraph 7 – Taxable Year. This is always a mandatory provision.

Paragraph 8 – Governing Law. State law can have a significant effect on the qualifications and administration of a charitable remainder annuity

trust. Rather than leave an open question as to governing law, most draftsmen prefer to include a specific governing law provision. The last sentence of the sample form provides assurance that state law will not give the trustee a power that would disqualify the trust as a charitable remainder trust.

Paragraph 9 – Limited Power of Amendment. This clause is generally included in every charitable remainder trust agreement.

Paragraph 10 – Investment of Trust Assets. This is a mandatory provision.

Special Provisions for Inter Vivos Annuity Trust for Two Lives

A charitable remainder annuity trust can provide for the payment of the annuity to two individuals for as long as either of them may live. The individual beneficiaries can be given consecutive interests (i.e., to A for life and then to B for life) or concurrent and survivor interests (i.e., equally to A and B for their lives and then to the survivor for his or her life).

The trust instrument for two lives is very similar to the standard one-life instrument. The biggest difference is the requirement of a paragraph relating to the payment of estate and death taxes.

The IRS has provided sample forms for both consecutive life interests and concurrent and survivor life interests. They follow the standard form with the following exceptions.

Opening Paragraph. For consecutive life interests substitute “Rev. Proc. 2003-55” for “Rev. Proc. 2003-53.” For concurrent and consecutive life interests, substitute “Rev. Proc. 2003-56.”

Paragraph 2 – Payment of Annuity Amount. For consecutive life interests substitute the following:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [permissible recipient] (hereinafter “the Initial Recipient”) until the Initial Recipient’s death, and thereafter to [permissible recipient] (hereinafter “the Successor Recipient”) (subject to any proration in paragraph 4), an annuity amount equal to [a number no less than 5 and no more than 50]

percent of the initial net fair market value of all property transferred to the trust, valued as of the above date (that is, the date of the transfer). The first day of the annuity period shall be the date the property is transferred to the trust and the last day of the annuity period shall be the date of the death of the survivor of the Initial Recipient and the Successor Recipient. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income, and to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Initial Recipient and/or Successor Recipient (in the case of an undervaluation) or receive from the Initial Recipient and/or Successor Recipient (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

For concurrent and consecutive annuity interests substitute the following:

Paragraph 2 – Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [permissible recipient] and to [permissible recipient] (hereinafter “the Recipients”) in equal shares during their lifetimes, an

annuity amount equal to [a number no less than 5 and no more than 50] percent of the initial net fair market value of all property transferred to the trust, valued as of the above date (that is, the date of the transfer), and upon the death of one (hereinafter “the Predeceasing Recipient”), the Trustee shall pay the entire annuity amount (subject to any proration in paragraph 4) to the survivor (hereinafter “the Survivor Recipient”). The first day of the annuity period shall be the date the property is transferred to the trust and the last day of the annuity period shall be the date of the Survivor Recipient’s death. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

New Paragraph 2A. For consecutive interests, add new paragraph 2A as follows:

2A – Payment of Federal Estate Taxes and State Death Taxes. The lifetime annuity interest of the Successor Recipient will continue in effect upon the death of the Initial Recipient only if the Successor Recipient furnishes the funds for payment of any federal estate taxes and state death taxes for which the Trustee may be liable upon the death of the Initial Recipient. If the funds are not furnished by the Successor Recipient, the annuity period shall terminate on the death of the Initial Recipient, notwithstanding any other provision in this instrument to the contrary.

For concurrent/consecutive interests, add the following new paragraph:

2A – Payment of Federal Estate Taxes and State Death Taxes. The lifetime annuity interest

of the Survivor Recipient will continue in effect upon the death of the Predeceasing Recipient only if the Survivor Recipient furnishes the funds for payment of any federal estate taxes and state death taxes for which the Trustee may be liable upon the death of the Predeceasing Recipient. If the funds are not furnished by the Survivor Recipient, the annuity period shall terminate on the death of the Predeceasing Recipient, notwithstanding any other provision in this instrument to the contrary.

Paragraph 3. For consecutive interests, substitute the following:

3. Proration of Annuity Amount. The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. If the Successor Recipient survives the Initial Recipient, the Trustee shall prorate on a daily basis the next regular annuity payment due after the death of the Initial Recipient between the estate of the Initial Recipient and the Successor Recipient. In the taxable year of the trust during which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

For consecutive/concurrent interests, substitute the following:

3. Proration of Annuity Amount. The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. Upon the death of the Predeceasing Recipient, the Trustee shall prorate on a daily basis the Predeceasing Recipient’s share of the next regular annuity payment between the estate of the Predeceasing Recipient and the Survivor Recipient. In the taxable year of the trust during which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

Paragraph 4. Distribution to Charity. For both consecutive and consecutive/concurrent annuity interests, substitute the words “Recipients or their estates” for “Recipient or the Recipient’s estate.”

