Planning and Drafting Charitable Gifts and Trusts with Real Property

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American Institute for Cancer Research®

Major Gifts, Trusts and Bequests to the American Institute for Cancer Research

The American Institute for Cancer Research is devoted to the task of conquering our nation's most dreaded illness. Today, scientists funded by AICR are closer than ever to uncovering the root causes of cancer. That means all of us are closer to living in a world in which every cancer that can be prevented is prevented.

Here at AICR, that's the rallying cry of a mission we take very seriously. Right now, nearly 1.7 million cases of cancer occur in the United States every year. But AICR researchers estimate that we could cut that number by about one-third, simply by eating better, moving more and staying as lean as we can.

AICR has provided more than $100 million in research grants to leading scientists at clinics, universities and cancer centers throughout the United States. AICR's research is revealing how and why cancer happens, and, more importantly, what we can do to bolster our bodies' natural defenses and stop cancer in its tracks.

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 to name the Institute as the beneficiary of a trust, a life insurance policy, a retirement death benefit or other form of estate gift. We invite you or your client to call us at your convenience.

To encourage generous gifts to the Institute and other charities, we have prepared this booklet to help attorneys and other financial advisors 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. And 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 1-800-843-8114. 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 further the fight against cancer and also enhance their personal tax, investment, retirement and estate plans.

PLANNING AND DRAFTING CHARITABLE GIFTS AND TRUSTS WITH REAL PROPERTY

Real property – whether residential, investment, agricultural or commercial and whether improved or unimproved – can often be given to a charitable remainder trust with very favorable tax and financial consequences.

Benefit One: No matter how much the property may have appreciated in value, the donor will completely avoid capital gains taxes. Of course, this may be even more important where the land includes buildings that have been subject to depreciation. Depreciation deductions reduce the owner's basis and will produce capital gain upon sale that is taxed at a 25% rate – all avoidable with a CRT.

Benefit Two: The present value of the remainder interest given to the American Institute for Cancer Research will qualify for an immediate income tax charitable deduction. In most cases, the deduction will be based on the fair market value of the property transferred to the trust, even though the appreciation in the value of the property has never been taxed to the donor.

Benefit Three: The donor will also avoid paying sales commissions, which may be as much as 10% of the selling price.

Benefit Four: Federal estate and gift taxes are significantly minimized when the property is transferred to a charitable remainder trust.

Benefit Five: The donor, or his or her designated beneficiaries, can receive a substantial lifetime income when real property is given to a charitable remainder trust. The donor can direct the amount of income, the beneficiaries who will receive the income, the time the income will be paid and whether the income will start immediately or be deferred for a number of years.

Benefit Six: The donor will have the immense personal satisfaction of knowing that his or her gift to the Institute will bring us all closer to the day when cancer is no longer such a terrible threat to our society. *Gifts made by generous and concerned friends of the American Institute for Cancer Research in recent years have permitted the Institute to complete an important study showing Americans how they can reduce their risk of cancer by one-third*.

Depending on the specific facts, there may be other benefits that can be gained by transferring real property to the Institute or to a trust for the benefit of the Institute. These special benefits will be expressed later in this booklet.

We need to add that there may also be challenges in transferring real property to a charitable remainder trust. For example, a client may sometimes find that it is difficult and costly to establish the fair market value of the property for tax purposes. Potential environmental liability may have to be addressed before the charitable remainder trust can accept a gift of real property. The existence of a mortgage can cause the disqualification of the trust. There also may be questions concerning the basic marketability of the property. Indeed, the trustee may be unwilling to accept a gift of real property until a title search has been made or the donor acquires title insurance.

The primary purpose of this booklet is to examine the benefits of gifts of real property to a charitable remainder trust and to suggest methods for gaining the maximum tax and financial benefits while minimizing or avoiding the problems. Outright gifts of real property to the American Institute for Cancer Research are briefly discussed on page 8.

THE INCOME TAX CHARITABLE DEDUCTION FOR A GIFT OF REAL PROPERTY TO A CHARITABLE REMAINDER TRUST

Real property in most jurisdictions can be transferred to a charitable remainder trust for the American Institute for Cancer Research (or other qualified charity) by a typical quitclaim deed of conveyance. After being assured of a marketable title, free from environmental liability, the trustee will accept the deed and file it in the proper office. The trust will thereupon become the legal owner of the property.

