Planning & Drafting a Testamentary Charitable Remainder Trust

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To encourage generous gifts to the Institute and other charities, we have prepared this booklet to help attorneys and other financial advisors understand all the important tax and financial rewards Congress has provided. Our staff can provide the exact tax and financial consequences of any gift, trust or bequest your clients may want to consider. And because we are so active in this specialized field, we can furnish 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 Department at any time. Our toll free telephone number is 1-800-843-8114. And please . . . if the opportunity presents itself, inform your clients about how a gift, trust or bequest to the American Institute for Cancer Research can further the fight against cancer and also enhance their personal tax, investment, retirement and estate plans.

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Planning and Drafting a Testamentary Charitable Remainder Trust

A charitable remainder trust can be created during the life of a client (an *inter vivos* trust) or at the death of the client (a testamentary trust). This booklet will emphasize the planning and drafting of testamentary charitable remainder annuity trusts and unitrusts, but will also point out the relative advantages of setting up a trust during life as compared to setting up the trust at the time of death.

A client who wants to set up a testamentary charitable remainder trust can do this through his or her last will and testament or through a revocable living trust agreement. The client, of course, is free to set up any form of testamentary trust he or she may choose. However, if the trust is to be exempt from taxation or is to provide an estate tax charitable deduction or other tax benefits, it must meet all the technical requirements of a qualified charitable remainder annuity trust or unitrust.

Throughout this booklet, the term charitable remainder trust will mean a trust that qualifies as a charitable remainder annuity trust or a charitable remainder unitrust under Section 664 of the Internal Revenue Code.

Basic Nature of Charitable Remainder Trusts

Charitable remainder trusts – whether testamentary or *inter vivos* – are a product of the Internal Revenue Code and, as such, are subject to very rigid and technical requirements.

Conceptually, however, testamentary charitable remainder trusts are quite simple. The trust instrument (generally the will or revocable living trust) must direct that benefits be paid at least annually to one or more noncharitable beneficiaries (generally family members) for a specified period of years or for the life or lives of the designated beneficiaries. The annual benefits must be either a specific dollar amount (an annuity trust) or a specified percentage of the current value of the trust (a unitrust). The trust instrument must also provide that at the end of the specified trust term the then principal of the trust is to be paid or held for the benefit of the American Institute for Cancer Research or other qualified charitable institution.

As previously noted, the trust must be either a charitable remainder annuity trust or a charitable remainder unitrust.

A typical testamentary unitrust instrument might direct the trustee to:

(a) determine the value of the trust assets every year;

(b) pay the decedent's daughter 8% of the value of the trust each year for as long as she might live; and

(c) at the death of the daughter distribute the principal to the American Institute for Cancer Research.

The percentage of value payable to the daughter could be 7% or any other percentage the client might choose. The only requirement is that it be at least 5% and no more than 50%. There could be one beneficiary or several consecutive or concurrent beneficiaries of the trust and the unitrust amount could be payable to them for their lives or for a specified period of years (up to a maximum of twenty years).

A typical annuity trust instrument might contain similar provisions, except that the annual payments to the daughter would be a specified dollar amount that will not change over the life of the trust. The annual payments from an annuity trust must be at least 5% of the initial value of the trust and generally cannot be much higher than the assumed interest rate of the trust, in order to provide a charitable deduction equal to at least 10% of the inital trust value. Consecutive or concurrent beneficiaries can be

named and the trust can last for the life or lives of the beneficiaries or for a specified number of years (not to exceed 20 years).

The trust forms and comments starting on page 11 demonstrate the technical requirements of a testamentary remainder annuity trust or unitrust. Please feel free to call our Gift Planning Office (800-843-8114) if you have questions about the drafting of either a testamentary or *inter vivos* trust. The Institute will be pleased to provide additional safe harbor IRS charitable remainder trust forms without cost or other obligation.

Tax Advantages of a Testamentary Charitable Remainder Trust

There are three distinct tax advantages that will result from a typical testamentary charitable remainder trust. The first, of course, is the estate tax charitable deduction. The second advantage is the tax exemption that will be enjoyed by the trust. And the third advantage is the ability to provide a tax-free or favorably taxed income to the individual beneficiaries.

