Supplementing Retirement Savings with Charitable Gifts

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American Institute for Cancer Research®

Major Gifts, Trusts and Bequests
For 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. Each year, the Institute sponsors important research projects at universities and research facilities across America, focusing on the cause and prevention of cancer. It has long been a leader in providing effective educational programs on the prevention of cancer – directed to both health care professionals and the general public.

The primary focus of the American Institute for Cancer Research – in both its research projects and its educational programs – has been the role of diet and nutrition in the development and prevention of cancer. (There is scientific evidence that estimates an average of 35% of all cancer deaths might be linked to diet and nutrition.)

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

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

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

Please feel free to call the Gift Planning Office at any time. Our toll-free telephone number is 1-800-843-8114 or contact us by email at gifts@aicr.org. And please, if the opportunity presents itself, inform your clients about how a gift, trust or bequest to the American Institute for Cancer Research can help in the fight against cancer, while also enhancing their personal tax, investment, retirement and estate plans.

SUPPLEMENTING RETIREMENT SAVINGS WITH CHARITABLE GIFTS

Many clients would like to set aside more funds for retirement than their qualified plans or IRAs currently allow, especially if they could find savings arrangements that reduce current taxes and provide tax-deferred growth of principal. Some would be particularly pleased if their increased savings could also benefit important causes, such as the work of the American Institute for Cancer Research, after their deaths. This booklet illustrates how charitable remainder unitrusts and deferred payment gift annuities can achieve retirement savings goals and provide clients with the personal satisfaction of making a significant contribution to the war against cancer. Grantor lead trusts are also discussed as an option for donors who wish to reduce income taxes in the years leading up to retirement while assisting the mission of AICR.

Case: Dr. Jennifer R, an oncologist, has "maxed out" on the amount she can shelter under her 401(k) plan. She also is considering the possiblity of early retirement, with the hope of "packing it in" by age 60. Jennifer is looking for ways to boost her retirement income, save current taxes, and have access to some retirement funds at 60 – without penalty. Jennifer would also like to fulfill a lifetime goal of providing meaningful support for AICR. Question: What financial or gift arrangements could help Jennifer, given her circumstances? Let's look first at the charitable remainder trust – sometimes referred to as a net-income with makeup unitrust, or "charitable IRA."

PLANNING AND DRAFTING A CHARITABLE REMAINDER INCOME DEFERRAL TRUST

For many years, charitable remainder trusts have provided a great opportunity for clients to make generous gifts to the important programs of the American Institute for Cancer Research and, at the same time:

(a) provide a good and dependable lifetime income for themselves and/or other designated persons;

(b) gain an immediate income tax charitable deduction;

(c) avoid capital gains taxes by transferring appreciated property to the tax-exempt charitable remainder trust; and

(d) minimize probate costs, estate taxes and inheritance taxes.

A special form of charitable remainder trust can add another important benefit: income can be effectively accumulated and grown in a tax-free account for distribution at a future time when the beneficiary wants to receive additional income (i.e., at retirement).

This unusual form of charitable remainder trust is a version of the income only unitrust – with special provisions in the trust agreement and with special investment and administrative techniques. Throughout this booklet, this trust will be referred to as a *charitable remainder income deferral trust*.

A Typical Charitable Remainder Income Deferral Trust

Paul J. is a good example of why the charitable remainder income deferral trust has become popular. Paul became interested in a charitable remainder trust primarily to avoid a capital gains tax.

He wanted to dispose of a parcel of real property worth about $300,000. But because his depreciated cost basis was only $60,000, a sale would have resulted in a capital gains tax of almost $50,000.

Paul knew he could completely avoid this tax by transferring the real property to a typical charitable remainder trust that would pay him 6% (or other specified percentage of the value of the trust) each year for as long as he might live. The catch: Annual payments would have to start immediately and Paul, already in a high tax bracket, did not want additional income.

The ability of his adviser to create a charitable remainder income deferral trust that would permit distributions to be deferred until such time as Paul wanted to start receiving additional income – and the ability to build a substantially higher income-- was a major factor in Paul's decision to transfer the realty to a trust that would assure Paul of a very high retirement income and eventually benefit our ongoing war against cancer.

