

**PLANNED GIVING 101:**  
**AN OVERVIEW OF PLANNED GIVING VEHICLES**

**AFP/OSU EDUCATION SUMMIT**  
**June 24, 2009**

**Presented By:**

Sindy L. Craig, J.D., LL.M.  
Director of Development for Planned Giving  
The Ohio State University Medical Center  
Columbus, Ohio

Materials prepared by Joseph R. Irvine, J.D., CPA & Sindy L. Craig, J.D., LL.M.

## **I. REVOCABLE GIFTS**

### **A. BEQUESTS**

- i.** Donors may name the Charity in their wills or trusts. Language related to the specific use of the gift should be in the gift agreement rather than the wills or trust. This allows a change to be made without requiring a revision to the wills or trust and also allows the donor to complete the will or trust even if specific use of the gift has not been decided.
- ii.** Gift may be a specific amount or a percentage of the estate or trust.
- iii.** Recognition requires completion of the Confirmation of Planned Gift form.
  - a.** A copy of the pages from the will or trust should be obtained, if possible.
  - b.** It is advisable to execute a gift agreement to set forth the donor's wishes.
- iv.** Estate and gift tax savings.
- v.** Benefits to knowing that the Charity is a beneficiary.
  - a.** Recognition and points.
  - b.** Stewardship opportunities.
  - c.** Fulfillment of the donor's wishes.
  - d.** Counting issues.

### **B. IRA/RETIREMENT PLAN DESIGNATION**

- i.** Donors may name the Charity as the beneficiary of their IRA or retirement plan accounts.
- ii.** The Charity may be the primary or the contingent beneficiary.
- iii.** Recognition requires completion of the Confirmation of Planned Gifts form.
  - a.** A copy of the beneficiary designation form should be obtained, if possible.
  - b.** It is advisable to execute a gift agreement to set forth the donor's wishes.
- iv.** Income tax and estate and gift tax savings.

A \$1 million IRA gift to charity would save an Ohio donor approximately \$675,000 of tax (\$450,000 of estate tax and \$225,500 of Federal and state income tax.)

### **C. LIFE INSURANCE**

Donors may name the Charity as a beneficiary (primary or contingent) of a life insurance policy they continue to own.

## II. CHARITABLE GIFT ANNUITY

### A. CHARITABLE GIFT ANNUITY – STRUCTURE/REQUIREMENTS

- i. A Charitable Gift Annuity (“CGA”) is a contract between a donor and a charitable organization, whereby the donor irrevocably transfers property to the charitable organization and the charitable organization guarantees a specific payment for the remainder of an annuitant’s life.
- ii. The annuitant, i.e., the person entitled to receive payments under the annuity, may be the donor alone, the donor and the donor’s spouse collectively, or another person, not more than two in number, designated by the donor.
- iii. Rates suggested by the American Council on Gift Annuities (“ACGA”) contemplate that approximately 50% of the amount initially transferred by the donor will ultimately be received by the charity. The rates are reviewed annually, but do not necessarily change every year. See Exhibit A for ACGA rates effective February 1, 2009 for a one annuitant CGA. ACGA data was updated on December 29, 2008 and can be located at [www.acga-web.org/welcome.html](http://www.acga-web.org/welcome.html).

### B. TAXATION

#### i. Charitable Deduction

- a. The charitable deduction is the difference between the fair market value of the property contributed and the actuarial value of the annuity interest. See 26 USC 170 (d); 26 CFR 1.170A-1(d)(1); 26 CFR 20.2055-2(f); and 25.2522(c)-3(d). Using factors from IRS Publication 1457, the calculation of the actuarial value of the annuity is based on the age of the annuitant and the Charitable Federal Mid-Term Rate (CFMR).
- b. If appreciated property is used to fund a CGA, the donor has a capital gain. The capital gain portion is taxed according to the bargain sale rules of IRC § 1011, and can be spread out ratably over the life expectancy of the donor if the transfer qualifies for a charitable deduction, the donor is the sole annuitant or the initial annuitant in a two-life annuity, and the annuity is non-assignable except to the issuing organization. Reg. § 1.1011-2(a)(4)(ii).
- c. For examples of the impact of age and number of annuitants on the charitable deductions, see Exhibits B and C.