Whether a client chooses an annuity trust or a unitrust, the present value of the charitable remainder interest will be deductible for federal estate tax purposes. In a typical situation, family members gain both an income from the trust and a larger distribution from the estate because federal estate tax costs have been reduced. (See page 5 for an explanation of how the charitable deduction is computed.)

If the decedent's spouse is named as the only individual beneficiary of the trust, the value of his or her interest will qualify for an estate tax marital deduction. The result, of course, is that the full value of the trust will escape taxation in both the estate of the creator of the trust and the estate of his or her spouse. (See page 7 for a comparison of a charitable remainder trust with a charitable remainder QTIP trust.)

A second advantage of a testamentary charitable remainder trust is that the trust itself will be tax-exempt. This feature of a charitable remainder trust makes it advantageous to fund the trust with assets that are income in respect of a decedent. For example, a charitable remainder trust can receive the proceeds of an IRA or other retirement plan completely free of income taxes. The full amount of the proceeds can be invested to provide an income for family members or other individual beneficiaries.

Retirement account distribution rules allow donors to name charities or charitable trusts as death beneficiary of part or all of their retirement savings without fear of exhausting the account prematurely. Account owners will calculate how much to take out from their accounts each year according to a uniform table (the "applicable distribution period") that assumes a joint life expectancy with a survivor beneficiary who is ten years younger. The calculation is the same irrespective of who is named as death beneficiary – including charitable organizations and trusts – and the death beneficiary can be changed at any time.

There is one exception: If a donor names a spouse as death beneficiary, and the spouse is more than ten years younger, more favorable joint-life tables may be used.

Note that a charitable remainder trust is generally not feasible if the trust is to last for the lifetimes of very young beneficiaries, due to the 10% minimum charitable remainder requirement. If the 10% test is a problem, planners should consider leaving charity a portion of the IRA outright with the remaining portion passing to an eligible "look-through" trust to benefit grandchildren or other young beneficiaries. A term-of-years charitable remainder trust would work for beneficiaries of any ages if the donor is satisfied to have distributions continue for a maximum of 20 years.

Heirs normally receive an income tax deduction for estate taxes that were owed on an IRA or other retirement account. The IRS ruled, however, that if the IRA passes to a CRT, the deduction will belong to the trust, not passed through to the income beneficiaries. The result is to convert part of the trust's income (IRD) to tax-free corpus – which may not benefit the income beneficiaries for many years, under trust taxation rules. (PLR 199901023).

The tax-exempt status enjoyed by a charitable remainder trust also makes it possible to accumulate income and growth in the trust tax-free for later distribution to family members or other beneficiaries. A special form of unitrust (an income-only trust with make-up provisions) can permit a client to arrange a comfortable retirement income for family members or other individual beneficiaries. The trust could be designed as a so-called "flip" unitrust. Call us for details (800-843-8114).

A third advantage of a testamentary charitable

remainder trust is the ability to provide a tax-free or favorably taxed income to the individual beneficiaries. Distributions to individual beneficiaries are taxed as ordinary income to the extent the trust has ordinary income and as capital gain to the extent the trust has capital gain. Additional distributions can be tax free to the beneficiaries. Because most assets (except IRD) going to a testamentary trust will take a stepped-up basis, the trustee can convert them to municipal bonds or growth stock and pay a tax-free (or capital gain) income to the individual beneficiaries.

Generation Skipping Tax with a Testamentary CRT

The individual beneficiaries may have to pay a generation skipping tax on amounts they receive from the trust if they are more than one generation below the decedent and if the decedent's lifetime generation skipping exemption (equal to the estate tax credit shelter) does not shelter the trust from the generation skipping tax. Of course, in the vast majority of cases, the exemption will be sufficient to prevent any generation skipping tax problem.

The generation skipping tax rate is computed under a formula that takes into account the highest federal estate tax rate and the allowable estate tax charitable deduction. The tax is levied on each annuity or unitrust amount and is deductible by the beneficiary for income tax purposes. Although it is possible to make the trust liable for this tax, such a provision would result in the disqualification of the trust as a testamentary charitable remainder trust.

Calculating the Estate Tax Charitable Deduction

Whether a client chooses a testamentary annuity trust or testamentary unitrust, the present value of the remainder interest given to charity will be deductible for federal estate tax purposes.