Basic Nature of a Charitable Remainder Income Deferral Trust

The only form of charitable remainder trust that can be used to defer the distribution of income to the individual beneficiaries of the trust is the income only charitable remainder unitrust. The "flip" unitrust, described later, is a variation on this plan that provides payouts that are more certain and favorably taxed.

The trust agreement will direct the trustee to determine the fair market value of the trust assets every year (usually on the first business day of th calendar year) and to pay the beneficiaries a specified percentage of this value, or the income actually earned by the trust in that year, whichever is the lesser.

The trustee, in its discretion, will invest for growth with little or no income. There are several ways to accomplish this objective (see page 6), but the simplest technique is to invest in growth securities that do not pay interest or dividend income. Because there is no income, no distributions can be made to the beneficiaries.

When the beneficiaries want to start receiving income, the trustee will sell the growth securities (which have increased substantially in value) and invest for a high income. Thereafter, all the income earned by the trust, up to the specified percentage of the value of the trust in that year, will be paid to the individual beneficiaries.

The trust agreement will also provide that, to the extent the specified percentage of value is not paid out in any year, the cumulative unpaid deficit will be paid in a later year from trust income that is in excess of the specified percentage of income. The cumulative deficit can be quite substantial if incomeis deferred for many years. It should be noted that this deficit can be paid only from income earned byt he trust during a particular year that is in excess of the specified percentage of value of the trust assets for that year.

The table at the bottom of this page shows how a 6% unitrust funded with $100,000 can provide a very high deferred income for the individual beneficiaries if the trustee can invest for an average 9% growth over ten years and then convert to a high income investment (one that produces an average income of 8%).

After the tenth year, the trust will invest in high income securities that produce an income of $18,940 a year (8% of $236,700). The beneficiaries can be paid all this income, up to 6% of the value of the trust ($14,200), and they can also be paid all excess income until the cumulative deficit of the first ten years has been paid. With our assumed 8% income and assuming the value of the trust does not change, it will take almost 20 years to repay the deficit.

Result: The client making a gift of $100,000 to a charitable remainder income deferral trust can reasonably receive an annual income equal to 19% of the gift, starting in ten years and continuing for as long as he or she may live.

The client also gains an immediate income tax charitable deduction for the present value of the charitable interest. Assuming the client is 55 years of age, the deduction will be approximately $28,000 – resulting in an immediate tax savings of more than $7,000.

Building a Retirement Income

Beginning of Year	Value of Trust	Deficit Year's End	Cumulative Deficit
1	$100,000	$6,000	$6,000
2	$109,000	$6,540	$12,540
3	$118,800	$7,130	$19,670
4	$129,500	$7,770	$27,440
5	$141,200	$8,470	$35,910
6	$153,900	$9,230	$45,140
7	$167,750	$10,070	$55,210
8	$182,850	$10,970	$66,180
9	$199,300	$11,960	$78,140
10	$217,200	$13,030	$91,170
11	$236,700		

Multiple Contributions an Option

Donors have the option of making additional contributions to charitable remainder unitrusts. So an executive or professional might contribute $25,000 or $50,000 a year to an income deferral unitrust – a "charitable IRA" – but without the contribution ceiling that applies to true IRAs.

The donor could deduct a portion of each contribution, and the size of the deduction would grow each year as the donor grows older. If a donor established a one-life 5% payout unitrust at age 45, about 24% of any amount transferred would be deductible; an additional contribution made at age 60 would be about 40% deductible. A married person probably would want to establish the retirement unitrust for two lives (to include the life of the surviving spouse). Alternatively, a donor could have the trust last for only his or her life and use some of the tax savings and income from the unitrust to purchase life insurance payable to family beneficiaries. The insurance could replace the trust assets lost to the estate from the unitrust. The insurance proceeds could pass free of federal estate tax if the policies are purchased within an irrevocable life insurance trust ("wealth replacement trust").

As a retirement savings vehicle, the unitrust offers income deferral, tax-free buildup of principal (remember that it is a tax-exempt trust, so long as it has no unrelated business taxable income) and deductions for part of each contribution. The following table illustrates financial results from a one-life 5% unitrust started by Dr. R at age 50. She plans to make $50,000 contributions at the start of each year for 15 years.

In an average 33% tax bracket, the retirement unitrust will provide Dr. R $83,582 in deduction tax savings, based on total contributions of $750,000.