#### ii. Payment to Annuitants

- a. The payment received is a combination of both return of principal and interest (and capital gain if appreciated property was used to fund the annuity). The return of principal is the only portion of the payment that is not taxable. The “exclusion ratio” is used to determine the amount of the annuity payment that is return of principal and not taxable. 26 U.S.C. 72(b). The exclusion ratio is a fraction (value of the annuity/expected return). 26 U.S.C. 72(b); 26 C.F.R. 1.72-4(a). The excludible portion of an annuity payment is computed as follows: (1) Divide the investment in the contract by the expected return (the amount expected to be received over the life of the contract) as of the annuity starting date (when payments begin) and round out

to the nearest tenth. This is the exclusion ratio for the contract. (2) Multiply the amount received as an annuity by the exclusion ratio ((1), above) to determine the excludible amount for each payment. (3) Subtract the excludible amount ((2), above) from the annuity payment (or total payments in the year, if appropriate) to compute the taxable portion. Once an exclusion ratio has been determined for a particular contract, that same ratio is applied to all annuity payments received under the contract until the total investment is recovered tax-free. But the ratio must be redetermined if the contract is assigned or transferred for valuable consideration, or if it matures or is surrendered, redeemed, or discharged, or is exchanged.

- b. If the donor or another specified annuitant outlives his or her life expectancy, the entire annuity payment becomes taxable. 26 U.S.C. 72(b)(2). If the annuitant predeceases his or her life expectancy, the unrecovered annuity amount becomes an itemized deduction on the final income tax return. 26 U.S.C. 72(b)(3).

### C. CHARITABLE DEFERRED GIFT ANNUITY—STRUCTURE/REQUIREMENTS

- i. The donor may elect to structure the CGA as a charitable deferred gift annuity, whereby the annuity payments are deferred a specified number of years, beginning any time after one year from the date of the gift. *Deferred Annuity* is negatively implied via the definition of *Immediate Annuity* which is explained at 26 U.S.C. 72(u)(4).
- ii. The donor selects when the annual payout amounts will begin; the longer the payment deferral, the more substantial the corresponding benefits.
- iii. Benefits: Due to the deferral of the initial payment, a charitable deferred gift annuity's payout rate is higher and the annual payout amounts are larger than those of similarly funded CGA. Likewise, the immediate itemized income tax charitable deduction will also be larger. For example, the rate for an immediate annuity for a 60 year old is currently 5.0%. If the start is deferred to age 70, the rate is 8.6%.
- iv. The start date for the first payment can be a fixed date or a flexible date. If a flexible date is used, the income tax deduction is based on the first date a payment could possibly be made.

### D. PLANNING WITH GIFT ANNUITIES

- i. CGAs are popular deferred gifts because they are easy to implement. Unlike a CRT, no separate legal entity is created.
- ii. Deferred gift annuities are one way to plan for donors' retirement income while receiving a sizable charitable deduction while still employed. The IRS has given some leeway for donors to choose when the annuity payments are to begin; in one letter ruling, the IRS allowed a provision in which a surviving annuitant could request that payments begin immediately after the death of the other annuitant even though the payments were not to commence until a later date. PLR 9017071. The IRS has also given a favorable ruling to a provision that allowed the donor/annuitant to choose the date that payments were to begin, as long as it was after a certain number of years. PLR 9743054.
- iii. Charitable gift annuities can also be combined with retained life estates, although the scope of the underlying transaction is beyond this presentation.

- iv. If a gift annuity for a married couple is funded with one spouse's separate property, the transfer will not be eligible for the marital deduction. The annuity interest in the CGA transferred to the spouse is a terminable interest. See IRC Section 2523 (f)(6).

### III. CHARITABLE REMAINDER UNITRUST

#### A. STRUCTURE/REQUIREMENTS

- i. The Internal Revenue Code defines a CRUT as a “trust from which a fixed percentage ... of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c).” IRC § 664(d)(2)(A).
- ii. The IRC definition sets out several requirements that a trust must meet in order to qualify as a CRUT.
  - a. The fixed percentage payable must be not less than 5% or more than 50% of the net fair market value of the trust's assets. IRC § 664(d)(2)(A). The term of the payable fixed percentage of assets revalued annually must be a term of not more than 20 years, or measurable by the life or lives of the income beneficiaries. IRC § 664(d)(2)(A).
  - b. If income beneficiaries are individuals, they must be living when the trust is created. IRC § 664(d)(2)(A).
  - c. No distributions may be made to any non-section 170 organizations or to any individuals other than to the income beneficiary(ies). IRC § 664(d)(2)(B). The remainder must go to a § 170 organization(s). IRC § 664(d)(2)(C).
  - d. The value of the remainder interest must be at least 10% of the fair market value of the assets placed in trust. IRC § 664(d)(2)(D).
  - e. A donor may add assets to a CRUT after it is established. See IRC § 664(d)(2)(D). (The opposite is true for CRATs; see section IV. A. ii. d. below).
- iii. There are four different variations of CRUTs:
  - a. Straight - payout is defined as x% of the fair market value of the assets revalued annually. IRC § 664(d)(2)(A).
  - b. Net Income – payout is defined as the lesser of x% of the fair market value of the assets revalued annually OR the annual trust income. IRC § 664(d)(3)(A).
  - c. Net Income with Makeup – payout is defined as the lesser of x% of the fair market value of the assets revalued annually OR the annual trust income. Years in which the income paid is less than x% can be made up in later years when the income earned is greater than x%. IRC § 664(d)(3)(B).
  - d. Flip – payout is the lesser of x% of the fair market value of the assets revalued annually OR the annual trust income until a predetermined “Flip” event occurs. A “flip” event can be the passage of a term of years, sale of business, death, etc. After