Testamentary Charitable Remainder Annuity Trust for One Life

I give, devise and bequeath [property bequeathed] to my Trustee in trust to be administered under this provision. I intend this bequest to establish a charitable remainder annuity trust, within the meaning of Rev. Proc. 2003-57 and section 664(d)(1) of the Internal Revenue Code (hereinafter “the Code”). The trust shall be known as the ___ Charitable Remainder Annuity trust and I hereby designate ___ as the initial trustee (hereinafter “the Trustee”).

1. Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [permissible recipient] (hereinafter “the Recipient”) an annuity amount equal to [a number no less than 5 and no more than 50] percent of the net fair market value of all property passing to this trust as finally determined for federal estate tax purposes. The first day of the annuity period shall be the date of my death and the last day of the annuity period shall be the date of the Recipient’s death. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income, and to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined then, within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. Deferral Provision. The obligation to pay the annuity amount shall commence with the date of my death, but payment of the annuity amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is completely funded, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between any annuity amounts actually paid, plus interest, and the annuity amounts payable, plus interest. The interest shall be computed for any period at the rate of interest, compounded annually, that the federal income tax regulations under section 664 of the Code prescribe for this computation.

3. Proration of Annuity Amount. The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year of the trust during which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. Distribution to Charity. At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Recipient or the Recipient’s estate under the provisions above) to [designated remainderman] (hereinafter “the Charitable Organization”). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in sections 170(c) and 2055(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion.

5. Additional Contributions. No additional contributions shall be made to the trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the trust by reason of my death.

6. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of

section 4941(d) of the Code, as modified by section 4947(a)(2)(A) of the Code, and shall not make any taxable expenditures within the meaning of section 4945(d) of the Code, as modified by section 4947(a)(2)(A) of the Code.

7. Taxable Year. The taxable year of the trust shall be the calendar year.

8. Governing Law. The operation of the trust shall be governed by the laws of the State of _____. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the trust as a charitable remainder annuity trust under section 664(d)(2) of the Code and the corresponding regulations.

9. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(2) of the Code.

10. Investment of Trust Assets. Nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

Drafting Comments

In General. This agreement provides for the creation of a testamentary annuity trust, with the annuity amount payable for one life. Annuity payments are quarterly and are expressed as a percentage of the initial value of the trust assets. Alternative provisions in Rev. Proc. 2003-57 allow for (1) the annuity amount to be stated as a specific dollar amount, (2) payment of part of the annuity to a charity, (3) termination of the trust upon the happening of a qualified contingency, (4) the trust to end with the last regular payment prior to death, rather than a prorated amount and (5) granting the annuity beneficiary the power to designate the charitable remainderman. The IRS will recognize a trust as a qualified charitable remainder annuity trust meeting all of the requirements of IRC §664(d)(1) if the trust operates in a manner consistent with the terms of the trust instrument, if the trust is a valid trust under applicable local law and if the trust instrument (i) is substantially similar to the sample or (ii) properly integrates one or more alternate provisions from this revenue procedure.

Minimum Remainder Requirement. Paragraph 1 should be drafted to assure compliance with the minimum remainder interest (10%) requirements of IRC §664(d)(1)(D). For example:

1. *Payment of Annuity Amount.* In each taxable year of the Trust during the annuity period, the

Trustee shall pay to [permissible recipient] (hereinafter referred to as “the Recipient”) during the Recipient’s life an annuity amount equal to 7 percent [or any percent at least 5 but not exceeding 50 percent] of the initial fair market value of the assets of the Trust as finally determined for federal estate tax purposes, or the highest percent that will result in a qualifying remainder interest under section 664(d)(2)(D), but in no case shall the annuity amount exceed 7 percent of the initial fair market value of the trust assets. If the annuity amount required to satisfy the minimum remainder interest requirements falls below 5 percent, then the Trustee shall pay to the Recipient an annuity amount equal to 5 percent of the initial fair market value of the trust assets for the longest term of years, not exceeding 20, that will result in a qualifying remainder interest. (Add here additional payout language from IRS sample forms as adapted for a potential term-of-years arrangement.)

The IRS has provided detailed annotations for the testamentary annuity trust sample form (available from the Treasury at the following address: <http://www.irs.gov/pub/irs-irbs/irb03-31.pdf>). See also the comments to the inter vivos annuity trust form beginning on page 23.

