



# Using a Charitable Remainder Trust as the Recipient of Qualified Plan and IRA Interests<sup>1</sup>

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## **Introduction**

There are currently approximately 28 trillion dollars of assets in the United States that are held in pension type plans<sup>2</sup>, such as Section 401(k) and 457 plans and individual retirement accounts (IRAs). These arrangements provide at least three significant benefits.<sup>3</sup> The first is protection from claims of creditors of the plan participant or IRA owner, subject to certain exceptions. The second is that the amount of earnings contributed to the plan or account is generally not subject to income tax. The third is that the earnings realized inside the plan or account are, in general, not subject to income tax. This allows the earnings to grow tax-free, one of the most powerful phenomena in financial planning.<sup>4</sup> Deferral of taxation of earnings can last until the plan participant or IRA owner reaches his or her mandatory beginning date. to receive distributions. Typically, this is April 1 following the year the individual reaches the age of 72, at which point he or she will be required, so as to avoid excise tax (in the nature of a penalty) under Section 4974, to take required minimum distributions (RMDs) over his or her recalculated life expectancy.<sup>5</sup>

Prior to the effective date of the Setting Every Community Up for Retirement Enhancement Act (the SECURE Act),<sup>6</sup> once the plan participant or IRA owner died, the law required the property in the plan or account to be distributed by the end of the fifth calendar year following the death of the participant or owner (unless the plan or account was left to an identified individual, known as a “Designated Beneficiary” or a so-called “see-through” trust, in which case RMDs could be taken over the unrecalculated (or fixed at death) life expectancy of the identified individual. (For the surviving spouse of the participant or owner, distributions could be taken over the spouse’s recalculated life expectancy in some cases.) There were, and even after the effective date of the SECURE Act, two types of “see-through” trusts. One was and is called a “conduit trust” which mandates that all distributions received by the trust from the plan or account be distributed immediately to the Designated Beneficiary; essentially, for RMDs, the trust is treated as if it were that individual. The other see-through trust was and is called an “accumulation trust” which, as the name indicates, need not make any distributions to any beneficiary, only has beneficiaries who are identifiable individuals, and may take RMDs over the unrecalculated life expectancy of the oldest individual beneficiary of the trust.

## **Plans and IRAs in the Context of Estate Planning<sup>7</sup>**

Except for distributions from a Roth IRA,<sup>8</sup> distributions from plans and IRAs following the death of the participant or owner constitute income in respect of a decedent described in Section 691(a) and, therefore, are included in the gross income of the recipient. They may also be subject to estate tax in the estate of the participant or owner. The combined taxes may be very significant, especially if there are state estate and income taxes. For example, in the state of Washington, the top state

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estate tax rate is 20%. (In many other states, it is 16%.) State death taxes imposed on property included in the federal gross estate are deductible, under Section 2058, for purposes of determining the federal taxable estate, meaning, for example, where the state rate is 20%, that only 80% of what otherwise would be the taxable estate is exposed to the 40% federal estate tax rate. Forty percent of 80% is 32% which then is the effective federal estate tax rate, in such a case. When that is added to a 20% state estate tax, the combined effective estate tax rate is 52%. The 32% federal estate tax rate is deductible, pursuant to Section 691(c), for purposes of determining the amount that is subject to income tax on distributions from a plan or IRA. So only 68% of the plan or IRA distributions may be subject to income tax. The top federal income tax rate on plan or IRA distributions is 37%. State income tax can be as high as 13% (in California) meaning a potential combined income tax rate of 50% which if applied to the 68% of the distributions, after the Section 691(c) deduction, produces a next income tax on the distributions of 34% which, when added to the possible state and federal estate taxes, could bring the combined taxes to 86%. (The result could be worse after 2025 when the deduction limitation under Section 68 is restored.)

In addition, a transfer of an interest in a plan causes acceleration of the income except where it is transferred pursuant to a QDRO.<sup>9</sup> There is at least some question whether an interest in an IRA may be transferred by the owner prior to death without causing the account to lose its tax-exempt status.<sup>10</sup> Hence, interests in plans and IRAs are often the most difficult assets to deal with in the estate plan. And, as indicated, if estate tax cannot be reduced, it may make sense to try to reduce the present value income tax burden on a plan or IRA. Before the SECURE Act, that was somewhat possible by having plan or IRA distributions spread over a long period of time. However, the Act, as described below, has curbed that in many situations. Nonetheless, using a charitable remainder trust (CRT) as the receptacle for them may help reduce the burden in some cases.

### **Brief Overview of the SECURE Act**

The SECURE Act, signed into law in December 2019 and effective at the beginning of 2020, made significant changes to qualified (retirement) plans (“plans”) and IRAs. Probably, the most significant change was the elimination of the ability of most beneficiaries (upon the death of the plan participant or IRA owner) to take distributions, without additional tax (in the nature of a penalty) under Section 4974, over the successor beneficiary’s life expectancy. Except for five categories of individuals (known as “Eligible Designated Beneficiaries” or “EDBs”) and except with respect to a plan participant or IRA owner who at death was taking distributions over his or her life expectancy, beneficiaries must take the entire amount from the plan or account by the end of the fifth calendar year or, if there is a Designated Beneficiary (essentially an identifiable individual) or a conduit or accumulation trust, by the end of the tenth calendar year following the calendar year of the death of the participant or owner.

Perhaps, the two most important impacts of such changes are (1) to shorten the

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period following the death of the participant or owner of tax-free compounding provided by the use of the plan or IRA (the so called “stretch”) and (2) to shorten the period that the plan or IRA interests may remain free from the claims of creditors, although using a trust may provide significant creditor protection for the beneficiary or beneficiaries.

The five categories of EDBs, who may continue to use their life expectancies for payouts from a plan or IRA, are (1) the surviving spouse or (2) a minor child of the participant or owner, (3) an individual who is not more than ten years younger than him or her and an individual who at the death of the participant or owner is (4) disabled or (5) chronically ill within the meaning of Sections 72(m)(7) or 7702B(c)(2), respectively. Note that the life expectancy of a minor child of the participant or owner may be used only until the minor reaches majority when the ten-year payout rule commences. Just as under prior law, if there is no Designated Beneficiary (whether or not also an EDB), the entire plan or account must be distributed under the same five-year payout regime as under prior law (or, if the participant died after commencing required minimum distributions, over the participant’s remaining life expectancy).

Unless the beneficiary is an EDB, the proceeds payable to an individual (or to a conduit or a see-through accumulation trust) must be withdrawn in their entirety by the end of the tenth calendar year following the calendar year of the death of the plan participant or IRA owner, so as to avoid the additional tax (in the nature of a penalty) under Section 4974. There are no annual minimum distributions required for individual beneficiaries (who are not EDBs) as there were under prior law. Rather, a non-EDB individual need take nothing from the plan or IRA, so income tax deferral may continue for that ten-year period.