Fixing the Fair Market Value of Real Property

A client who transfers real property to a charitable remainder trust can deduct, as an income tax charitable contribution, the present value of the remainder interest given to the Institute. In most cases, this deduction will be based on the fair market value of the property on the date of the gift. But if the property has not been held by the client for more than one year, the charitable deduction will be based on the client's adjusted cost basis.

The fair market value of the real property will be the basis of computing the present value of the remainder interest even though depreciation deductions had been claimed by the client in years prior to the gift. (Note, however, that some forms of accelerated depreciation will reduce the allowable charitable deduction.)

Special IRS tables, and a number of other factors, are used to compute the value of the remainder interest (and the charitable deduction). But the basis for the deduction for any gift of real property made to a charitable remainder trust will be the fair market value of the property, which must be determined through a so-called "qualified appraisal" unless the charitable deduction claimed for the property is less than $5,000.

The law is very specific in requiring that a qualified appraisal must be in writing and must be prepared no more than 60 days before the date of the gift and no later than the date for filing the donor's income tax return. The written appraisal must contain a detailed description of the property; the physical condition of the property; the method used by the appraiser in fixing the value; the date the appraisal was made; facts supporting the appraised value; and, of course, the fair market value determined by the appraiser.

Comparative sales prices will be the primary consideration for many forms of real property, but an income and expense analysis may be the most important consideration in fixing the value of apartments and other investment properties.

The trustee receiving the gift must sign a qualified appraisal form (IRS Form 8283) and if the property is sold within three years of the gift the trustee must report to the IRS, within 125 days after the sale, the sales price and other details of the sale (IRS Form 8282).

There are no specific requirements as to who can make a qualified appraisal of real property. It is necessary only that the appraiser hold himself or herself out as an appraiser and affirm that he or she is qualified to make the appraisal.

It should be noted that stiff penalties can be imposed – on both the appraiser and the donor – for a substantial overstatement of value.

The cost of the appraisal can be claimed as a miscellaneous itemized deduction on the donor's income tax return.

Establishing the Value of the Charitable Remainder Interest

Every charitable remainder trust must provide for the payment of an annuity or unitrust amount (a percentage of the value of the trust) at least once a year to designated individual beneficiaries. The trust agreement must also direct that the property remaining in the trust at the termination of the payments must be distributed to the American Institute for Cancer Research or other qualified charity.

Typically, the trust agreement will direct that the annuity, or the unitrust amount, be paid to the donor during his or her life and then to the spouse of the donor for as long as he or she may live. After the death of both beneficiaries, the property remaining in the trust is paid to the Institute. Only the present value of the Institute's right to receive the trust property at some later time qualifies for an income tax charitable deduction.

The IRS has provided special tables for computing the value of each of these interests. There is one set of tables for annuity trusts and a second set of tables for unitrusts. The unitrust tables are used for a straight unitrust, an income-only unitrust and a flip unitrust. (The charitable deduction for all forms of unitrusts will be identical.)

The calculation of the charitable deduction for any trust arrangement involves the age of the beneficiary (or the term of the trust), the fair market value of the gift, the amount of income that will be distributed each year to the individual beneficiaries, the times the income will be distributed and current economic conditions.

We need to note that the charitable remainder interest must be at least 10% of the initial value of the trust. Otherwise, the trust will not be a qualified charitable remainder trust.

We invite you to call our Office of Gift Planning for the exact income tax deduction (and other tax and financial consequences) of any charitable remainder trust a client may want to consider. There is never a cost or obligation for this service. You can call the Office of Gift Planning toll free at 1-800-843-8114.

The following table will give you a rough idea of the charitable deduction allowable for a charitable remainder unitrust that pays an income for the life of one individual:

Age of Beneficiary	**Percentage of Value** 5%	6%	7%
55	31.9%	26.2%	21.7%
60	38.1	32.2	27.4
65	44.9	39.0	34.0
70	52.3	46.6	41.7
75	60.1	54.8	50.2
80	67.8	63.1	58.8

This table indicates the approximate percentage of the fair market value of the property that can be deducted for income tax and gift tax purposes. It is based on an applicable federal rate of 2.2%.