the “flip” event, the trust converts to a straight CRUT and the payout is the set percentage from the trust instrument. See Reg. § 1.664-3(a)(1)(c).

- iv. The four variations above do not apply to CRATs (CRATs are discussed below).
- v. The *Net Income* and *Net Income with Makeup* variations above have an added benefit that the trust corpus will normally not be invaded to make payments to the income beneficiary. “Income” is defined by the governing instrument and applicable local law. IRC § 643(b).
- vi. See Rev. Proc. 2005-52 through Rev. Proc. 2005-59 for sample CRUT instruments.

## **B. INCOME TAX DEDUCTIBILITY OF THE INITIAL GIFT**

- i. The charitable deduction is equal to the present value of the remainder interest. The method of calculating it is in Reg. § 1.664-4.
- ii. The donor will be entitled to a charitable deduction for the present value of the remainder interest. Factors taken into account include the percentage payout, frequency of payments, the length of the trust term, and the current Applicable Federal Midterm Rate, which is used as a discount rate. Reg. § 1.664-4.
- iii. Note: The 5% Probability Test which applies to CRATs (discussed below in section IV. A. ii. a.) is not applicable for CRUTs because there is an assumption that they will never be fully exhausted due to their payout calculations being based on revaluation of the trust annually instead of the initial value.
- iv. Because the allowed deduction attempts to approximate the actual charitable remainder, slight changes in the design of a CRUT can have significant impact on the deductible amount. For examples, please see the Exhibits D-F listed below. Each Exhibit starts from the same basic case of a 72 year-old donor setting up a 5% unitrust and changes certain variables.
  - a. Change in the CRUT Payout Percentage – EXHIBIT D
  - b. Change of Income Beneficiary’s Age – EXHIBIT E
  - c. More than One Beneficiary – EXHIBIT F

## **C. TAXATION OF DISTRIBUTION TO RECIPIENT**

- i. The distribution is taxable to the recipient via a four-tiered system. Reg. § 1.664-1(d). The tiers in order of their applicability are:
  - a. Ordinary Income
  - b. Capital Gain Income
  - c. Other Income
  - d. Return of Principal

- ii. The taxation of the unitrust distribution within the tiers depends on the character of the income from the trust's perspective – if income was a capital gain to the trust, the income will be capital gain to the beneficiary as well. These categories encompass income both from the current year as well as any undistributed income from the prior year.

#### **D. ESTATE TAX**

- i. The value of the CRUT may be included in a donor's estate if the donor was a beneficiary of the CRUT. See IRC § 2036. However, the entire amount may be offset by deductions, depending on who the beneficiaries were:
  - a. If the donor was the only non-charitable beneficiary, the estate will receive an offsetting charitable deduction for the entire value of the trust.
  - b. If the donor and his/her spouse were the only non-charitable beneficiaries, the estate will receive a charitable deduction for the value of the remainder and a marital deduction for the value attributable to the spouse's life interest. This also results in a fully offsetting deduction.
  - c. If person(s) other than the decedent or decedent's spouse were the non-charitable beneficiaries, the estate will receive only a charitable deduction for the value of the remainder. IRC § 2055(e)(2)(A).
  - d. If the donor retained the right to revoke the non-spouse's interest in the charitable remainder trust, the present value of that beneficiary's interest is included in the donor's estate.
  - e. If the donor did not retain the right to revoke the non-spouse's interest, than a taxable gift occurred at the time the charitable remainder trust was established and nothing is included in the donor's estate.