### **Power of Tax Deferred Compounding**

Probably, the most important factor in efficient financial planning is tax-free compounding. Next best is tax-deferred compounding. The longer the period of deferral the better for building wealth, all other things being equal.<sup>11</sup> Indeed, the inability to use the ten-year payout regime (which has been substituted for the life expectancy regime except for the plan participant or owner himself or herself and for EDBs), in which case the five-year payout regime must be used, retards the accumulation of wealth, all other things being equal.

Here is a comparison. Taxpayer at death has a \$1 million IRA. If it grows 20% a year, it will be worth \$2,488,000 in five years<sup>12</sup> and is then subject to an assumed 37% income tax<sup>13</sup> and which would leave \$1,567,000 at the end of five years. If that amount then grew at a rate of 12.6% (the net after-tax net earnings of a 20% a year return taxed at 37%) for five more years, the taxpayer would have \$2,837,000. If, instead the ten-year regime applies and the IRA grows income tax-free for ten years (instead of only five years), the IRA would be worth \$6,191,000 in ten years when it is subject to an assumed 37% tax, leaving about \$3,900,000. So, the postponement

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of taxation from five years to ten years would produce a significant financial benefit: \$3.9 million vs. \$2.837 million. This analysis, however, assumed a very high rate of return (20% a year). Suppose instead the annual return (before any income tax) were only 1% a year. After five years, the IRA would be worth \$1,051,000 when it would be subject (it is assumed) to a 37% income tax, leaving \$662,000. That amount then grows for five more years at a 1% rate or .63% after tax (that is .0063 annual growth after tax) to \$683,000. If the IRA grows income tax-free for ten years (instead of five years) at 1% annually, it would be worth \$1,104,000 before tax and \$696,000 after a 37% income tax. So, tax deferral is always better (all other things being equal, like growth inside and outside the IRA or plan and income tax rates being the same on all amounts) if, but only if, there is growth. What can be gained by a slower payout is a longer time for tax-deferred compounding, again all other things being equal. This is attributable to attaining tax-deferred earnings on the income tax postponed - it is, in theory, presumably the primary reason taxpayers contribute to plans and IRAs.<sup>14</sup>

So, the question naturally arises: what can a taxpayer do to extend the period of tax-free compounding? The answer, for some, is to have the plan or IRA paid to a CRT described in Section 664 which will receive the proceeds free of income tax (because a CRT is exempt from such tax under Section 664(c)(1)) and distributions from the CRT may be made, if certain actuarial requirements are not violated, over the life of one or more individuals or for a fixed term of up to 20 years and not just within the ten-years provided by the SECURE Act. However, because the remainder interest of the CRT must pass to charity, the additional time the trust is exempt from income taxation may not always offset the cost to individuals of the loss of the value of the remainder interest passing to charity upon the termination of the CRT. In effect, when using a CRT, the taxpayer is renting the trust's exemption from income taxation. The price paid is the value of the remainder interest that must be committed to charity. Of course, for individuals that are charitably inclined, including those wanting to fund their own private foundations, the "price paid" in this context may be of no real consequence, particularly since (as discussed further below) the minimum actuarial value of the remainder interest need only be equal to 10% of the value contributed to the CRT.

There are many distinctions between CRTs and plans and IRAs that one must consider. A CRT is subject to a 100% excise tax under Section 664(c)(2) on any unrelated business taxable income (UBTI) it receives. A plan or IRA, on the other hand, simply pays the corporate tax rate on any UBTI received. All distributions from a plan or IRA (other than a Roth IRA) are taxed as ordinary income. Under Section 664(b), distributions from a CRT retain their tax character (e.g., as ordinary income, capital gain or tax-exempt income), although the highest taxed income a CRT receives is deemed to be distributed until an income subject to a lower (or no) tax is deemed distributed. Those distinctions make the comparison of using a CRT more complicated.

In any event, as indicated below, it will be rare for a CRT to be the best choice for a

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surviving spouse of the participant or owner who otherwise would have the proceeds pass directly to the survivor. Similarly, it will be rare to have a CRT be the best choice for a Roth IRA.

### **Brief Discussion of CRTs**

As virtually everyone who deals with them knows, a CRT described in Section 664 must either be a charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) as described in that section.<sup>15</sup> A CRAT must provide each year for a minimum annuity payment, to and for the life or lives of identified living individuals or to or for an individual or a groups of persons (including charity although at least one person must not be a charity) for a fixed-term of not more than 20 years, of a minimum of five percent (5%) and a maximum payment of fifty percent (50%) of the value of the assets contributed to the trust at the time of their contribution. A CRUT must provide each year for a minimum annual payment to an individual or a group of persons of five percent (5%) and a maximum payment of fifty percent (50%) of the annual value of the assets then held by the trust. A CRUT may also provide for annual payment of the lesser or the 5% minimum/50% maximum of the trust's fiduciary accounting income (FAI), described in Section 643(b) and its regulations thereunder, and may provide that, if the FAI is less than the unitrust amount for any year, the "short fall" may be made up in a later year if and to the extent the FAI for the subsequent year exceeds the unitrust amount for that year. (Adjustments are required for any "short" year and the percentage payout for either a CRAT or a CRUT may not vary from year-to-year.) This latter type of unitrust is commonly called a "net income with make-up charitable remainder unitrust" or "NIMCRUT." (If the governing instrument does not provide for the make-up of the short fall, the trust is typically called a "net income charitable remainder unitrust" or a "NICRUT.") In addition, the actuarial value of the remainder, which will pass ultimately to or for charity, must be at least ten percent (10%) of the actuarial value of the assets at the time of their contribution to the trust.<sup>16</sup> Moreover, there cannot be more than a five percent (5%) probability that the trust will be exhausted by the payments<sup>17</sup> (which as a practical matter cannot happen with a CRUT as the unitrust payments will diminish if the value of the trust declines).<sup>18</sup>

The value of the remainder of a CRT is determined by how long the trust is expected to last, the required payout (and for a CRUT that limits payments to FAI, the calculation will be based upon the unitrust percentage even if that is greater than the assumed rate of FAI to be earned in the trust).<sup>19</sup> For an annuity trust, the value will depend on the Section 7520 rate that must be used to value interests in CRTs. Except for the timing during each year when the unitrust will be paid, the value of the remainder in a CRUT will not be affected by the Section 7520 rate.<sup>20</sup> Also, the probability of exhaustion of the trust by payments cannot be greater than five percent.<sup>21</sup> This may occur for a CRAT but probably not a CRUT as previously stated. Whenever the Section 7520 (which is the assumed annual rate of growth the CRAT will experience) is less than the annuity percentage used (which as mentioned

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earlier cannot be less than 5%), the trust may exhaust. Even if the Section 7520 rate is the same as the annuity rate, the 10% value of the remainder test may not be met. For example, if both the Section 7520 rate and the annuity rate are 5%, the trust will fail the ten percent value of the remainder test if the annuitant (for life) is under age 25. If the annuity is limited to 5% and the Section 7520 rate is at least 5.4%, the test will be met. In fact, the higher the Section 7520 rate, the higher the annuity can be without violating the ten percent value of the remainder test or the 5% probability of exhaustion test. As the Section 7520 rate increases, the value of the remainder increases, all other things being equal. Unfortunately, this violates the premise of using a CRT: renting the trust's exemption from taxation and paying the lowest rent possible, which is the value of the remainder. Ideally, this would be 10% of the value of what is being contributed to the trust and not more.