Limitations on the Charitable Deduction. The income tax charitable deduction can never exceed 50% of the donor's adjusted gross income. The deduction is limited to 30% of the donor's adjusted gross income where the value of the property exceeds the donor's adjusted cost basis and the asset has been held more than one year. In both cases, however, any excess amount can be carried over and deducted for up to five additional years.

Note: A donor can elect to deduct only his adjusted cost basis, rather than the higher fair market value, and thereby qualify for the 50% limitation. This election should be considered if the donor has a short life expectancy or if the appreciation in the value of the property is relatively small.

PLANNING A CHARITABLE REMAINDER TRUST WITH REAL PROPERTY

Real property can be transferred to a charitable remainder trust simply by giving the trustee a deed to the property. The property can then be sold by the trust and the sales proceeds invested, typically in marketable securities. The trustee may elect to retain the property as an investment of the trust.

The donor must choose the trust beneficiaries, the amount that will be paid to the beneficiaries each year, the length of time the payments will be made and the person or institution that will serve as trustee. Most importantly, the donor must also choose the form of the charitable remainder trust.

Whether the donor chooses an annuity trust, a unitrust, an income-only unitrust or a flip unitrust, the trust will completely avoid capital gains tax no matter how much the real property has appreciated in value. In addition, the donor will minimize potential gift and estate taxes and will gain an immediate income tax charitable deduction for the present value of the remainder interest given to the American Institute for Cancer Research (or other qualified charity).

Reminder: The value of the remainder interest must be at least 10% of the initial value of the trust. Otherwise, the trust will be disqualified and no charitable deduction will be allowed.

Choosing the Form of the Charitable Remainder Trust

Assume that one of your clients wants to transfer a parcel of real property, appraised at $200,000, to a charitable remainder trust that will give him or her a good income for as long as he or she may live and provide future funding for important cancer research and education programs. The client has the following options:

1. The client can transfer the real property to an annuity trust that would pay him or her a fixed dollar amount of income every year for life. The exact amount of income must be specified in the trust agreement and must be at least $10,000 a year (5% of the initial value of the trust). Payout cannot be so high as to reduce the charitable remainder value below 10%. Furthermore, annuity trusts must pass the IRS "5% probability test."

Example: Pay the donor $10,000 every year for as long as he or she may live.

2. The client can transfer the property to a unitrust that would require the trustee to determine the value of the trust assets every year and to pay a specified percentage of that value to the beneficiary every year. The percentage of value to be paid to the beneficiary could be as low as 5% or it could be any higher percentage (not in excess of 50%) that would give rise to a charitable deduction of at least $20,000 (10% of the initial value of the trust).

Example: Pay the donor 6% of the value of the assets of the trust every year for as long as he or she may live.

3. The property could be transferred to an income-only unitrust that would pay the lesser of the specified percentage of value (subject to the limitations in the above paragraph) or the income actually earned by the trust in that year. The trust instrument could contain an optional make-up provision whereby income in excess of the specified percentage would also be paid to the beneficiary to "make up" for amounts not paid in prior years because trust income was less than the specified percentage of value.

Example: Each year, pay the donor the lesser of 6% of the value of the trust assets in that year or the income earned by the trust in that year.

4. The client could transfer the realty to a so-called flip unitrust that would pay the lesser of the specified percentage of value or income until a specified date or the occurrence of a "triggering event" (possibly the year the property was sold) and the full specified percentage of value for all years after the triggering event.

Example: Each year until the realty is sold, pay the donor the lesser of 6% of the value of the trust in that year or the income earned by the trust in that year and thereafter pay the donor 6% of the value of the trust assets every year for as long as he or she may live.

The choice of trust could be a simple personal decision if the real property produced a cash flow adequate to pay the annuity or unitrust amount or if it was quite certain that the property could be sold quickly and thereby produce enough cash to make the required payments. An older, conservative client might choose the certainty of an annuity trust and a younger client might choose the unitrust, which could be a hedge against inflation. Or the client might choose an income-only unitrust if he or she wanted to defer income payments until some later time. In this example, there would be no reason to choose a flip unitrust.

In many cases, however, real property will not produce a cash flow sufficient to make the annuity or unitrust amount payments. Furthermore, it may be apparent that selling the property at its fair market value could take several years. If this is the situation, the client's options are more limited.