### **IV. CHARITABLE REMAINDER ANNUITY TRUST**

#### **A. STRUCTURE/REQUIREMENTS**

- i. The IRC defines a CRAT as a “trust from which a sum certain ... is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c).” IRC § 664(d)(1)(A).
- ii. The IRC definition sets out several requirements that a trust must meet in order to qualify as a CRAT.
  - a. The “sum certain” payable must be not less than 5% nor more than 50% of the initial fair market value of the property initially placed in the trust. IRC § 664(d)(1)(A). In the trust instrument, this can either be expressed as a percentage of the assets in the trust or a specific dollar amount payable annually, as long as the percentage requirement is met.
  - b. The term of the payable “sum certain” must be a term of not more than 20 years, or measurable by the life or lives of the income beneficiaries. IRC § 664(d)(1)(A). Income beneficiaries must be living when the trust is created, if individuals. IRC § 664(d)(1)(A).

- c. No distributions may be made to any non-section 170 organizations or individuals other than to the income beneficiary(ies). IRC § 664(d)(1)(B). The remainder must go to a § 170 organization(s). IRC § 664(d)(1)(C). The value of the remainder interest must be at least 10% of the fair market value of the assets placed in trust. IRC § 664(d)(1)(D).
  - d. No additional contributions may be made to the trust.
- iii. See Rev. Proc. 2003-53 through Rev. Proc. 2003-60 for sample CRAT instruments.

**B. INCOME TAX DEDUCTIBILITY OF THE INITIAL GIFT**

- i. In addition to the above requirements, a donor will not receive a charitable deduction if there is more than a 5% probability that the trust corpus will be exhausted before the charity receives its remainder interest. Rev. Rul. 70-452
- ii. The donor will be entitled to a deduction for the present value of the remainder interest. Factors taken into account include the percentage payout, frequency of payments, the length of the trust term, and the current Applicable Federal Midterm Rate, which is used as a discount rate.
- iii. For a CRAT, the present value of the remainder interest is the difference between the fair market value of the trust assets at date of transfer and the present value of the annuity interest.
- iv. Because the allowed deduction attempts to approximate the actual charitable remainder, slight changes in the design of a CRAT can have significant impact on the deductible amount. Exhibits G-I start from the same basic case of a 72 year-old donor setting up a 5% annuity trust and change certain variables.
  - a. Change in the Annuity Percentage – Exhibit G
  - b. Change of Income Beneficiary’s Age – Exhibit H
  - c. More than One Beneficiary – Exhibit I
- v. Like any charitable deduction, this deduction is limited to 50% of the donor’s AGI with carryover of any excess; long-term capital gain property is limited to 30% of AGI. The provisions for full deductibility of the present value of the remainder interest assume that public charities are the only charitable remainder beneficiaries and that the trust instrument specifies that the donor cannot change the remainder beneficiary to a private foundation. If the charitable remainder beneficiaries include private foundations, the tax deduction will be limited by the normal limitations placed on contributions to private foundations.

**C. TAXATION OF ANNUITY TO RECIPIENT– IDENTICAL TO CRUT (SEE ABOVE)**

**D. ESTATE TAX– IDENTICAL TO CRUT (SEE ABOVE)**

## V. ISSUES WITH CRTS

### A. DRAFTING CONSIDERATIONS

- i. Prohibitions against the trustee selling trust property will run afoul of Reg. § 1.664-1(a)(3), which prohibits a trust instrument from restricting the trustee from investing in “a manner which could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.”
- ii. A CRT may not contain a provision that allows the donor to remove the trustee if the trustee has discretion to allocate the income between the donor and another beneficiary. Rev. Rul. 77-285.
- iii. A provision allowing an income beneficiary to assign his/her interest to the charitable remainder beneficiary may provide a means to terminate a trust early.
- iv. Unlike CRUTs, donors cannot add assets to CRATS once established. This means that if a donor wishes to fund a CRAT with multiple assets (such as cash and stock, or stock from different brokers), the transactions must be monitored carefully to ensure that the trustee receives all assets intended to be part of the trust on the same day. 26 C.F.R. 1.664-2 (b)
- v. If the donor retains the right to change income beneficiaries, no gift tax will be due. 26 C.F.R. 25.2511-2.
- vi. The IRS model documents do not contain many useful provisions. For example, they do not contain language related to:
  - a. Spousal waivers
  - b. Successor trustees
  - c. Independent special trustees
  - d. Trustee removal
  - e. Options for multiple charitable beneficiaries
  - f. A spendthrift clause
  - g. Authority to not diversify assets
  - h. Special definitions of income and principal

### B. PLANNING WITH CRTS

- i. Flip CRUTs can be used to plan for income during retirement because of the flexibility of determining the “Flip” criteria. For example, the IRS has allowed a Flip CRUT in which the donor/income beneficiary could elect to begin receiving payments at any time past his 55<sup>th</sup> birthday. The election itself is the “flip” event, after which a fixed percentage of the assets of the trust, revalued annually, must be paid.