The amount of the deduction will depend on:

(a) whether the trust is an annuity trust or a unitrust;

(b) the annuity or unitrust amount payable to individual beneficiaries;

(c) the age or ages of the beneficiaries at the death of the decedent or the number of years the trust will last;

(d) the frequency of payments to the individual beneficiaries;

(c) the initial value of the trust; and

(f) the federal midterm interest rate for the month in which the decedent died or either of the preceding two months.

The following table will give you a good approximation of the estate tax charitable deduction that will be allowed for a testamentary charitable remainder unitrust:

Approximate Charitable Deduction Percentage for a Unitrust

Age of Beneficiary	Percentage of Value 5%	6%	7%
55	33.8%	28.1%	23.5%
60	40.0	34.2	29.4
65	46.7	40.8	35.9
70	53.8	48.2	43.3
75	61.0	55.8	51.1
80	68.3	63.7	59.5

This table is based upon a federal midterm interest rate of 5% and quarterly payments to the individual beneficiary. For a closer approximation or for the exact amount of the charitable deduction after the death of the settlor, please call us at 1-800-843-8114. There is no cost or obligation for this service.

Example: In his will, Peter Jones bequeaths $200,000 to a charitable remainder unitrust that will pay 7% of the value of the trust to his sister every year for as long as she lives. If his sister is 70 years old at Peter's death, the charitable deduction will be approximately $86,600. If the sister is 75 years old, the deduction will be approximately $110,200. As you can see from the chart, the charitable deduction would be greater if the percentage payable to his sister was less than 7%.

Planning Suggestions for a Testamentary Charitable Remainder Trust

When Is a Testamentary Trust Most Appropriate for a Client?

A testamentary charitable remainder trust can be appropriate for most clients who would like to make a major contribution to the war against cancer and have estates that will be subject to the federal estate tax at their deaths. Because a carefully planned trust can significantly reduce the taxes incurred at death, it can benefit family members as well as the American Institute for Cancer Research or other important humanitarian programs.

Consider the situation of a client with an estate of $3,000,000 who is widowed and wants to provide financial security for her son, who is now age 62. Estate taxes could reduce the estate passing to her son to as little as $2,540,000. But, if the client bequeaths half of her estate ($1,500,000) to a charitable remainder annuity trust that will pay $90,000 to her son every year for as long as he may live, estate taxes will be reduced by at least $200,000. And this tax savings will pass directly to the client's son. (The age of the son at the client's death will, of course, determine the exact amount of the estate tax savings.)

Income in Respect of a Decedent Assets. If your client owns an IRA or other qualified retirement account – or if he or she has U.S. savings bonds or other assets that could be taxed as income in respect of a decedent – the testamentary charitable remainder trust can be especially advantageous.

Consider the situation of a client with an estate of $2,500,000, including retirement benefits worth $1,500,000. The client wants the bulk of his estate to go to his sister, who is now age 71. If the estate is left outright to the sister, the estate tax will be about $230,000 and the sister will pay an income tax of more than $500,000 when and as she withdraws the IRA proceeds.

The client could create a 6% charitable remainder unitrust in his will and name the trust as the survivor beneficiary of the retirement benefit. The charitable remainder trust would eliminate estate taxes and would not be depleted by any income tax on the retirement benefits. The sister would receive a good income for as long as she lived. And the American Institute for Cancer Research would receive the principal of the trust at the death of the sister.

Choosing an Annuity Trust or a Unitrust

Deciding between a testamentary annuity trust and a testamentary unitrust often is simply a matter of personal preference. Some clients will definitely want a fixed and certain amount paid to the trust beneficiaries for their lives. Other clients will want to provide a variable income to the trust beneficiaries that can reasonably keep pace with inflation.

We generally recommend the certainty of an annuity trust when the beneficiary will be quite elderly at the death of the decedent. We often recommend the unitrust as a hedge against inflation where the beneficiary is relatively young and in good health.

We pointed out before that charitable remainder trusts must provide a remainder equal to at least 10% of the initial trust value. Annuity trusts must also satisfy the 5% probablility test. This can pose a problem for testamentary trusts because the midterm rate is not known at the time the trust is drafted. It is possible that an annuity greater than 6% of the value of the trust would cause a disqualification under the 5% probability rule. And it is also possible that a 9% annuity would be acceptable. The 5% test does not apply to a unitrust, which can direct the payment of up to 50% of value to the individual beneficiaries, if the 10% remainder test is met.