Real Property That Does Not Produce Income Needed by the Trust

The client who funds a charitable remainder trust with realty that does not provide an adequate income puts the trustee in the impractical situation of having to distribute a small undivided interest in the real property in satisfaction of each annual annuity or unitrust amount payment until such time as the trust is able to make cash payments. In-kind distributions are treated as if the trust had sold the undivided interest and distributed the proceeds to the client. Thus, part of the in-kind distribution will be taxed to the client as a capital gain and the client will take a cost basis in the undivided interest equal to its then fair market value.

An alternative would be for the client to make additional annual gifts to the trust of cash or marketable securities sufficient to make the required distribution in cash. These gifts, of course, would give rise to additional charitable deductions. Note, however, that additional contributions cannot be made to an annuity trust.

An income-only unitrust would, of course, avoid any need for taking back small undivided interests in the real property (or of making additional cash contributions). By including a make-up provision in the trust agreement, as well as a clause to the effect that all capital gains resulting from post-gift appreciation would be considered income, the donor might be assured of eventually receiving all or most of the full specified percentage of value.

Example: Your client transfers real property worth $200,000 to a 6% income-only unitrust with a make-up provision. The trust has no income and after three years the deficit to be made up from excess income is $36,000. In the fourth year, the property is sold for $220,000. The sales proceeds, to the extent of $20,000, will be considered income and can be immediately distributed to the client, leaving a deficit of only $16,000. In the next year, the trust has dividend income and capital gains of $16,000. Even though 6% of the trust's value is only $12,000, the client can be paid $16,000 in that year, paying off more of the prior deficit.

The major disadvantage of the income-only unitrust may be the limitation it imposes on investments. If the trustee must always strive to have annual income or realized capital gains equal to the specified percentage of value, a great deal of investment flexibility can be lost. This would be most acute if the trust instrument required a rather high percentage of value to be paid every year.

A flip unitrust would be the fourth option available to the client. Selecting this form of trust would avoid any possible need to give the client small undivided interests in the property. And it would also avoid the limitation the income-only unitrust has on investment flexibility. But because make-up payments cannot be made in years after the trust flips to a standard unitrust, the donor could lose a significant amount of income.

Which is the best trust arrangement? The answer hinges on whether the property produces income and the prospects for an early sale. Many practitioners typically recommend a flip unitrust, giving the client the ability to receive post-contribution capital gains as a make-up in the final year the trust operates as a net-income with make up unitrust.

Choosing the Property to Be Transferred to the Trust

Real property can be residential, investment, agricultural or commercial; it can be improved or unimproved; it can be readily marketable or very difficult to market; it can be unoccupied, rented, occupied by the donor or used in the donor's business; it can be owned free and clear or subject to a mortgage or other lien; it can be wholly owned by the donor or the donor may own only an undivided interest.

With the exception of mortgaged property, almost all these many forms of realty can be effectively transferred to a charitable remainder trust.

Mortgaged Real Property. Until 1990, it was generally believed that mortgaged property could be effectively transferred to a charitable remainder trust. But in that year, the IRS issued a Private Letter Ruling to the effect that any amount paid by a charitable remainder trust on a mortgage would be a prohibited "other payment" that would disqualify the trust.

It is possible that a gift of mortgaged property to a charitable remainder trust could also be a form of self-dealing that would disqualify the trust. Furthermore, the trust might have debt-financed income, which would cause a loss of its tax exemption if the mortgage had been placed on the property within five years of the gift to the trust.

Note: Although mortgaged real property can be given outright to a qualified charitable organization, the gift would be a bargain sale, making a portion of the appreciation in value immediately taxable to the donor. If the mortgage had been placed on the property within five years of the gift, the charity might incur a debt-financed income tax.

Rental or Commercial Property. The income realized by a charitable remainder trust from some forms of real property would be unrelated business income that would cause the trust to lose its tax exemption. The law is clear, however, that rental income is not considered unrelated business income. Apartments and office buildings held for rental and investment can be effectively given to a charitable remainder trust.

Personal Residence. A personal residence can be given to a charitable remainder trust, but the donor (or members of the donor's family) cannot continue to occupy the property without violating the prohibition against self-dealing. A client can, however, give the Institute a remainder interest in his or her personal residence and continue to reside in the residence for life. (See page 9.)

Undivided Interests in Realty. An undivided interest in real property can be given to a charitable remainder trust if it is the entire interest the client owns and it does not result in self-dealing. There could be self-dealing where an individual gives the trust an undivided interest and retains an interest in the property. The IRS held, in PLR 9114025, that self-dealing would arise if an individual transferred his complete, undivided interest to a charitable trust and close family members continued to hold undivided interests in the property.