- ii. CRTs funded with appreciated stock may be able to generate more current income than would result from simply investing the cash left over from the sale of stock and payment of capital gains tax.

### C. OTHER ISSUES

- i. Unrelated Business Income
  - a. Prior to January 1, 2007, if a CRT incurred unrelated business taxable income (UBTI) in any year, it lost its exemption for that year for all income. IRC § 664(c), *Leila G. Newhall Unitrust v. Commissioner*, 105 F.3d 482 (9th Cir. 1997). As of January 1, 2007, a 100% excise tax is imposed on UBTI of a CRT, but it does not lose its exemption.
- ii. Mortgaged Property
  - a. Any income from debt-financed property is considered UBTI. Reg. §1.514(b)-1(a).
  - b. Transferring mortgaged property to a CRT when the donor is personally liable on the debt disqualifies the CRT.
  - c. Funding CRTs with mortgaged property is therefore fairly unusual.
- iii. Control of Trust Investments by the Donor
  - a. In the 1950s, CRTs were used as tax shelters by donors contributing appreciated property to a CRT. The CRT then invested in tax-exempt securities, which resulted in the income beneficiary owing no tax on the income due to the 4-tiered scheme.
  - b. The Pomona Ruling: In 1960, the IRS issued Rev. Rul. 60-370, which concerned an exempt educational institution that acted as trustee for a CRT and had an express obligation to invest only in tax-exempt securities. The IRS ruled that the donor was subject to tax on the gain of the sale of the appreciated property because the donor maintained incidents of ownership (i.e., direction of how the gift was to be invested).
- iv. Self-Dealing and other Private Foundation Issues
  - a. While CRTs are not considered private foundations, they may be subject to private foundation excise taxes under certain circumstances.
  - b. Generally, if a CRT continues to hold assets for the benefit of a charitable organization beyond the expiration of the income interests, the CRT will be subject to private foundation rules.
  - c. However, the rules regarding self-dealing and private foundation expenditures always apply. IRC § 4947(a)(2).
  - d. A donor may serve as trustee of the CRT and the self-dealing rules will not apply, unless a charitable organization is an income beneficiary. Ltr. Rul. 8839071.

- e. Although CRTs are not subject to all private foundation rules, prohibitions on violating any private foundation rule are found in the IRS model trust instruments. See Rev. Proc. 2003-53 et. seq. and Rev. Proc. 2005-52 et. Seq.
- v. Impact of Right of Surviving Spouse Election
- a. Rev. Proc. 2005-24 provided a safe harbor rule for CRTs established in states that provide for a surviving spouse to take a statutory elective share of a decedent spouse's estate. If such election were to be made and the share could be satisfied with assets from the CRT, the trust would no longer qualify as a CRT. Under Rev. Proc. 2005-24, a trust instrument must contain a spousal waiver that no part of the statutory share will be paid from the assets of the CRT.
  - b. Commentators argued that the waiver created a host of potential problems, even if a valid waiver was executed at the time the CRT was created. Examples include:
    - 1. If a married couple moves to a state with more stringent waiver requirements, the waiver may be invalid.
    - 2. This creates a potential conflict of interest for attorneys drafting CRTs to represent both spouses.
  - c. The IRS issued Notice 2006-15 in response to the criticism. The IRS noted that the "Service and Treasury are reconsidering the approach of Rev. Proc. 2005-24" and extended the original grandfathering date until further guidance is published.
  - d. Thus, absent a spousal waiver, the IRS will disregard the existence of the right of election unless the surviving spouse does make the election.
- vi. Early Terminations
- a. In a private letter ruling issued in October 2005, the IRS granted permission for the early termination of a charitable remainder unitrust that provided for distribution of the trust assets to the income beneficiaries and the remainder beneficiary according to the values of their interests. Ltr. Rul. 200525014.
  - b. However, in January, the IRS issued another private letter ruling that revoked the prior ruling. This ruling provided no explanation for the revocation. Ltr. Rul. 200614032.
  - c. After additional information was submitted, the IRS issued a third private letter ruling that granted permission. The additional information was that the charitable remainder beneficiary had been changed from a private foundation to publicly supported organizations, indicating that the IRS may have had concerns with self-dealing issues.

## **VI. CHARITABLE LEAD TRUSTS**

### **A. GENERALLY**

- i. In a charitable lead trust, or CLT, the income and remainder interests of a charitable organization and a non-charitable person are reversed from what they are in charitable

remainder trusts: the charitable organization is the income beneficiary and the non-charitable person (usually the donor or family members of the donor) is the remainder beneficiary.