For CRUTs, the analysis may be quite different. Unlike an annuitant of a CRAT, a unitrust recipient will receive more if the value of the trust increases. For example, at a 5% unitrust, the recipient will receive more if the trust grows more than 5% a year. For example, if the trust starts at \$1 million and grows to \$1,050,000 by year end, when the unitrust amount of \$50,000 is paid, the unitrust recipient will receive a \$50,000 payment if the 5% unitrust payment is calculated at the beginning of each year. The trust will then drop back to \$1 million and the unitrust amount for the second year will also be \$50,000. However, if the trust grows at 6% a year, there would be \$1,010,000 at the beginning of the second and year producing a \$50,500 for the second year. That does not seem like much of a difference, but over time it could grow significantly and that may be especially important in later years when the value of a fixed (annuity) payment may be eroded by inflation. Of course, if the trust assets grow at a much higher rate (as equities historically have<sup>22</sup>), the difference will be quite stark.

### **Benefit of Exemption from Income Taxation**

There seem to be some "truths" about CRTs. First, for many taxpayers, the most significant benefit of a CRT is its exemption from income taxation.<sup>23</sup> Although distributions to taxable beneficiaries (e.g., an individual who is the annuitant or unitrust recipient) will be included in the recipient's gross income to the extent the trust has experienced and is not treated as already having distributed taxable income (with the highest taxed class of income being deemed distributed first unless paid to a charity which is an annuitant or unitrust recipient of the CRT), the CRT itself is not subject to income tax under Section 664(c)(1). When someone creates a CRT, he or she (or it) may (indirectly) benefit from the CRT's exemption from taxation to the extent, if any, the trust has taxable income in excess of the amount currently payable to an annuitant or unitrust recipient. That is because the next best thing to avoiding income tax is postponing income taxation, as a general rule.<sup>24</sup> This often occurs when a taxpayer holds appreciated property that the taxpayer decides to sell (or is compelled to sell). Subject to exceptions,<sup>25</sup> taxpayer must pay income tax on gain recognized, leaving a smaller base of wealth to generate future earnings. By contributing the appreciated assets to a CRT, the trust may sell them

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without paying income tax because the trust is exempt from such taxes<sup>26</sup> so the amount in the trust is not eroded by taxes. as a result of the sale, even though the sale would otherwise be subject to tax if sold outside the confines of a CRT.

For an annuity trust, that may not be important. For example, a taxpayer holds an asset that produces little current income and is worth \$1 million with a zero basis. She anticipates that if she sells it, she will pay a 24% tax on the gain, leaving her only \$760,000. Instead, she intends to contribute the asset to a CRT with the hope that trustee will sell it.<sup>27</sup> She wants to receive an annuity of \$50,000 each year for her life. Before we even begin to look at the “economics” of that move and consider alternatives, it is appropriate to note that she will violate the five percent probability of exhaustion test if she is under age 72 with a Section 7520 rate of 2%. Even at a 4% Section 7520 rate, she will violate the test if she is under 56. Moreover, at younger ages, she will also violate the 10% value of the remainder requirement. Also, she cannot provide for a payment of less than \$50,000 a year so the 10% minimum value of the remainder and 5% probability of exhaustion tests will not be violated as a CRAT must pay an annuity equal to at least 5% (5% of the \$1 million is \$50,000). Although if the Section 7520 rate is at least 5%, a 5% CRAT can be created without violating the 5% probability of exhaustion test, the grantor who creates a CRAT at death will not be able to know what Section 7520 rate might apply.<sup>28</sup> Note, however, that the remainder value may vastly exceed ten percent so the taxpayer will have paid very high rent for the trust’s exemption from taxation.

Consider that if she sold the asset and paid the 24% tax and there are no earnings on the \$760,000, the after tax wealth will be exhausted before the 16<sup>th</sup> year. Of course, she will have received the annuity payment of \$50,000 for 15 years free of any income tax which, if reinvested, may grow in value. With the CRAT, even if it never grows in value, the \$50,000 annual payments will last 20 years, but each annuity payment will be subject to income tax. The same result presumably would occur by simply selling \$50,000 of the property each year for 20 years. Perhaps, the CRAT is preferable if the property must be sold and gain recognized. Although an installment sale might be considered, such a sale can be complicated from both a management and tax perspective.<sup>29</sup>

The major advantage of a CRAT is that the same payments continue (unless and until the trust is exhausted) even if the trust diminishes in value each year. With a CRUT, the payments will decline for each year the trust decreases in value. But, as mentioned below, a taxpayer may be better off acquiring a commercial annuity if he or she believes there will be no increase in the value of the funds.

Of course, with a CRAT, an increase in value of the assets in the trust does not benefit the noncharitable beneficiary except to ensure the payments will continue beyond the payment of the amount of the original corpus. For example, if the original corpus is \$1 million and the CRAT provides for annual payments of \$100,000 for ten years, the payments will cease by the end of tenth (10<sup>th</sup>) year (and if the Section 7520 rate is less than 2.6%, the trust will not meet the minimum 10% value

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for the remainder requirement). Even if the Section 7520 rate is above 2.6%, the beneficiary may fail to receive the payments for ten (10) year if the assets decline in value while in the trust.

With a CRUT, the taxpayer participates with growth in the assets and the trust should never be exhausted by payments (although it could be if the assets investment performance decline in value to zero, which would also mean a loss of all payments from a CRAT as well). In any case, the beneficiary of a CRUT will receive more than a beneficiary of a CRAT, all other things being equal, if the trust increases in value (after making the required annual payments) over the life of the CRT. Note that if the annuity percentage, unitrust percentage and the Section 7520 rate are the same, the tax value of the payments and the remainders will be the same. Of course, in the real world, the return almost certainly will not remain the same for the life of the trust.<sup>30</sup> If the property owner is concerned that value of the trust will not increase, then consideration likely should be given to acquiring a commercial annuity as that likely will provide greater payments<sup>31</sup> than the CRAT would. For example, the taxpayer could buy a commercial annuity<sup>32</sup> to receive an annual payment that would at least equal the amount to be paid from the CRAT and contribute a smaller amount to the CRAT. However, to buy a commercial annuity the taxpayer would have to sell the assets. Nonetheless, the commercial annuity may well pay more than a CRAT even if the CRAT can pay 5% for life.<sup>33</sup> It might not even be possible to create a \$1 million CRAT to pay \$50,000 a year, if the Section 7520 rate is below the 5% payout. For example, the exhaustion test will be violated with a 5% annuity (payable at year end), if the Section 7520 rate is below 3.8%. In fact, even if both the payout and Section 7520 rate are 5%, the ten percent (10%) value of the remainder will not be met if the annuity is to be paid for life for someone under the age of 24 years. In any case, as explained, even if the actuarial tests are not violated, the value of the remainder may exceed ten percent, which means too high of a price has been paid to rent the trust's exemption from income tax.