A drafting solution to the 10% minimum remainder requirement is to structure the annuity trust or unitrust to make the highest payment that will result in a qualifying remainder interest, subject to a payout ceiling (7%, for example). If the payment required to satisfy the minimum remainder interest requirements under this formula falls below the minimum 5% payout, then the trust can prescribe payments for the longest fixed term of years (up to

20 years) that will satisfy the 10% remainder requirement. Note: A term of years trust won't have to comply with the 5% probability test that applies to charitable remainder annuity trusts established for one or more lives.

In some cases, it may be prudent to fix the annuity as a percentage of the initial value of the trust rather than as a specific dollar amount. The reason: a specific dollar amount might not satisfy the requirement that the annuity be at least 5% of the value of the trust if the amount actually passing to the trust is more than the amount contemplated when the will or revocable trust was executed.

Funding a Testamentary Charitable Remainder Trust

Unlike the income tax charitable deduction, the estate tax charitable deduction has no limitations or special rules based on the nature of the property passing to the testamentary charitable remainder trust. It doesn't matter whether the property is appreciated in value, whether the property had been held for less than one year, whether a sale would have resulted in ordinary income or whether the property is personal or real. The allowable estate tax charitable deduction will be based on the fair market value of the property passing to the trust as of the date of death of the decedent.

There are, however, special advantages to funding a testamentary charitable remainder trust with retirement accounts or other assets, such as U.S. savings bonds, that are treated as income in respect of a decedent. Because the charitable remainder trust is a tax-exempt entity, it can receive and convert these properties without incurring any income tax liability.

Delayed Funding of the Testamentary Charitable Remainder Trust

Probate being what it is, a rather lengthy period of time may be required before an estate can fully fund a testamentary charitable remainder trust.

But the law is clear that the obligation to pay the annuity or unitrust amount must begin as of the date of the decedent's death.

The problem of having to pay an annuity or unitrust amount before the trust is funded can be avoided by including in the trust instrument a provision that all payments can be deferred until the end of the taxable year in which the trust is completely funded. Where this provision is included, it should follow the forms provided by the IRS that mandate the payment of an ascertainable amount of interest to the individual beneficiaries. (See the IRS forms at the end of this booklet for recommended provisions to be included in the trust instruments.)

QTIP Trust Compared to Charitable Remainder Trust

A married client can create a simple testamentary QTIP trust that will pay all income to his or her spouse for life and pass to the American Institute for Cancer Research at the death of the spouse. All property passing to this trust will, if the executor so elects, qualify for an estate tax marital deduction, so it will be free of estate taxes at the client's death. The trust will be part of the spouse's estate, but the full value will qualify for an estate tax charitable deduction at the death of the spouse.

A charitable remainder trust that pays an annuity or unitrust amount to the client's spouse for life will also be completely free of estate taxes both at the death of the client and at the death of the spouse.

In some cases, a charitable QTIP trust will be preferred by the client because it provides more practical financial security for his or her spouse – the spouse can have the right to withdraw all or part of the principal during his or her life. This, of course, is not possible with a charitable remainder trust.

Also, there are situations where a charitable remainder trust will be preferable because it will not be part of the gross estate of the spouse, because the charitable trust is exempt whereas the QTIP trust is taxed as a complex trust, or because the testamentary charitable remainder trust will provide a more definite deferred gift to the American Institute for Cancer Research.

Consider a Non-Qualified Charitable Remainder Trust

A client, by his or her will or revocable living trust, can create a trust that will pay income – rather than an annuity or unitrust amount – to one or more family members for life and pass to the American Institute for Cancer Research when the income rights have terminated. The trustee can be given discretion to pay principal as well as income to family members, or to accumulate income in the trust. Indeed, the trust can contain just about any provisions the testator may want to include.

This form of trust will not give rise to an estate tax charitable deduction and it will not be a tax-free entity. But it may effectively accomplish the purposes of the client, especially if the client's estate will not be subject to the federal estate tax.

Inter Vivos Trust Compared to Testamentary Trust

In some cases, an *inter vivos* trust will be significantly more advantageous to a client than a testamentary trust. Creating the trust during life, rather than at death, will give rise to an income tax deduction for the present value of the charitable remainder interest. An *inter vivos* trust and a testamentary trust will produce approximately the same estate tax charitable deduction, but an *inter vivos* trust that does not include the grantor as a beneficiary will also prevent any gift or estate tax on post-gift appreciation in the value of property given to the trust.