How much income would Dr. R receive at retirement? That depends on how the trustee invested during the 15-year "deferral period." Suppose the trustee was able to invest in stock that paid 1% dividends but grew at an average annual rate of 8%. After 15 years, the trust contributions would have grown to $1,466,200. The trustee will sell the growth stock when the beneficiary retires and invest in something that pays high income. Dr. R could start receiving 5% of $1,466,200 ($73,310) a year. The trustee could also begin paying Dr. R additional amounts for payout deficiencies that occurred during years when the trust was invested in growth stock. She would receive the 5% unitrust amount ($73,310) plus any extra trust income earned in excess of the $73,310, until the past deficiencies are "paid back."

Age	Gift	Deduction
50	$ 50,000	$14,093
51	50,000	14,632
52	50,000	15,184
53	50,000	15,748
54	50,000	16,324
55	50,000	16,913
56	50,000	17,514
57	50,000	18,126
58	50,000	18,749
59	50,000	19,379
60	50,000	20,016
61	50,000	20,662
62	50,000	21,317
63	50,000	21,982
64	50,000	22,655
	$750,000	$273,294

FLIP UNITRUST PROVIDES FAVORABLY TAXED PAYOUTS

A "flip" unitrust, invested to produce long-term capital gains (growth stock, for example) may be more tax efficient for the donor/beneficiary than the previous plan and has the further advantage of providing payments that are more predictable than a net-income unitrust with make up provision. That is, the distributions to the income beneficiaries will become a fixed percentage of the value of the trust assets after a "triggering event"– and will not be wholly dependent on the amount of income earned by the trustee during the year.

Mr. K, 45, transfers assets worth $100,000 to a net-income unitrust that will pay him the lesser of the trust's net income or 6% annually. The trust contains a "flip" provision that will cause the trust to change to a standard unitrust in the year following his 69th birthday(a "triggering event"). In the year he sets up the trust, Mr. K can deduct a charitable contribution of $18,126 (5.0% §7520 rate). The trustee invests in growth stock that is expected to appreciate in value by 9% a year. Mr. K's trust will have grown to $862,300 by the time he retires at age 70 (an investment return based on historical stock market averages). By then he will enjoy 6% annual payments of nearly $52,000 that will be part tax free return of corpus, part capital gain, under the four-tier system of charitable remainder trust taxation, assuming the trustee sells just enough growth stock each year to make the 6% payout.

A Pre-Retirement "Bonus"

If Mr. K wishes, he could suggest that the trustee sell some growth stock in the year he turns 69. If the unitrust has a "make up" provision and the trust document has defined capital gains as income, then Mr. K can receive a significant one-time payment that makes up for part or all deficiencies from the 6% payout amount in prior years. It's important to note that deficiencies in prior payouts cannot be made up after the trust switches to "straight unitrust" status in the year after the triggering event.

Note: If Mr. K wishes, he can add even more each year to his "retirement unitrust" and receive additional deductions and even more income.

Sample "Flip" Unitrust Form

An annotated "flip" unitrust trust form, taken from the IRS approved "safe harbor" forms issued in 2005, is contained at the end of this booklet. In the above example, the "triggering event" is the attainment of the income recipient's 69th birthday; in the year following this event the trust will pay the recipient a fixed percentage of the trust assets, without regard to the amount of income earned by the trust.

INVESTMENT STRATEGIES FOR A CHARITABLE REMAINDER INCOME DEFERRAL TRUST

It should be clear that deferring distributions from a charitable remainder trust requires: (1) that, during the deferral period the trust assets be invested in a manner that produces little or no interest or dividend income; and (2) that, during the distribution period, the trust assets be invested in a manner that will produce a high income, as that term is defined in the trust agreement.

There are several IRS approved techniques that will accomplish these objectives.

Investing in Growth Securities and Converting to High Income Investments

A charitable remainder income deferral trust can not direct the trustee to invest for growth or to invest for a high income. IRS Regulations make it clear that the trustee must have discretion to invest in a manner that could result in the annual realization of a reasonable amount of income or gain from the disposition of assets.

The trustee can, in its discretion, invest all the assets of the trust in growth securities that provide little or no dividend income. There are literally hundreds of corporations on the stock exchange that do not pay dividends but invariably plow back earnings for future growth.