Historically, stocks do increase in value over time.<sup>34</sup> "According to historical records, the average annual return since its inception in 1926 through 2018 is approximately 10%. The average annual return since adopting 500 stocks into the index in 1957 through 2018 is roughly 8% (7.96%)."<sup>35</sup>

As explained, a taxpayer seems to benefit very little from the trust's exemption from income tax when creating a CRAT but may receive considerably more with a CRUT, if it increases in value. For example, with a \$50,000 a year CRAT payment, the annuitant will receive \$1,000,000 over 20 years (\$50,000 x 20). With a CRUT, a unitrust recipient entitled to a 5% unitrust payment each year would receive approximately \$1,650,000 over the same 20 year period if the assets grow at 5% a year (much lower than then S&P 500 returns for any 20 year period in modern times).

In effect, the taxpayer is "renting" the exemption from taxation of charity and is paying for it by committing the remainder of the CRT to charity. In a CRT, that must be at least 10% percent of the value of the assets donated to the trust (the

minimum the law allows). Note if a taxpayer wants charity to get more, the taxpayer should limit the value of the remainder of the CRT to ten percent and simply donate more directly to charity.

The postponement of the taxation of income earned inside the CRT may or may not be beneficial for the taxpayer. For example, as indicated, for a CRAT, it seems that other than locking in the base of wealth with no tax, the beneficiary really does not benefit from the tax exemption from the trust. But for a CRUT, the beneficiary may benefit from the trust's exemption from income tax in the same way the participant in a qualified plan does (at least to the extent growth and income each year exceed distributions to the unitrust recipient for the year).

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If a CRT could be a good receptacle for an IRA or plan, it may be best to name a non-see-through accumulation trust with discretionary beneficiaries which include a CRT. The IRA or plan proceeds will have to be entirely distributed by the end of the calendar year following the year of the death of the owner of participant. Even if the trustee chooses to distribute all proceeds to the CRT, there will be no requirements for distributions from the CRT until it receives the proceeds, adding to flexibility. In fact, making the plan or IRA proceeds payable to such a non-see through accumulation trust with both a CRT and those individuals whom the owner or participant wishes to benefit will allow the trustee to wait to see where it would be best to dedicate the proceeds including, perhaps, in whole or in part, to the CRT. However, that structure, compared to naming the CRT as of death, means no charitable estate tax deduction will be allowed.

### **A NIMCRUT May Be Best**

Another option with a unitrust is to make it an “income only with make-up” (a NIMCRUT).<sup>36</sup> By investing, for example, in growth stocks that pay little (if any) dividends, no significant distributions need be made. At the appropriate time, the trustee may be able to change the investments so receipts do constitute FAI and are well in excess of the unitrust amount for year of the change. For example, the trust may have been invested in growth stocks that pay no dividends. The stock can be sold without income tax (because the NIMCRUT is income tax exempt) and then invest in bonds, for example, with a yield more than the unitrust amount. There are some restrictions, however, imposed by the regulations on converting corpus into FAI for purposes of this strategy. For example, although having gain treated as FAI is permitted in an income-only unitrust, any gain arising from a sale or exchange of assets contributed to the trust may be treated as FAI only to the extent the assets have appreciated in value, such that pre-contribution gain cannot be taken into account in computing FAI.<sup>37</sup> Similarly, gain arising from a sale or exchange of assets later acquired by the trust may be treated as FAI only to the extent they have appreciated after acquisition.<sup>38</sup>

Some states have statutes which seem to permit significant flexibility in controlling the amount and timing of FAI. For example, Alaska's income and principal act,

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which is based upon the uniform act, provides essentially that there is no accounting income merely by the imputation of tax income to a trust. So, a NIMCRUT trust must report all income imputed or allocated to it for income tax purposes, such as where the trust is a partner in a partnership (or limited liability company [LLC] treated as a partnership for income tax purposes). Partnerships are ‘flow-through’ entities. Flow-through taxation means that the entity does not pay taxes on its income. Instead, the owners of the entity pay tax on their ‘distributive share’ of the entity’s taxable income, even if no funds are distributed by the partnership to the owners.”<sup>39</sup> Hence, if a NIMCRUT is a partner, it will report as its income any income of the partnership properly allocated to it, but if the trust received no FAI from the partnership, none of the partnership (imputed) income will be distributable to or taxed to the unitrust recipient.

Alaska law, for example, essentially limits FAI from a partnership to be limited to distributions only of money (except for reinvested dividends) and then only if the money was (1) money received in one distribution or a series of related distributions in exchange for part or all of a trust’s interest in the entity, (2) money received in total or partial liquidation of the entity, (3) money received from an entity that is a regulated investment company or a real estate investment trust if the money distributed is a short-term or long-term capital gain dividend for federal income tax purposes. Money is deemed received in a partial liquidation to the extent, and presumably only to the extent, (1) the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation, or (2) the total amount of money and property received in a distribution or series of related distributions is greater than 20 percent of the entity’s gross assets, as shown by the entity’s year-end financial statements immediately preceding the initial receipt. (There is a further limitation: Money is not received in partial liquidation, and it may be taken into account as a partial liquidation only to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money.)

Hence, if an Alaska NIMCRUT invests in a limited partnership, nothing will be distributable to the unitrust recipient based purely on imputed income from the partnership. Hence, if the NIMCRUT receives no FAI, the share of income it earns (through the partnership) essentially will accumulate in the NIMCRUT income tax free.<sup>40</sup> If and when the trustee wishes to generate FAI, it could seek a distribution in cash from the partnership that is not indicated to be of a partial liquidation and is not a distribution as part of related distributions consisting of greater than 20 percent of the entity’s gross assets, which would cause the money received to be treated as corpus under the act. This can be made more certain by having the trust itself provide that distributions of profits experienced by the entity shall be FAI and that only a distribution that the partnership advises is in partial liquidation of the partnership shall be considered principal. This almost certainly would be respected for tax purposes. Reg. 1.643(b)-1 provides, in part, that FAI “means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Trust provisions

*If a partnership, LLC or other entity will be used to control the amount of FAI the NIMCRUT receives, the person in control of the distributions from the entity should be someone other than the grantor, trustee, beneficiary or a person related or subordinate to any of them.*

that depart fundamentally from traditional principles of income and principal will generally not be recognized.” Until the Uniform Income and Principal Act was promulgated (in 1997) there was little, if any, developed law on how distributions from business entities (such as a limited partnership) were to be treated for income and corpus purposes. Indeed, common entities used today, such as LLCs, just did not exist.<sup>41</sup> Hence, it is very difficult to see how specific provisions on how receipts from such an entity could depart fundamentally from traditional principles of income and principal.