An *inter vivos* trust will also reduce settlement costs because the properties transferred to the trust will not be in the client's probate estate.

Certainly, if the client could benefit from an income tax charitable deduction or if he or she owns property that is likely to appreciate quickly and substantially in value, an *inter vivos* trust should be considered. If it fits the client's objective, the annuity or unitrust amount can be paid to him or her for life and then to the persons who would have been the beneficiaries of a testamentary trust.

The disadvantages of an *inter vivos* trust could include the loss of a stepped-up basis (which can result in higher taxes to the surviving beneficiaries). With a testamentary charitable remainder trust, it often is possible to pay the individual beneficiaries a tax-free or favorably taxed income even though the trust is funded with property that appreciated in value during the decedent's life. An *inter vivos* trust would take the donor's cost basis in appreciated property, and any capital gain could be taxed to the individual beneficiaries under the four tier distribution rule. **Exception:** If the trust assets are required, for any reason, to be included in the client's gross estate, a step-up in basis will be allowed.

An *inter vivos* trust also can result in an immediate gift tax liability if the value of the taxable gift to the trust and prior gifts exceed the gift tax credit. In most cases, this potential problem can be avoided by making the gifts to individual beneficiaries incomplete during the client's life.

If the client has a substantial estate and is expected to live for more than three years, incurring a gift tax liability rather than a later estate tax liability will effectively reduce the total transfer taxes imposed on the estate.

Gift and Estate Tax Results of Charitable Remainder Trusts

Clients who establish one-life charitable remainder trusts for themselves escape estate taxes on the value of the CRT thanks to the 100% estate tax charitable deduction. Two-life trusts, where a spouse is the survivor beneficiary, qualify for the 100% estate tax marital deduction under IRC §2056(b)(8). Donors who establish testamentary trusts for someone other than a spouse, or who have a non-spouse as a survivor beneficiary of their lifetime CRT, will have the trust assets included in their gross estates, subject to an estate tax charitable deduction for the date-of-death value of charity's remainder interest (IRC §2055). The table on the following page gives a short-hand view of the gift tax and estate tax consequences of establishing lifetime charitable remainder trusts.

	Donor Creates Lifetime CRT Paying Income to:	Taxable Gift?	Gift Tax Exclusion?	Marital Deduction?	Included in Gross Estate?
1.	Self for life	No	N/A	N/A	Yes, but 100% charitable deduction
2.	Spouse for life	No	N/A	Yes	No
3.	Self and spouse for life (joint and survivor)	No	N/A	Yes	Yes, but 100% marital deduction
4.	Spouse and third person	Yes	Yes	No	No, but gift value is adjusted taxable gift
5.	Non-spouse for life, no right to revoke by will	Yes	Yes	No	No, but gift value is adjusted taxable gift
6.	Self, then to non-spouse – no right to revoke by will	Yes	No (gift of future interest)	No	Yes, but charitable deduction for date-of-death remainder value
7.	Self, then to non-spouse with right to revoke by will	No (gift incomplete)	N/A	No	Yes, but charitable deduction for date-of-death remainder value
8.	Self, then to spouse with right to revoke by will	No (gift incomplete)	N/A	No	Yes, but 100% marital deduction
9.	Self and non-spouse as joint/survivor beneficiaries – no right to revoke by will	Yes	Yes	No	Yes, but charitable deduction for date-of-death remainder value
10.	Non-spouse for life, reserving right to revoke by will as "qualified contingency"	Annual payout yes; income interest, no*	Yes, for annual payouts	No	Yes, but charitable deduction for date-of-death remainder value
11.	Spouse or non-spouse for term of years, with right to revoke in will	Annual payout yes; income interest, no	Yes, for annual payouts	No	Yes, but charitable deduction for date-of-death remainder value
12.	Spouse or non-spouse for term – no right to revoke by will	Yes, on value of income interest	Yes	No	No, but gift value is adjusted taxable gift

* A private letter ruling (PLR 8949061) allowed a donor to use the right-to-revoke-by-will strategy to minimize gift tax in a *term of years* unitrust (and presumably an annuity trust) where he/she is not an income beneficiary. (See #11.) The IRS has not ruled, however, on the situation where a donor creates a charitable remainder trust that is to last for the life of another person or persons and keeps the right to revoke by will. The strategy in situation #10 is that the donor would include right-to-revoke-by-will language within a trust for life/lives, avoid a completed gift on the value of the income interest, and not disqualify the trust because potential revocation is designated as a "qualified contingency" within the scope of IRC §664(f).