The investment goal, of course, is to increase the value of the trust assets so that, when distributions are to start, the percentage of value distribution will be based on the new high value of the trust. For example, if the trust can grow at an average rate of 9%, in ten years the value of the trust will increase by a factor of 2.367 (e.g., a $100,000 trust will have a value of $236,700 and a 6% payout will be $14,200 rather than $6,000).

The following table shows the approximate retirement income a client could receive from a 6% charitable remainder income deferral trust funded with $100,000 if the distribution was deferred for five, 10 or 15 years and if investments could provide an average growth of 6%, 8%, 10% or 12%.

The table assumes that the payments to the individual beneficiaries will be made for 20 years and that the trust is able to invest for an income adequate to make the distributions without lessening the value of the trust in future years.

Advantages of Deferring Income in a $100,000 CRT with a 6% Payout

Growth	Period of Deferral		
Percentage	5 Years	10 Years	15 Years
6%	$9,700	$14,700	$21,400
8	10,600	17,300	27,800
10	11,500	20,300	34,600
12	12,500	24,000	44,000

Clearly, deferring the distribution of income for a period of years has the potential for providing a substantially larger total benefit for the individual beneficiaries than an immediate distribution could provide.

Capital Gains Treated as Trust Income

Almost every state has adopted a version of the Uniform Principal and Income Act, which permits a trust agreement to define what constitutes income and what constitutes principal. In these states the trust agreement can direct that all realized capital gains – or a portion of realized capital gains – are to be treated as trust income.

A charitable remainder income deferral trust can so provide, subject to the IRS requirement that pre-gift appreciation in value must be treated as trust principal. Expressed differently, in most states a charitable remainder income deferral trust agreement can provide that all or a portion of realized capital gains – to the extent they represent post-gift appreciation in value – can be treated as trust income for purposes of making distributions to individual beneficiaries.

Adding this clause to a charitable remainder income deferral agreement will clearly make it easier for the trustee to make maximum distributions to the individual beneficiaries. But it could also cause the trustee to make a very large – and perhaps unwanted – distribution in a year when a highly appreciated asset is sold.

For example, a 6% charitable remainder income deferral trust funded with $100,000 will grow to approximately $259,000 if distributions are deferred for ten years (assuming a 10% annual growth). With the cumulative deficit also distributed, the trustee would require an income equal to 7.8% of the value of the trust to pay the maximum amount to the individual beneficiaries. Depending on the economy, this may be difficult or impossible to achieve. But if post-gift capital gains are treated as income, the trustee will generally find it easier to provide the beneficiaries with a maximum amount of income. This power must be permitted under state law.

IRS regulations prohibit net-income unitrusts from determing trust income by reference to a fixed percentage of the annual fair market value of the trust property, even though state law provisions might allow otherwise. The IRS is concerned that defining "income" as a unitrust amount might result in a 4% or 3% annual payout – permitting donors to avoid the requirement that unitrusts have a minimum 5% payout.

Note that, in many cases, it may be advantageous to give the trustee discretion to treat post-gift capital gains as income rather than directing that all such gains will be considered trust income.

Investing in a Commerical Annuity Contract to Defer Distributions

A charitable remainder income deferral trust agreement can – and must – give the trustee very broad discretion in the investment of trust assets – including discretion to invest all or part of the trust assets in a deferred annuity contract. The trust agreement can also provide that, in the event the trustee invests in a deferred annuity, the trust will be deemed to have income for accounting and distribution purposes only in the year that an actual distribution of income is received.

The result: The trustee can invest the trust assets in a variable deferred annuity which is likely to grow in value and will not produce any income until funds are withdrawn from the annuity contract. Even though the trust will have constructive income equal to the appreciation in the value of the annuity contract every year, there will be no trust income, and no distributions to the individual beneficiaries will be required, until amounts are actually withdrawn from the annuity contract.

This investment technique can often be substantially more effective during the deferral period than investing in growth securities because the investments will not be limited to those that do not produce dividend or interest income.

It is in the distribution period, however, that the deferred annuity investment technique becomes especially attractive. Every dollar withdrawn from the contract – up to the appreciation in the value of the contract – will be trust income which must be distributed to the individual beneficiaries (up to the specified percentage of value and the cumulative deficit). The trustee can almost invariably control the distributions to an exact dollar and exact time and thereby provide the greatest benefit to the individual beneficiaries.