### **Expressed IRS Concern on NIMCRUTs**

However, the Internal Revenue Service has indicated some concern over the ability of a NIMCRUT to “manipulate” what is income (FAI) and principal. For example, although the Uniform Act permits a trust to pay a unitrust amount (generally, of between 3% and 5%) and for it to be treated as FAI for tax purposes, Reg. 1.664-3(a)(1)(b)(3) provides that “trust income may not be determined by reference to a fixed percentage of the annual fair market value of the trust property, notwithstanding any contrary provision in applicable state law. Proceeds from the sale or exchange of any assets contributed to the trust by the donor must be allocated to principal and not to trust [accounting] income at least to the extent of the fair market value of those assets on the date of their contribution to the trust. Proceeds from the sale or exchange of any assets purchased by the trust must be allocated to principal and not to [fiduciary accounting] income at least to the extent of the trust’s purchase price of those assets.”

Shoemaker and Jones, “Charitable Remainder Trusts: The Income Deferral Abuse and Other Issues”, IRS exempt Organizations CPE Textbook 1997-139, discusses other possible manipulation of distributions from NIMCRUTs. That report did not make specific proposals, and none have yet to be implemented after more than 20 years. In Rev. Proc. 97-23, 1997-1 CB 654, the IRS announced it would not issue rulings on whether an income only CRT qualifies under Section 664 where the grantor, trustee, beneficiary or a person related or subordinate to any of them controls the timing of the CRT’s receipt of trust income from a partnership or a deferred annuity contract. It is understood the IRS was studying whether other investments might disqualify the trust as a CRT. Again, it has been more than 20 years since the revenue procedure and the Shoemaker report were issued. And in National Office Technical Advice Memorandum (TAM) 9825001 (not precedent), the IRS rules that the acquisition by a NIMCRUT of deferred payment annuities (which avoid the current generation of FAI) was not an act of self-dealing under Section 4941<sup>42</sup> and would not prevent the trust from being a “qualified” CRT. Perhaps, more important, after the issuance of the Shoemaker report and Rev. Proc. 97-23, the Treasury revised the CRT regulations (see Treasury Decision 8791) and basically only inhibited controlling the amount of FAI by prohibiting the allocation of proceeds of sale or exchange to FAI to the extent not in excess of the value of the assets when contributed to or purchased by the NIMCRUT and by prohibiting the use of a unitrust percentage to determine FAI of an income only CRT.

Hence, it seems that managing a NIMCRUT to produce minimum or maximum FAI is permitted (subject to the prohibitions just mentioned).<sup>43</sup> Nonetheless, if a partnership, LLC or other entity will be used to control the amount of FAI the NIMCRUT receives, the person in control of the distributions from the entity should be someone other than the grantor, trustee, beneficiary or a person related or subordinate<sup>44</sup> to any of them.

*Are individual beneficiaries better off with a CRT?  
It depends.*

### **Are Individual Beneficiaries Better Off with a CRT?**

The answer is: it depends. If the ability to postpone income taxation of the plan or IRA proceeds is desirable (for example, to have tax deferred growth), the answer may well be yes. As demonstrated above, postponement of taxation of the proceeds from a plan or IRA may produce overall greater wealth if the assets grow in value. Due to the fact that, (except for EDBs), plan and IRA proceeds must be distributed essentially within ten years of the death of the plan participant or IRA owner, a mechanism to postpone their taxation for a longer period may also be beneficial.

*Postponement of taxation of the proceeds from a plan or IRA may produce overall greater wealth if the assets grow in value.*

For example, a taxpayer may create a CRUT to pay 11% a year to a beneficiary for 20 years (the maximum fixed period for a CRT) without violating the ten percent value of the remainder requirement. If it is assumed that the trust will grow at 6% a year and no unitrust payments are made for the first 19 years because there is no FAI, the NIMCRUT will be worth \$3,207,135. If instead, the beneficiary received the amount in the plan or IRA in ten years (which would be \$1,790,847 or \$1,128,234 after a 37% income tax) and that were invested at 6% taxable each year (or 3.78% after a 37% tax) for another ten years, the beneficiary would then have \$1,635,068. With the NIMCRUT if no unitrust payments were made until the end of 20 years, the recipient would have faced total shortfalls for the first 19 and with the unitrust payment for year 20 of \$ 4,289,200. The CRT would then be worth \$3,207,135. Note that, although the shortfall in unitrust payments are nearly \$4,300,000, the CRT is worth only about \$3.2 million and, obviously, no more than the trust's value could be transferred to a beneficiary. The increase in value from the inception would be \$2,207,135 and if that entire amount were paid out at the end of the 20-year term and was FAI, the beneficiary would net \$1,390,495 after a 37% income tax. Perhaps, it would be possible for the trust to pay more of the shortfall of \$4,289,200 to the unitrust recipient (although, again, never more than the \$3,201,135 in the trust), so that, after a 37% income tax, the recipient would have more than \$1,635,068. That obviously would mean charity would get after 20 years less than \$1,000,000. But that result is not unfair or constitute "cheating" of the charitable remainder beneficiary which was to receive a present value interest, at inception, of \$100,000 (that is 10% of the \$1,000,000 account). Indeed, if the charitable remainder beneficiary received \$600,000 at the end of 20 years that would represents a 9% compounded growth for the 20 years on the \$100,000 value of the remainder at inception of the trust. So, if \$2,607,135 of FAI were received in the 20<sup>th</sup> year and paid to the unitrust recipient and subjected to a 37% tax, the recipient would have \$1,642,495 slightly more than if the CRT were not used.

*With a unitrust for life of someone relatively young, the tax-free compounding inside a NIMCRUT can also mean more ultimately for the unitrust recipient.*

Even if only part of the increase in value in the trust (from inception) constitutes FAI, the unitrust recipient may receive more if the growth in the trust is greater. For example, if the trust grew not at 6% annually but at 11% a year (the same as the 11% unitrust percentage), the unitrust recipient would receive approximately \$4.5 million after income tax compared approximately \$3.5 million after tax if the plan or account grows tax free at 11% annually for ten years, is then withdrawn subject to a 37% tax and reinvested at 11% (6.39% after a 37% tax) for another ten years.