Commentators have suggested several different ways whereby an undivided interest could be given to a trust without running into the self-dealing prohibition. Please call our Office of Gift Planning if you would like to discuss this issue.

NON-TRUST CHARITABLE GIFTS OF REAL PROPERTY

Real property can, of course, be given outright to any charitable organization willing to accept it. Most charitable organizations (including the American Institute for Cancer Research) will want to be assured of a marketable title and the absence of environmental problems before accepting a deed to real property.

The charity may use the property for its own charitable purposes or, in some cases, the charity may want to hold the property as an investment. In most cases, the charity will want to sell the property and use the proceeds to further its charitable purposes. In that case, it may be reluctant to accept any property that is not readily marketable. The American Institute for Cancer Research will almost invariably sell the property given to it in outright ownership and use the sales proceeds to further its important research and educational programs.

The client giving a parcel of real property outright to charity will completely avoid capital gains tax no matter how much the property may have appreciated in value. The client can also deduct the fair market value of the property as an income tax charitable deduction. (Note, however, that the deduction will be limited to the client's cost basis if the property had been held for less than one year; accelerated depreciation claimed on the property could also reduce the allowable charitable deduction.)

The need for a qualified appraisal and the limitations on the charitable deduction, discussed earlier in this booklet, are applicable to outright gifts of real property as well as the gifts to a charitable remainder trust.

Mortgaged real property can be given outright to charity but, unless the charity uses the property for its charitable purposes, or unless the mortgage was placed on the property more than five years before the date of the gift, the charity will incur unrelated business income taxes. Also, because the gift will be treated as a "bargain sale," a portion of the appreciation in the value of the property will be immediately taxable to the client.

As a general rule, no income tax charitable deduction will be allowable if a client gives charity less than his or her entire interest in the real property (a so-called "partial interest gift"). But there are several important exceptions to this basic rule.

As the preceding discussion should have made clear, a client can give the American Institute for Cancer Research a remainder interest in a charitable remainder trust and he or she can deduct the full value of the remainder interest for income tax, gift tax and estate tax purposes.

There are two other important exceptions to the "partial interest rule." First, a gift to the Institute of an undivided interest in property can qualify for a charitable deduction and, in some cases, produce important practical benefits for the donor. Second, a gift of a remainder interest in a farm or personal residence can qualify for a charitable deduction.

Gifts of Undivided Interests In Real Property

An undivided interest in real property is typically a percentage of ownership in the entire property as distinguished from a remainder interest or an income interest. For example, a client can give the Institute a 20% interest in real property and keep the other 80% interest. The fair market value of the 20% interest can be deducted as an income tax charitable contribution.

After the gift, the Institute would be a tenant in common with the donor and would be entitled to 20% of any rents or income produced by the property. The Institute would also be entitled to possess the property 20% of the time.

Some donors have given charitable organizations undivided interests in vacation real property. This means that charity can possess the property part of each year and the donor can possess the property for the remainder of the year. If the donor uses his or her vacation home only six months a year, a gift to charity of a 50% interest in the property would give rise to major income tax savings without interfering with the donor's enjoyment of the property.

In most cases, the Institute will consider this form of gift only if the donor is willing to pay all taxes and maintenance costs and to agree to bequeath the remaining interest to the Institute at his or her death.

Other clients interested in contributing a valuable piece of realty to the Institute may want to give small undivided interests every year as a way to gain maximum benefits from the income tax charitable deduction.

Gift of Remainder Interest In a Personal Residence

Persons who really want to help the American Institute for Cancer Research continue the fight against cancer may want to consider giving the Institute a remainder interest in their personal residence. This is a gift that can be made without disturbing the donor's personal lifestyle and that will produce immediate and substantial income tax savings and future gift and estate tax savings.

The donor simply deeds his or her residence to the American Institute for Cancer Research but retains the right to occupy the property for as long as he or she may live. The donor continues to have full and absolute control and possession of the property for life but, at the death of the donor, title to the residence passes automatically to the Institute.