It should be note, however, that all payments from the trust will be taxed 100% as ordinary income, in contrast to a trust invested in assets that produce long-term capital gain.

Self Dealing May Be a Problem with a Deferred Annuity Investment

There is a possibility that the IRS will consider the investment in a deferred annuity contract to be an act of self dealing. However, a Technical Advice Memo and IRS Training Publication make this quite unlikely. They take the position that investing the assets of a charitable remainder income deferral trust in a commercial deferred annuity will not be self dealing unless the income beneficiary is the trustee or is in control of the trustee and the deferral of distributions adversely affects the charitable remainder interest. (In most cases, the deferral of distributions will be beneficial to the charitable beneficiary.)

Note: Self dealing will not disqualify a charitable remainder trust but it can result in severe penalties. Once it is brought to the attention of the trustee it can not be continued and generally must be corrected.

It is important to point out that, in most cases, the trustee of a charitable remainder income deferral trust should be a disinterested person free to exercise its discretion as to the investment of trust assets and the timing of withdrawals from the annuity contract.

Investing in Zero Coupon Bonds to Defer Distributions

There is a another income deferral technique that has been approved by the IRS. The trustee of a charitable remainder income deferral trust can avoid the receipt of income and grow the value of the trust assets by investing in zero coupon bonds and by providing in the trust agreement that the trust will have income for accounting and distribution purposes only when income is actually received in a cash distribution. During the deferral period, the trust will have no cash income (even though annual increases in the value of the bonds will be constructive income) and the value of the bonds (the assets of the trust) will increase every year.

At the maturity of the bonds, the total increase in value will be paid to the trust and will be considered trust income that must then be distributed to the beneficiaries up to an amount equal to the specified percentage of value and any cumulative deficit from amounts not distributed in prior years.

There are two possible disadvantages of this technique. First, zero coupon bonds may offer only limited opportunities for growth. Second, because income will be received in the year a bond matures, it can be very difficult to control the timing of distributions to the individual beneficiaries or to provide level distributions over the beneficiaries life expectancies.

RETIREMENT BENEFITS FROM SMALLER GIFTS: DEFERRED PAYMENT GIFT ANNUITIES

AICR offers charitable gift annuities that have a payment deferral option. Deferred payment charitable gift annuities provide a way for "baby boomers" to make important charitable gifts that cut taxes and improve their retirement security. Minimum contributions are only $3,000 and deferred annuities can be established for individuals as young as 45 (payments may start no earlier than age 60).

Deferred payment charitable gift annuities provide an attractive alternative to "retirement unitrusts." Larger charitable deductions are available to clients and, in many cases, larger payments at retirement, as well. Here are examples of payout rates for different ages and deferral periods:

Present Age of Donor	Deferred Gift Annuity Rates 5-year Deferral	10-year Deferral	15-year Deferral	20-year Deferral
45	—	—	11.8%	15.9%
50	—	9.3%	12.5	17.2
55	7.3%	9.8	13.5	18.8
60	7.7	10.6	14.8	21.2

Payout rates are based on recommendations and calculation methods suggested by the American Council on Gift Annuities and are subject to change.

Flexible Deferred Payment Gift Annuities

Suppose Mr. C is age 50 and decides to give $10,000 in stocks to AICR for a deferred payment gift annuity. He guesses that he might retire at age 65, so he picks that age as the "ballpark estimate" of when payments should begin. He is entitled to a charitable deduction this year of roughly $3,000 (depending on current interest factors) and at age 65 can start receiving annuity payments of $1,250 (12.5%) a year. But suppose Mr. C decides to keep working past age 65, or for any reason wants to postpone the start of annuity payments. Two private IRS rulings would permit him substantial choice if he establishes a "flexible" deferred payment annuity. He could elect to initiate benefits at age 68 and be paid 15.2%, for example, or receive 17.2% by starting at age 70, as shown in the table.

Starting Age	Payout Rate	Annual Payout
65	12.5%	$1,250
66	13.3	1,330
67	14.2	1,420
68	15.2	1,520
69	16.2	1,620
70	17.2	1,720
71	18.4	1,840
72	19.6	1,960
73	20.9	2,090
74	22.2	2,220
75	24.0	2,400

Donors could arrange additional flexible deferred gift annuities every year, similar to IRA contributions, with partial deductions available. If you would like further information about charitable gift annuities, including gift deduction calculations and other tax and financial data, please call our office at 1-800-843-8114.