### **NIMCRUT for Life**

A NIMCRUT may provide for payments for the life of an individual. However, to avoid violating the 10% minimum value of the remainder, no one younger than someone 23 years of age may be the unitrust recipient (and then only with a 5% unitrust payout and having the percentage applied and paid after 12 months from the funding of the trust). The older the unitrust recipient the higher that unitrust percentage may be for life. For example, an 11% unitrust payout can be provided for life for someone 51 years of age or older, the same maximum percentage for a fixed 20-year term unitrust.

With a unitrust for life of someone relatively young, the tax-free compounding inside a NIMCRUT can also mean more ultimately for the unitrust recipient. For example, if the beneficiary received the amount in the plan or IRA in ten years (which would be \$1,790,847 if it earned 6 percent a year or \$1,128,234 after a 37% income tax) and that were invested at 6% taxable each year (or 3.78% after a 37% tax) for 30 more years, the beneficiary would then have \$3,434,070. If instead, the beneficiary received no distributions from the NIMCRUT for 40 years and it grew at 6% a year, the unitrust recipient would receive \$10.2 million (on account of the shortfalls in FAI during the years), leaving approximately \$6.5 million after tax and having the original \$1million corpus pass to charity at that time, which represents an approximate 6% compounded growth in the \$100,000 value of the remainder for 40 years. An alternative would be not to make up payments made to the unitrust recipient but to convert the NIMCRUT to a standard CRUT at some time.

### **Another Option to Build In: A Flip Unitrust**

For a variety of reasons, one of which may be that the amount of FAI generated each year is insufficient from what the beneficiary will desired and that a “standard” unitrust would have been preferred as payments would not be limited to FAI. Reg. 1.664-3(a)(1)(i)(c) permits the conversion of an income only unitrust to a standard unitrust (one that pays the unitrust amount each year regardless of the amount of FAI the trust receives). Once the conversion occurs, the beneficiary will receive the amount of the unitrust determined without regard to the amount of FAI. The conversion has to occur at a date certain what the regulations call a “triggering event,” which the regulations provide is a single event whose occurrence is not discretionary with or within the control of the trusts or any other person. Regulations specifically provide that the sale of unmarketable assets,<sup>45</sup> or the marriage, divorce, death or birth of a child with respect to any individual may be such a triggering event.

*Whether a CRT is suitable for an EDB depends on facts and circumstances.*

### **What About for EDBs?**

Whether a CRT is suitable for an EDB depends on facts and circumstances. For the surviving spouse of the participant or IRA owner, it likely is best to name the spouse or a conduit trust for the spouse as the beneficiary on account of the unique options the spouse has such as rolling the plan or IRA into his or her own IRA (or adding it to his or her employer's plan). That will permit RMDs to be taken over the recalculated life expectancy of the surviving spouse. Unless the survivor wants the proceeds never to be taxed (or to be taxed at a much later time), a CRT may not be the best choice. However, if a CRT is not used, the spouse (or conduit trust for the spouse) will have to take distributions over his or her recalculated life expectancy. The survivor may delay taking RMDs until either (1) the survivor reaches his or her required beginning date (RBD) but only if survivor is named as the "outright" beneficiary (and not through a conduit trust) and rolls the benefits owner to his or her own IRA (in which case the survivor may take RMDs under the Uniform Lifetime Table, which is a joint life table which is more favorable than the single life table which would be applicable to a conduit trust). If a conduit trust for the spouse is named as the beneficiary (or the spouse is named but does not rollover the funds to his or her own IRA), RMDs must commence no later than the later of (1) the year of the participant's death or (2) the year the participant would have reached age 72. If the spouse is quite young, naming the spouse as the outright beneficiary and having him or her rollover the proceeds to his or her own IRA may be the best move (having the spouse delay payments until his or her RBD) rather than paying the proceeds to a CRT. The survivor will get the benefit of a long stretch where the entire plan or account can continue to grow tax-free. This seems especially beneficial for a Roth IRA as the survivor can delay taking any distributions during the balance of his or her lifetime, greatly benefitting from long term tax-free (not just tax-deferred) compounding.

*A minor child of the participant or owner does not have the same flexibility as does the surviving spouse.*

A minor child of the participant or owner does not have the same flexibility as does the surviving spouse. The minor need not take distributions out under the ten-year regime but can wait until he or she reaches majority<sup>46</sup> when the ten-year payout rule will commence. During minority, however, it seems the minor just needs to take RMDs based on his or her (long) life expectancy (account balance divided by life expectancy). Once he or she reaches majority and the ten-year rule kicks in, he or she can wait until the end of the tenth calendar year following the year he or she reaches majority. This treatment of minor children of the participant or owner is complicated. Some might feel a CRT for the life of the minor is best, but as explained above, a CRUT cannot be created for the life of anyone under the age of 25 and, as also explained, usually a CRUT is better than a CRAT (which could be created for a minor if the Section 7520 rate is high enough, something very difficult to forecast very far into the future). If the plan participant or owner does not want the child to receive much of the proceeds early in life, there is little, it seems, that can be done if the participant or owner want to use the special treatment for a minor who is an EDB. Although, a conduit trust for the minor could be used once he or she reaches majority, the entire amount in the plan or account will have to be taken by the trust within the ten year period after majority is reached and then immedi-

*An accumulation trust may be used for a beneficiary who is chronically ill or disabled if the person is the only one to whom the trustee may make distributions during his or her lifetime.*

ately distributed outright to the former minor. Although, perhaps, not absolutely certain, it does not seem that an accumulation trust may be created for a minor of the participant or owner and have the minor treated as an EDB so payment during his or her lifetime can be made under the RMD rules until he or she reaches majority when the ten year rule must be used.

One possible option is to have the conduit trust be a grantor trust as to the minor by granting him or her a unilateral right described in Section 678 to withdraw everything in the trust for a time and then having it be withdrawable only with the consent of a non-adverse party, such as the trustee.<sup>47</sup> This would be similar to a so-called “Crummey Trust” with a so-called “hanging power.”<sup>48</sup> Even assuming such a trust may be used, it may be subject to the claims of creditors in some jurisdictions and presumably the trustee would at least distribute to the minor (or former minor) an amount equal to the income tax he or she will owe on the income attributed to him or her under the grantor trust rules.

For an EDB, who is not the spouse of the participant or owner and not more than ten years younger than him or her (such as a sibling or significant other whom the participant or owner does not marry), unrecalculated life expectancy can be used. A conduit trust can be used but probably not an accumulation trust. Depending upon the age, health and financial needs of the beneficiary, a charitable remainder trust may be considered (at least for part of the proceeds of the plan or IRA).