- ii. CLTs can be structured so that the charity receives an income interest calculated as an annuity based on the initial value of the trust (charitable lead annuity trust, or CLAT) or as a unitrust interest based on the value of the trust as revalued annually (charitable lead unitrust, or CLUT).

#### **B. CHARITABLE LEAD ANNUITY TRUST (CLAT)**

- i. Similar to CRATs, no additional contributions may be made to CLATs. Additional contributions may be made to CLUTs.
- ii. CLATs preserve the asset appreciation for the remainder beneficiaries while CLUTs allow the charitable organization to share in the appreciation of the trust's assets.
- iii. Sample documents: Rev. Proc. 2007-45 (Intervivos CLAT); Rev. Proc. 2007-46 (Testamentary CLAT).

#### **C. CHARITABLE LEAD UNITRUST (CLUT)**

- i. Unlike CRATs and CLATs, additional contributions may be made to CLUTs.
- ii. CLUTs allow the charitable organization to share in the appreciation of the trust's assets while CLATs preserve the asset appreciation for the remainder beneficiaries.
- iii. Unlike CRUTs, CLUTs cannot have a net income provision that limits the charitable organization's interest to the trust accounting income, if less than the payout percentage described in the trust instrument. However, the governing instrument may provide that all income shall go to the charitable organization if the income exceeds the payout percentage.

#### **D. TAXATION OF CLTs**

- i. Unlike CRTs, there is no 5% minimum or 50% maximum payout requirement and CLTs can be established for any term of years.
- ii. Income and estate tax benefits depend on whether the CLT is a grantor or non-grantor CLT. In a grantor CLT, the donor is the remainder beneficiary, in a non-grantor CLT, someone other than the donor (usually the donor's heirs) is the remainder beneficiary.
- iii. Gift tax impact for both qualified types is identical – the trust is bifurcated into the charitable organization's income interest and the non-charitable beneficiary's remainder interest. The annual and lifetime exclusions do not apply to the remainder interest because it is a gift of a future interest.
- iv. Taxation of Grantor CLTs.
  - a. Donor receives a charitable deduction for the present value of the income interest to the charitable beneficiary.
  - b. Donor is taxed on all CLT income and capital gains.

- c. Donor's remainder interest is included in the donor's estate.
  - d. Provides a way to accelerate charitable deductions.
- v. Taxation of Non-Grantor CLTs.
- a. Donor is not entitled to an income tax deduction for amounts of income paid to charity and the donor is not taxed on any of the trust's income.
  - b. The trust is taxed as a complex trust under the rules of Subchapter J and receives a charitable income tax deduction for the amounts distributed to charity.
  - c. As long as the donor does not retain a reversionary interest exceeding 5% of the corpus, there will be no additional inclusions of the trust for estate tax purposes. Only the actuarial value of the remainder at the date of the transfer will be treated as a prior gift.

#### **E. CLAT EXAMPLE**

- i. College department would like to generate \$150,000 per year for 18 years to pay off debt service on loan. Donor would like to pass \$2 million to his children without incurring any estate or gift tax.
- ii. If the donor establishes a charitable lead annuity trust with the principal of \$2 million and the trust pays 7.5%, the annual distribution to the charity will be \$150,000.
- iii. The trust principal will pass to the donor's children in 18 years. There will be no estate and gift tax on the transfer. The amount passed to the children will depend upon the rate of return for the trust.
- iv. If the donor transferred \$2 million to his children today, the gift tax could be as high as \$900,000 (it would be at least \$450,000). If the donor has a taxable estate, a \$2 million bequest would result in \$900,000 of estate tax.

### **VII. RETAINED LIFE ESTATES**

#### **A. REQUIREMENTS**

- i. The Code provides that "a contribution of a remainder interest in a personal residence or farm" shall be an exception to the partial interest rule. IRC § 170(f)(3)(B)(i).
- ii. Definition of Personal Residence
  - a. "Any property used by the taxpayer as his personal residence even though it is not used as his principal residence." This also includes stock owned in housing co-ops if the donor occupies the dwelling he/she is entitled to as a personal residence. Reg. § 1.170A-7(b)(3)
  - b. Residence is not defined in this section of the code, but the Regulations discuss the definition of residence for qualified personal residence trust purposes as "generally includ[ing] a house, condominium, mobile home, boat, or house trailer, that contains

sleeping space and toilet and cooking facilities.” The determination of whether property is a residence is to be made upon consideration of all facts and circumstances, including the good faith of the taxpayer. Reg. § 1.163-10T(p)(3)(ii). Based on this definition, vacation properties qualify as “personal residences.”