SECTION THREE

ADDITIONAL TRUST PROVISIONS

The following alternative IRS safe-harbor provisions can be added or substituted in a charitable remainder unitrust. The unitrust clauses set out below are from Rev. Proc. 2005-52 (inter vivos unitrust for one life). They can be employed with annuity trusts in many instances by substituting “annuity” for “unitrust,” and 664(d)(1) for 664(d)(2) each time they appear. But see Rev. Procs. 2005-56 to 2005-59 for exact annuity trust language, particularly as to payment of part of the annuity amount to charity.

Payment of Part of the Unitrust Amount to an Organization Described in §170(c).

(1) Explanation. An organization described in §170(c) may receive part, but not all, of any unitrust amount [Section 664(d)(2)(A)]. If a gift tax charitable deduction and, if needed, an estate tax charitable deduction are sought for the present value of the unitrust interest passing to a charitable organization, the trust instrument must contain additional provisions. First, the trust instrument must specify the portion of each unitrust payment that is payable to the noncharitable recipient and to the charitable organization described in §§170(c), 2522(a), and, if needed, §2055(a). Second, the trust instrument must contain a means for selecting an alternative qualified charitable organization if the designated organization is not a qualified organization at the time when any unitrust amount is to be paid to it. Third, the trust instrument must contain prohibitions against investments that jeopardize the exempt purpose of the trust within the meaning of §4944, as modified by §4947(a)(2)(A), and against retaining any excess business holdings within the meaning of §4943, as modified by §4947(a)(2)(A).

(2) Instructions for use. (a) Replace paragraph 2, Payment of Unitrust Amount, of the sample trust with the following paragraph:

Payment of Unitrust Amount. The unitrust amount is equal to [a number no less than 5 and no more than 50] percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust (hereinafter “the valuation date”). In each taxable year of the trust during the unitrust period, the Trustee shall pay [the percentage of the unitrust amount payable to the noncharitable recipient] percent of the unitrust amount to [permissible recipient] (hereinafter “the Recipient”) and [the percentage of the unitrust amount payable to the charitable recipient] percent of the unitrust amount to [an organization described in §§170(c), 2055(a) and 2522(a) of the Code] (hereinafter “the Charitable Recipient”). The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Recipient’s death. If the Charitable Recipient is not an organization described in §§170(c), 2055(a), and 2522(a) of the Code at the time when any unitrust payment is to be distributed to it, then the Trustee shall distribute that unitrust payment to one or more organizations described in §§170(c), 2055(a) and 2522(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee’s sole discretion. The unitrust amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal. If, for any year, the net fair market value of the trust assets is incorrectly determined then, within a reasonable period after the correct value is finally determined, the Trustee shall pay to the Recipient and the Charitable Recipient (in the case of an undervaluation) or receive from the Recipient and the Charitable Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount(s) properly payable and the unitrust amount(s) actually paid. (b) Replace the first parenthetical in paragraph 4, Distribution to Charity, of the sample trust with the following parenthetical: (other than any amount due the Recipient and the Charitable Recipient under the terms of this trust) (c) Replace each reference to “the Recipient” in paragraph 6, Deferral of the Unitrust Payment Allocable to Testamentary Transfer, of the sample trust with a reference to “the Recipient and the Charitable Recipient.” (d) Add the following sentence after the first and only sentence in paragraph 8, Prohibited Transactions, of the sample trust: The Trustee shall not make any

investments that jeopardize the exempt purpose of the trust within the meaning of §4944 of the Code, as modified by §4947(a)(2)(A) of the Code, or retain any excess business holdings within the meaning of §4943 of the Code, as modified by §4947(a)(2)(A) of the Code.

Comment: Paying a portion of the unitrust or annuity amount to charity will not increase the donor's income tax charitable deduction, but income distributed to a qualified organization is not taxable to the income recipient of the unitrust or annuity trust recipient.

Qualified Contingency

(1) Explanation. Under §664(f), payment of the unitrust amount may terminate upon the earlier of the occurrence of a qualified contingency (as defined in §664(f)(3)) or the death of the recipient. The amount of the charitable deduction, however, will be determined without regard to a qualified contingency. See §664(f)(2).

(2) Instructions for use. Replace the second sentence of paragraph 2, Payment of Unitrust Amount, of the sample trust with the following sentence:

The first day of the unitrust period shall be the date property is first transferred to the trust and the last day of the unitrust period shall be the date of the Recipient's death or, if earlier, the date on which occurs the [qualified contingency].

Comment: Virtually anything can be a "qualified contingency" – remarriage and death of some other person are two examples cited by the joint committee on taxation that drafted §664(f). The IRS has issued private letter rulings approving various contingencies that would cause a trust to end "early:" Separation or divorce of the donor's son and daughter-in-law (eliminating survivorship interest of daughter-in-law), death of a particular individual and completion of the college educations of 15 children.