The donor can give the full remainder interest to the Institute or he or she can give the Institute an undivided interest in the remainder and other undivided interests to his or her children. If a time comes when the donor does not want to continue to occupy the property, he or she can rent the property (keeping the rental income) or give or sell his or her lifetime interest to the Institute. During his or her life, the donor remains liable for the payment of taxes and for the general maintenance of the property.

Our Office of Gift Planning will be pleased to discuss the practicalities of this gift with you or your client. We can also provide a computer analysis showing the charitable deduction and other tax and financial benefits that will be allowed.

"Flip" 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) and (d)(3) 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

(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 the sale by the Trustee of the real property described in Schedule A, a 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. 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. 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

(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-contribution 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).

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 "flip" unitrust, with the unitrust amount payable to one beneficiary for life. Unitrust payments are quarterly and provide initially for a net income with makeup payout arrangement, but with a "flip" provision that will switch to a standard unitrust payout in the year following a "triggering event" – the sale of real estate, in this example.

The IRS will recognize a trust as a qualified charitable remainder unitrust meeting all of the requirements of Code §664(d)(2) and (d)(3) 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 the 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 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 smaller 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. IRS Explanation. The net income method or the net income with make up method may be combined with the fixed percentage method for calculating the unitrust amount. Section 1.664-3(a)(1)(i)(c). More specifically, the governing instrument may provide for payment of the unitrust amount not less often than annually using the net income or the net income with make up method of calculation, and then, in the years following a permissible triggering event (as described in §1.664-3(a)(1)(i)(c) and (d)), for payment of the unitrust amount using the fixed percentage method of calculation. To provide for a one-time conversion from the net income or the net income with make up method to the fixed percentage method of calculation, the governing instrument must provide that: (i) the change in method is triggered on a specific date or by a single event whose occurrence is not discretionary with, or within the control of, the trustees or any other persons; (ii) the change in method occurs at the beginning of the taxable year that immediately follows the taxable year during which the permissible triggering event occurs; and (iii) following the trust's conversion to the fixed percentage method, the trust will pay at least annually to the recipient the amount described in §1.664-3(a)(1)(i)(a) and no amount described in §1.664-3(a)(1)(i)(b). Section 1.664-3(a)(1)(i)(c). Thus, any make up amount described in §1.664-3(a)(1)(i)(b)(2) that is not paid by the beginning of the taxable year immediately following the taxable year during which the permissible triggering event occurs shall be forfeited by the recipient and added to principal.

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.

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), i.e., a public charity.

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, D.C.

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 mandatory.

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.

A clause setting out the powers of the trustee should be included, of course. Here is one example:

Powers and Duties of Trustees. The Trustees shall at all times administer, invest and manage the corpus and income of the Trust in a manner that will assure that the Trust will be and remain a tax-exempt qualified charitable remainder flip unitrust within the meaning of section 664 of the Code and section 1.664-3(a) of the Regulations.

Subject to that duty and to the limitations and prohibitions otherwise provided in this Trust agreement, the Trustees shall have the following powers, to the extent allowable under the laws of the State of ____________.

(a) The power to continue to hold any property transferred to the Trust in the form in which it was at the time of transfer;

(b) The power to sell, exchange or otherwise dispose of any property transferred to the Trust or acquired by the Trust, and to invest and reinvest in any property, real, personal or otherwise, including corporate equity securities, corporate debt securities, mutual fund shares, national and local government securities, limited partnerships, real estate investment trusts, zero coupon bonds, life insurance contracts, annuity contracts or listed options that the Trustees may in their absolute discretion deem advisable, without regard to any limitation imposed by law on the investment of Trust funds;

(c) The power to employ and compensate from Trust funds any attorney, investment advisor, accountant, tax specialist or other agent deemed necessary in the administration of the Trust;

(d) The power to lease Trust property to others and to lease non-Trust property for the benefit of the Trust;

(e) The power to purchase and carry, at the expense of the Trust, all forms of insurance reasonably necessary to protect the assets of the Trust;

(f) The power to accept secured or unsecured notes in full or partial payment of assets sold by the Trust;

(g) The power to determine what shall fairly and equitably be charged to principal and what to income;

(h) The power to make any distributions required by this agreement in cash or in kind; and

(i) The power to perform all other acts necessary or appropriate for the proper and effective administration of the Trust.

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:

"The American Institute for Cancer Research, a not-for-profit corporation located in Washington, D.C."

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:
  1-800-843-8114
- 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.

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