PRE-RETIREMENT CHARITABLE LEAD TRUSTS

High-income clients, who anticipate retiring in a year or two, might want to consider reversionary charitable lead trusts that provide income temporarily to AICR or other organizations. Such a trust could produce significant charitable deductions, creating tax savings that can be invested for future retirement income.

Basic Nature of a Pre-Retirement Charitable Lead Trust

A donor can set up a lead trust that provides either an annuity (fixed) or a unitrust (variable) payout to charity for several years, with reversion to the donor at the end of the trust, and claim an immediate income tax charitable deduction for the present value of charity's future income stream. Deductions will be high if §7520 (midterm) interest rates are low at the time the trust is funded.

The downside of this arrangement is that the donor will be taxed on all trust income under the grantor trust rules. Grantor-type (reversionary) lead trusts will make sense if the goal is to reduce income taxes in a year of high income, anticipating that the trust will be funded with or invested in dividend-producing stocks (preferred stock, for example), taxed at just 15%, or possibly tax-free bonds. If appreciated securities are sold to make the payout to charity, the donor would be taxed at low capital gains rates.

The year of retirement is often a year of high income, particularly if an individual is selling a business, receiving lump-sum bonuses or deferred compensation. The lead trust donor might enjoy tax savings while still in a 35% tax bracket, but subsequently drop into a 33% or 28% tax bracket in the years after retirement. So the fact that the donor is taxed on trust income may be less significant.

Donors who are concerned about federal transfer taxes can establish intentionally defective charitable lead trusts that provide the income tax savings described above, but also achieve gift tax savings, with trust assets passing to heirs when the trust terminates.

A Case Study

Winston is planning to retire as president of his company next year and is anticipating that his taxes for the current year will be extraordinarily high, due to a retirement bonus and payments from his company's profit-sharing plan. Suppose Winston places bonds paying $50,000 annual interest in a ten-year lead trust benefiting the American Institute for Cancer Research. Assuming a 5.0% §7520 rate, the value of the right to receive a $1.00 annuity for ten years is $7.7217 (see Table B, IRS Pub. 1457). Since AICR will be receiving $50,000, the value of its income interest is $7.7217 x $50,000, or $386,085. Winston would be entitled to a charitable deduction of $386,085 this year, while his federal income tax rates are still high, and is assured of getting the bonds back after ten years.

The major drawback to this plan is that Winston will be taxed on the income earned by the trust under the grantor trust rules (IRC §§671-677). His tax rates may be significantly lower after retirement, however. Winston may nonetheless wish to minimize the tax on this "phantom income." One strategy is to fund the trust with tax-free municipal bonds. The question of future taxation on the trust income would become moot because of the tax-free nature of the investment. Another idea is to fund the trust largely with growth stock that has been held more than 12 months. The trustee will be required to sell stock each year to make the payout to charity. Winston will be taxed only on the capital gain portion of the payout – and at a low rate (currently 15%). Winston will have realized income tax savings, however, at federal rates as high as 35%. Lead trust gifts are considered "for the use of" charity (gifts of income interests) and are deductible up to 30% of a donor's AGI [IRC §170(b)(1)(B)].

Please call our office at 1-800-843-8114 if you would like illustrations for charitable lead trusts or other gift arrangements.

CHARITABLE REMAINDER "FLIP" UNITRUST TO SUPPLEMENT RETIREMENT SAVINGS

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 attainment of the Recipient's 69th birthday, 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 make up payout arrangement, but with a "flip" provision that will switch to a standard unitrust payout in the year following a "triggering event" – the recipient's 69th birthday, 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, DC.

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

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

The War Against Cancer

When you have the occasion to draft a trust or a will 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 Gift Planning Office for additional information about the mission and the future plans of the American Institute for Cancer Research.

Our Gift Planning Office 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:
  The American Institute for Cancer Research
- AICR's mailing address:
  1560 Wilson Blvd, Suite 1000,
  Arlington, VA 22209
- AICR's phone number:
  800-843-8114
- AICR's 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.

Gift Planning Office

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