It seems virtually certain that an accumulation trust may be used for a beneficiary who is chronically ill or disabled if the person is the only one to whom the trustee may make distributions during his or her lifetime. This should provide maximum asset protection for the beneficiary including entitlement to government benefits (for which such a beneficiary may well be entitled). Although the trustee will be required to take RMDs based upon the beneficiary’s unrecalculated life expectancy, the accumulation trust may be drafted so no distributions are required to be made from the trust to the beneficiary. Of course, that will mean the RMDs will be subject to tax at the highest rate of income taxation (which for a trust occurs when the trust has nearly \$13,000 of income). A CRT might be considered for such a beneficiary as payment of plan or IRA proceeds received by the trust would not be subject, upon their receipt by the trust to any income tax. It could be created for a class so distributions would not be required to be made to that beneficiary, but could be made to others (such as a sibling of the beneficiary) who could apply the CRT distributions to benefit the disabled or chronically ill person. Or, as mentioned above, a NIMCRUT could be created for him or her and managed to produce little if any FAI until a need for a trust distribution is appropriate keeping in mind that the receipt of too much property may disqualify the beneficiary from certain government benefits such as Medicaid which may be critical for him or her.

### **Some Conclusions**

Interests in plans and IRAs often are the most complicated assets with which to

*The next best thing to income avoidance is income tax deferral which is why individuals contribute to qualified (retirement) plans and IRAs.*

deal in an estate plan. They may be subject to both estate tax and to income tax. It seems that little lifetime planning can be done with such plans or accounts during lifetime to reduce estate tax on them. Except for Roth IRAs, distributions from a plan or IRA (both before and after death) almost always will be subject to income tax as ordinary income. Because deferring income tax is a powerful income tax planning tool, individuals often sought to have payments from plans and IRAs stretch over as long a period as possible. The SECURE Act has significantly reduced that ability by generally requiring that all plan or IRA interests be distributed by the end of the tenth calendar year following the death of the plan participant or IRA owner. In order to delay the taxation of distributions, some individuals may wish to consider paying the plan or IRA to a charitable remainder trust where distributions can be paid over a 20-year period or, in some cases, for the life or lives of individual beneficiaries. In some case, the beneficiaries will succeed to more wealth over time with a CRT than if one were not used. A careful analysis of the CRT option should be undertaken for some taxpayers. In doing that, we think the following generalities should be considered:

- The next best thing to income avoidance is income tax deferral which is why individuals contribute to qualified (retirement) plans and IRAs.
- The principal benefit to the non-charitable beneficiaries of a CRT is the trust's exemption from income taxation.
- This benefit will occur whenever the CRT has tax income greater than the amount payable each year.
- This benefit essentially is the renting for the individual beneficiaries of the CRT of the trust's exemption from income taxation.
- Individuals wish to pay the lowest rent possible when renting and, with a CRT, that rent is the minimum allowed value of the remainder (10%).
- Because property tends to increase in value over an extended period of time, a CRUT almost always will be superior to a CRAT and a carefully administered NIMCRUT may be best of all.

## Endnotes

- 1 Portions of this article are derived from Blattmachr, “Using Charitable Remainder Trusts as Asset Management, Estate Planning and Private Retirement Plan<sup>sm</sup> Tools,” *The Chase Review* (July 1989). In this article, each reference to “Section” is to a section of the Internal Revenue Code of 1986, as amended. The authors greatly thank Natalie B. Choate, Esq., probably the leading expert on estate planning for retirement plans, Professor F. Ladson Boyle and Lawrence Macklin for reviewing a draft of this article. However, any errors contain in the article are to be attributed solely to the authors.
- 2 See <https://www.pionline.com/article/20180621/INTERACTIVE/180629958/u-s-retirement-assets-at-28-trillion-in-q1-little-changed-from-end-of-2017>
- 3 See, generally, Choate, *Lifetime and Testamentary Planning for Retirement Plans*, 8<sup>th</sup> Ed. (Tax Plan 2017), available at Ataxplan Publications c/o Nutter McClennen & Fish LLP 155 Seaport Blvd. Boston MA 02210-2604, (617) 439-2995, nataliechoate@cs.com.
- 4 The importance of this phenomenon is highlighted in Glickman & Blattmachr, “High Returns and Tax-Free Compounding: Important Goals in Building Wealth,” 43 *Estate Planning* 11 (May 2016).
- 5 Although someone of a particular age has a fixed (definite) life expectancy (or a specified time when such a person is expected to die), the longer the person lives, the later the age at which he or she is expected to die. Recalculation means that the individual’s life expectancy is extended for each additional year he or she lives. Essentially, this allows the plan participant or IRA owner to continue to receive payments from the plan or account without the imposition of tax under Section 4974, regardless as to what age he or she lives.
- 6 The SECURE Act is part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94, 12/20/2019), which was signed into law by the President on 12/20/2019. The SECURE Act significantly modifies many requirements for employer-provided retirement plans, IRAs, and other tax-favored savings accounts.
- 7 See Choate, *supra*, for a thorough discussion of this topic.
- 8 See Section 408A.
- 9 Section 414(p).
- 10 Cf. Horwitz & Damicone, “A Decent Proposal,” 150 *Tr. & Est.* 46 (November 2011) with CCA 201343021 (“PLRs 20117042 and 201129045 appear to conflict with Rev. Rul. 85-13. PLRs 20117042 and 201129045 were issued by IRS Employee Plans, and *state that an individual retirement account (IRA) cannot be transferred to a grantor trust of the IRA owner.* The conflict between these rulings and Rev. Rul. 85-13 was noted in Beers, Deborah M., ‘IRS Issues Two Seemingly Contradictory Rulings on Effects of Transfer of IRA to Special Needs “Grantor” Trust’, 36 *Tax Mgmt. Est. & Tr. J* 230 (2011) and Jones, Michael J., ‘The Economy and other Retirement Mysteries’, *Trusts & Estates*, January 2012, at 35. Both articles mention prior PLRs issued by the same office appearing to accept that the owner of a grantor trust is the owner of its assets, which may include an IRA. See PLRs 200620025, 200826008, and 201116005.” *Emphasis added.*)
- 11 These concepts are explained in detail in Glickman & Blattmachr, *supra*.
- 12 Under the five-year regime, the payout period could be somewhat longer than five years as the account must be fully distributed, to avoid the tax under Section 4974, by the end of the fifth calendar year following the year of death.
- 13 The highest income tax rate is 37%. The net investment income tax imposed by Section 1411 does not apply to plan or IRA proceeds. See Section 1411(c)(5). This avoidance of the NIIT for plans and IRAs applies if and when the proceeds are payable to a trust and then treated as distributed to a beneficiary of the trust, including a charitable remainder trust. See Blattmachr and Boyle, *Income Taxation of Estates and Trusts* (PLI 2019), at § 4:7.3
- 14 It, perhaps, is even more obvious that the longer assets are held in a Roth IRA (described in Section 408A) the better, as they not only grow income tax-free but are not included in gross income, in most cases.
- 15 For a further discussion of CRATs and CRUTs, including their governing instruments, see Fox, *A Guide to the IRS Sample Charitable Remainder Trust Forms* (Estate Planning, Jan. 2006).
- 16 Section 664(d)(1)(D) and (d)(2)(D).
- 17 Rev. Rul. 77-374, 1977-2 CB 329.
- 18 For a discussion of the 5% probability test, see Fox & Blattmachr, “IRS Provides Guidance to Avoid 5% Probability Test for Charitable Remainder Annuity Trusts”, 94 *Journal of Taxation* 246 (June 2017).
- 19 Treas. Reg. § 1.664-4. In essence, that regulation requires that the charitable remainder (and the annuity or unitrust interest or interests that precede it) must be determined using the rate in effect under Section 7520. (Section 7520(a) provides that if an income, estate, or gift tax charitable contribution deduction is allowable for any part of the property transferred, the taxpayer may elect to use such Federal midterm rate for either of the 2 months preceding the month in which the valuation date falls.) The Section 7520 rate