Testamentary Unitrust for One Life

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

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

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

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

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

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

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

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

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

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

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

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

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

Drafting Comments

In General. The form obviously is based on a trust created by will but it also can be used to create a charitable remainder trust through a revocable living trust.

The IRS has provided detailed annotations for the testamentary unitrust sample form, available from the Treasury at the following address: http://www.irs.gov/irb/2005-34_IRB/ar10.html. Sample forms and annotations for two-life testamentary unitrusts may be found at http://www.irs.gov/irb/2005-34_IRB/ar12.html. Sample forms and annotations for term-of-years testamentary unitrusts may be found at http://www.irs.gov/irb/2005-34_IRB/ar11.html.

It is important to provide very clearly in the will or revocable trust agreement for the payment of all debts, expenses and taxes of the estate from properties other than those that are to pass to the charitable remainder trust.

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

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

The trustee of the trust is designated in this opening paragraph of the safe harbor form. In most cases, the trustee can be any person or entity permitted by state law, including the beneficiary of the trust. It may be prudent to name alternate and successor trustees in this opening paragraph.

The American Institute for Cancer Research may agree to serve as trustee or co-trustee, without commissions or other fees, if it is named as the sole irrevocable remainder beneficiary of the trust.

Paragraph 1 – Payment of Unitrust Amount. The requirements are the same whether the trust is created during the life or at the death of the donor.

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

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

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

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

Paragraph 5 – Additional Contributions. The trust instrument could permit additional contributions although this is not generally done with a testamentary trust.

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

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

Testamentary Charitable Remainder Annuity Trust for One Life

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

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

2. Deferral Provision. The obligation to pay the annuity amount shall commence with the date of my death,

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

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

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

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

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

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

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

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

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

Drafting Comments

In General. This agreement provides for the creation of a testamentary annuity trust, with the annuity amount payable for one life. Annuity payments are quarterly and are expressed as a percentage of the initial value of the trust assets. Alternative provisions in Rev. Proc. 2003-57 allow for (1) the annuity amount to be stated as a specific dollar amount, (2) payment of part of the annuity to a charity, (3) termination of the trust upon the happening of a qualified contingency, (4) the trust to end with the last regular payment prior to death, rather than a prorated amount and (5) granting the annuity beneficiary the power to

designate the charitable remainderman. The IRS will recognize a trust as a qualified charitable remainder annuity trust meeting all of the requirements of IRC §664(d)(1) if the trust operates in a manner consistent with the terms of the trust instrument, if the trust is a valid trust under applicable local law and if the trust instrument (i) is substantially similar to the sample or (ii) properly integrates one or more alternate provisions from this revenue procedure.

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

1. *Payment of Annuity Amount.* In each taxable year of the Trust during the annuity period, the Trustee shall pay to [permissible recipient] (hereinafter referred to as "the Recipient") during the Recipient's life an annuity amount equal to 7 percent [or any percent at least 5 but not exceeding 50 percent] of the initial fair market value of the assets of the Trust as finally determined for federal estate tax purposes, or the highest percent that will result in a qualifying remainder interest under section 664(d)(2)(D), but in no case shall the annuity amount exceed 7 percent of the initial fair market value of the trust assets. If the annuity amount required to satisfy the minimum remainder interest requirements falls below 5 percent, then the Trustee shall pay to the Recipient an annuity amount equal to 5 percent of the initial fair market value of the trust assets for the longest term of years, not exceeding 20, that will result in a qualifying remainder interest. (Add here additional term of years payout language from IRS sample forms; see http://www.irs.gov/irb/2003-31_IRB/ar09.html.

The IRS has provided detailed annotations for the testamentary annuity trust sample form (available from the Treasury at the following address: http://www.irs.gov/pub/irs-irbs/irb03-31.pdf). Sample forms and annotations for two-life testamentary annuity trusts may be found at http://www.irs.gov/irb/2003-31_IRB/ar10.html.

The War Against Cancer

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

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

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 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:
  1759 R Street, NW
  Washington, DC 20009
- AICR's phone number:
  202-328-7744 or 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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