- c. Although not explicitly stated in the statutes or regulations, the IRS has issued private letter rulings that rental property may be considered a personal residence. See PLR 8711038.
- d. A charitable deduction is also permitted for capital improvements to a property subject to a retained life estate since they constitute an additional contribution. See PLR 8529014.

**iii.** Definition of Farm

- iv. “‘Farm’ means any land used by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. The term ‘livestock’ includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry. A farm includes the improvements thereon.” Reg. § 1.170A-7(b)(4).
- v. To qualify as a farm, the land does not have to be actively farmed; the donor need not live on the farm; and the farm does not have to constitute 100% of the acreage.

**B. TAXATION**

- i. Donor receives an income tax charitable deduction for the present value of the charitable organization’s remainder interest. The factors used to determine the present value include:
  - a. Fair market value of the property, including improvements, on the date of transfer
  - b. Fair market value of depreciable improvements or depletable resources
  - c. Useful life of depreciable improvements or depletable resources
  - d. Salvage value of depreciable improvements or depletable resources
  - e. Measuring term of the non-remainder interest – in one life, two lives, or a term of years
  - f. The current Applicable Federal Midterm Rate
- ii. Potential Pitfalls for the Charitable Organization.
  - a. Debt-encumbered property may be subject to UBIT
  - b. Lack of clear title
  - c. Environmental liability

### **C. CAREFUL GIFT AGREEMENT DRAFTING**

- i.** Governing documents should describe the responsibilities of the life tenant, including maintenance, insurance, and repairs. Governing documents should also prohibit the life tenant from encumbering the property in any way.
- ii.** Identity of tenants and the term of tenancy should be specific and unambiguous, and provisions should be made for the possibility that the tenant wishes to vacate the property.
- iii.** The charitable organization should also retain the right to inspect the property.

### **D. PLANNING WITH RETAINED LIFE ESTATES**

- i.** The charitable organization and donor can agree to sell the property and divide the proceeds according to the value of their respective interests. However, the gift agreement cannot require the charitable organization to agree to a sale. Rev. Rul. 77-305.
- ii.** The donor may accelerate the remainder interest by contributing the balance of the life estate to the charity. The donor receives an additional charitable deduction for the amount of the present value of the remaining life estate. This could be useful if a donor needs to enter an assisted living facility or is unable to continue maintaining the property.

**EXHIBIT A**

**SUGGESTED CHARITABLE GIFT ANNUITY RATES**  
**Approved by the American Council on Gift Annuities**  
**December 29, 2008**  
**Effective February 1, 2009 through June 30, 2009**

SINGLE LIFE

<b>Age</b>	<b>Rate</b>		<b>Age</b>	<b>Rate</b>
0-5	2.6%		66-67	5.4%
6-12	2.7		68	5.5
13-16	2.8		69	5.6
17-20	2.9		70	5.7
21-24	3.0		71	5.8
25-27	3.1		72	5.9
28-30	3.2		73	6.0
31-32	3.3		74	6.1
33-35	3.4		75	6.3
36-37	3.5		76	6.4
38-39	3.6		77	6.6
40-41	3.7		78	6.7
42	3.8		79	6.9
43	3.9		80	7.1
44-45	4.0		81	7.3
46	4.1		82	7.5
47	4.2		83	7.7
48	4.3		84	7.9
49-50	4.4		85	8.1
51	4.5		86	8.3
52	4.6		87	8.6
53	4.7		88	8.9
54-55	4.8		89	9.2
56-58	4.9		90 and over	9.5
59-60	5.0			
61-62	5.1			
63-64	5.2			
65	5.3			

**NOTES:**

1. The rates are for ages at the nearest birthday.
2. For immediate gift annuities, these rates will result in a charitable deduction of more than 10% if the CMFR is 2.4% or higher, whatever the payment frequency. If the CMFR is less than 2.4%, the deduction will be less than 10% when annuitants are below certain ages.
3. For deferred gift annuities with longer deferral periods, the rates may not pass the 10% test when the CMFR is low.
4. The new rates will qualify for all immediate gift annuities at all ages for a CMFR of 2.4% or above. In the case of deferred gift annuities, there may be a few instances in which rates based on the ACGA's suggested schedule and methodology do not qualify when the CMFR is quite low. In those instances, the deferred rates would have to be reduced to qualify.