Last Unitrust Payment to the Recipient

As an alternative to prorating the unitrust amount in the taxable year of the recipient's death, the obligation to pay the unitrust amount may terminate with the last regular payment preceding the recipient's death. However, the fact that the recipient may not receive a final prorated payment will not be taken into account for purposes of determining the present value of the remainder interest [Reg. §1.664-3(a)(5)(i)]. Note that, although the obligation to pay the unitrust amount may terminate with the last regular payment preceding the recipient's death, the trustee must pay to the recipient's estate any amounts allocated to the payments payable before the recipient's death that are due as a result of an adjustment to the unitrust amount payable for that year, as in the case of an undervaluation or an additional contribution. Replace paragraph 3, Proration of Unitrust Amount, of the sample trust with the following paragraph:

Proration of Unitrust Amount. For a short taxable year, the Trustee shall prorate on a daily basis the unitrust amount described in paragraph 2, or, if an additional contribution is made to the trust, the unitrust amount described in paragraph 5. In the taxable year of the trust during which the unitrust period ends, however, the obligation of the Trustee to pay the unitrust amount shall terminate with the last regular quarterly installment preceding the death of the Recipient.

Retaining the Right to Substitute the Charitable Remainderman

The donor may retain the right to substitute another charitable remainderman for the charitable remainderman named in the trust instrument. (See Rev. Rul. 76-8, 1976-1 C.B. 179). Insert the following sentence between the first and last sentences of paragraph 4, Distribution to Charity, of the sample trust:

The Donor reserves the right to designate, at any time and from time to time, in lieu of the Charitable Organization identified above, one or more organizations described in §§170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code as the charitable remainderman and shall make any such designation by giving written notice to the Trustee.

Comment: This clause should contain reference to Code §170(b)(1)(A) (inserted above) if the donor wishes to restrict the remainderman to a public charity and thereby qualify for more favorable charitable deduction treatment.

Power of Appointment to Designate the Charitable Remainderman

The trust instrument may grant the recipient a power of appointment to designate the charitable remainderman. (See Rev. Rul. 76-7, 1976-1 C.B. 179). Replace paragraph 4, Distribution to Charity, of the sample trust with the following paragraph:

Distribution to Charity. At the termination of the unitrust period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due the Recipient under the terms of this trust) to one or more charitable organizations described in §§170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code as the Recipient shall appoint and direct by specific reference to this power of appointment by inter vivos or testamentary instrument. To the extent the Recipient fails to effectively exercise the power of appointment, the principal and income not effectively appointed shall be distributed to one or more organizations described in §§170(c), 2055(a), and 2522(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee's sole discretion. If an organization fails to qualify as an organization described in §§170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the trust is to be distributed to it, then the Trustee shall distribute the then principal and income to one or more organizations described in §§170(c), 2055(a), and 2522(a) of the Code as the Trustee shall select, and in the proportions as the Trustee shall decide, in the Trustee's sole discretion.

Comment: This clause should contain reference to Code §170(b)(1)(A) (inserted above) if the donor wishes to restrict the remainderman to a public charity and qualify for more favorable charitable deductions.

The War Against Cancer

When you have the occasion to draft a trust or a bequest for a client who wants part of his or her estate to support the war against cancer, our correct legal name is:

“American Institute for Cancer Research, a not-for-profit corporation located in Washington, DC.”

Please feel free to contact our Office of Gift Planning for additional information about the mission and the future plans of the American Institute for Cancer Research.

Our Office of Gift Planning will be pleased to help you plan a trust or bequest that will accomplish the specific objectives of your client. We can also provide the exact tax consequences of any trust arrangement a client may want to consider. There is no cost or other obligation for this service.

Information for the Attorney or Advisor

- AICR’s official name:
American Institute for Cancer Research
- AICR’s mailing address:
1560 Wilson Blvd, Suite 1000,
Arlington, VA 22209
- AICR’s phone number:
800-843-8114
- AICR’s email address: gifts@aicr.org
- AICR’s identification:
A not-for-profit organization under Section 501(c)(3)
of the Internal Revenue Service Code
- AICR’s tax-exempt IRS number:
52-1238026

The information and examples provided in this booklet are for information and discussion purposes only. The examples are hypothetical, and the facts and tax consequences of individual transactions may vary from person to person. Each estate planning professional must independently determine and evaluate the tax and financial consequences of each individual situation.

Office of Gift Planning
AMERICAN INSTITUTE FOR CANCER RESEARCH
1560 Wilson Blvd, Suite 1000,
Arlington, VA 22209
800-843-8114 or 202-328-7744
www.aicr.org/estateplanner