is equal to 120% of the applicable federal midterm rate (determined under Section 1274) rounded to the nearest even two-tenths of one percent. Since the Section 7520 rate has been in effect (beginning in May 1989), it has reached a high of 11.6 percent and a low of 1.0 percent. <http://www.leimberg.com/software/7520rate>.

20 This is explained in detail in Blattmachr & Hastings, “Valuing Certain Split Interests,” 123 Trusts & Estates 27 (June 1983).  
21 Rev. Rul. 77-374, supra.

22 See <https://www.macrotrends.net/2526/sp-500-historical-annual-returns>.

23 A CRT is subject to a 100% excise tax on any unrelated business taxable income attributed to it. Section 664(c)(2). It seems this income will form the pool of taxable income that may be taxed to the trust’s annuitant or unitrust recipient which may cause the UBIT to be subject to overall taxation of more than one hundred percent (100%).

24 Just Google it. And note that the trillions of dollars that are in qualified retirement plans and individual retirement accounts (IRAs) got there based upon that assumption. See, also, Glickman & Blattmachr, supra.

25 See, e.g., Sections 1033 and 1244.

26 However, a CRT is liable for 100% excise tax on any unrelated business taxable income it has. See Section 664(c)(2).

27 At least in some circumstances, gain experienced by a CRT will be attributed to the trust’s grantor. See discussion in Blattmachr & Hastings, “Charitable Remainder Trusts,” The Chase Review (October 1988).

28 In valuing the interests in a CRT, the taxpayer may use the Section 7520 rate in effect when created (which will be the date of death for one created at death) or either of the two preceding months. Section 7520 X. Hence, for an individual who is known with medical certainty that he or she will die within the next two months, he or she can be morally certain of what type of CRAT will qualify. Also, a formula may be used. See the CRT forms available at InterActive Legal.

29 The creditworthiness of the buyer must be considered although sometimes an escrow may help eliminate that concerns. And see Sections 453, 453A and 453B.

30 Even if the trust purchases a bond that pays each year interest equal to the Section 7520 rate used to value interests in the trust for tax purposes, the value of the bond will change over time and that will affect the unitrust payments in future years.

31 “According to Fidelity, a \$100,000 deferred income annuity today that is purchased by someone at age 60 would generate \$671.81 a month (\$8,061.72 a year) in income for a woman and \$696.89 a month (\$8,362.68 a year) in income for a man,” available at <https://money.usnews.com/money/blogs/the-best-life/2013/07/09/when-to-convert-your-savings-into-an-annuity>. For a \$1 million payment, that would be \$83,627 a year not \$50,000. Charity might be better off as well—for example, giving \$100,000 to charity now and using \$900,000 for the annuity which based upon the same assumptions would produce an annual payment of \$75,264 each year.

32 There may an income tax advantage to a commercial annuity compared to a CRAT. All ordinary income is first treated as coming out of the CRAT, then long term gain, the tax free return of basis. With a commercial annuity, the payments will be deemed to consist proportionately of ordinary income (interest), gain and corpus until original basis is exhausted.

33 For example, if the \$1 million is sold, leaving \$760,000 and \$100,000 is given to charity, a commercial annuity purchased with the remaining \$900,000 for the 60 year old male would be about \$55,000 a year, more than the \$50,000 sought annually from the CRAT.

34 See <https://www.macrotrends.net/2526/sp-500-historical-annual-returns>.

35 <https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp>

36 Although an income only CRUT need not provide for the make-up payments for years when FAI exceeds the unitrust payment for the year (such a trust is commonly called a “net income charitable remainder trust” or “NICRUT”), there seems to be little downside in using the NIMCRUT design. However, if the taxpayer wants insure no “leaking” out of the trust for the long haul, the NICRUT may be best. The taxpayer may be waiting to convert (or flip) the income only trust to a regular CRUT until a later time.

37 Reg. 1.664-3(a)(1)(i)(b)(3).

38 Id.

39 Id.

40 As mentioned above, the trust will have to pay a 100% excise tax on any UBIT it must report. See Section 664(c)(2).

41 “In 1977, when the state of Wyoming first passed legislation allowing a new type of company called a Limited Liability Company (LLC), hardly anyone noticed. Today, over two-thirds of all new companies formed are LLCs.” Search “How long have LLC been around?” at [www.quora.com](http://www.quora.com/What-was-the-first-known-Limited-Company). What-was-the-first-known-Limited-Company.

42 Section 4941 imposes an excise tax on what it describes of acts of self-dealing.

- 43 The IRS has ruled (privately) that plan proceeds may be made payable to a CRT. PLR 199901023 (not precedent) and PLR 9634019 (not precedent); and see PLR 9919039 (not precedent).
- 44 A related or subordinate person is defined in Section 672(c).
- 45 A related or subordinate person is defined in Section 672(c).
- 46 There is some uncertainty what majority means. It may be the age under the minor's domicile that determines it (which in almost all but not all states is 18) or, for some, when the child completes a "specified course of education" within the meaning of Section 409(a)(9)(F).
- 47 Cf. PLR 200949012 (not precedent).
- 48 These concepts are discussed in detail in Blattmachr & Graham, "The Extra Crummey Trustsm: Maybe the Best Annual Exclusion Vehicle Around," 22 Probate & Property, No. 4, (July/August 2008).

## **Glossary of Acronyms**

- CRT - Charitable Remainder Trust
- CRAT Charitable Remainder Annuity Trust
- CRUT - Charitable Remainder Unitrust
- NIMCRUT - Net Income with Make-Up Charitable Remainder Unitrust
- NICRUT - Net Income Charitable Remainder Unitrust
- EDB - Eligible Designated Beneficiaries
- QDRO - Qualified Domestic Relations Order
- RMD - Required Minimum Distributions
- RBD - Required Beginning Date
- FAI - Fiduciary Accounting Income