**EXHIBIT B****CGA WITH CHANGING AGE OF ANNUITANT**

<b>Age of Income Beneficiary</b>	<b>60</b>	<b>70</b>	<b>90</b>
Initial FMV of Assets	\$100,000	\$100,000	\$100,000
Discount Rate*	2.8%	2.8%	2.8%
Annuity Rate (ACGA)**	5.0%	5.7%	9.5%
Annuity	\$5,000	\$5,700	\$9,500
Charitable Deduction	\$24,837	\$37,482	\$61,363

\*Gift Date: June, 2009 AFR: June, 2009

\*\*ACGA rate effective Feb. 1, 2009

**EXHIBIT C****CGA WITH TWO ANNUITANTS**

<b>Age of Income Beneficiary</b>	<b>70 – One Life</b>	<b>70 – Two Lives</b>	<b>75 – Two Lives</b>
Initial FMV of Assets	\$100,000	\$100,000	\$100,000
Discount Rate*	2.8%	2.8%	2.8%
Annuity Rate (ACGA)**	5.7%	5.2%	5.6%
Annuity	\$5,700	\$5,200	\$5,600
Charitable Deduction	\$37,482	\$27,125	\$34,046

\*Gift Date: June, 2009 AFR: June, 2009

\*\*ACGA rate effective Feb. 1, 2009

**EXHIBIT D****CRUT WITH CHANGING PAYOUT PERCENTAGES**

<b>Age of Income Beneficiary</b>	<b>72</b>	<b>72</b>	<b>72</b>	<b>72</b>
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Payout Rate	5%	6%	7%	30%
Discount Rate	2.8%	2.8%	2.8%	2.8%
Charitable Deduction	\$562,790	\$507,700	\$459,780	\$103,750
Passes 10% Remainder Test?	Yes	Yes	Yes	Yes

**EXHIBIT E****CRUT WITH CHANGING AGE OF INCOME BENEFICIARY**

<b>Age of Income Beneficiary</b>	<b>60</b>	<b>72</b>	<b>90</b>
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000
Payout Rate	5%	5%	5%
Discount Rate	2.8%	2.8%	2.8%
Charitable Deduction	\$395,950	\$562,790	\$809,260
Passes 10% Remainder Test?	Yes	Yes	Yes

**EXHIBIT F**

**CRUT WITH ADDITIONAL BENEFICIARIES**

Age of Income Beneficiary	One Life 72	Two Lives 72/72	Two Lives 72/40	Two Lives 60/60
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Payout Rate	5%	5%	5%	5%
Discount Rate	2.8%	2.8%	2.8%	2.8%
Charitable Deduction	\$562,790	\$449,000	\$176,030	\$284,470
Passes 10% Remainder Test?	Yes	Yes	Yes	Yes

**EXHIBIT G**

**CRAT WITH CHANGING ANNUITY PERCENTAGES**

Age of Income Beneficiary	72	72	72
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000
Annuity %	5%	6%	7%
Discount Rate	2.8%	2.8%	2.8%
Charitable Deduction	\$492,140	\$400,700 but actually \$0 RR 77-374	\$329,450 but actually \$0 RR 77-374
Passes 10% Remainder Test?	Yes	Yes	Yes
Passes 5% Probability Test?	Yes	<b>No</b> Probability of trust exhaustion 10.71%	<b>No</b> Probability of trust exhaustion 24.34%

**EXHIBIT H**

**CRAT WITH CHANGING AGE OF INCOME BENEFICIARY**

Age of Income Beneficiary	72	40	80
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000
Annuity %	5%	5%	5%
Discount Rate	2.8%	2.8%	2.8%
Charitable Deduction	\$492,140	\$63,600? <b>No-\$0-fails both tests</b>	\$643,050
Passes 10% Remainder Test?	Yes	<b>No</b>	Yes
Passes 5% Probability Test?	Yes	<b>No</b> Probability of trust exhaustion 76.24%	Yes

**EXHIBIT I**

**CRAT WITH ADDITIONAL BENEFICIARIES**

Age of Income Beneficiary	One Life 72	Two Lives 72/72	Two Lives 72/40	Two Lives 72/65
Initial FMV of Assets	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Annuity %	5%	5%	5%	5%
Discount Rate	2.8%	2.8%	2.8%	2.8%
Charitable Deduction	\$492,140	\$345,400	\$49,800? <b>No-\$0 fails both tests</b>	\$261,880? <b>No-\$0 fails 5% test</b>
Passes 10% Remainder Test?	Yes	Yes	<b>No</b>	Yes
Passes 5% Probability Test?	Yes	Yes	<b>No</b> Probability of trust exhaustion 76.56%	<b>No</b> Probability of trust exhaustion 10.67%