

TAX UPDATE

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The IRS Reconsiders—CRTs and Spousal Right of Election
February 11, 2006



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This week we look at a recent announcement by the IRS backing off of a deadline that passed over six months ago for what had to be done for charitable remainder trusts subject to certain state law provisions to be deemed valid charitable remainder trusts under §664.

Charitable Remainder Trusts

Generally, a taxpayer must make a gift of his/her entire interest in property in order to get a charitable contribution deduction under §170, although certain exceptions are carved out. One of the most important is an exception for a device known as a charitable remainder trust described in §664.

To begin, there is a general prohibition on donations that are of a partial interest that we find at §170(f)(3):

170(f)(3) DENIAL OF DEDUCTION IN CASE OF CERTAIN CONTRIBUTIONS OF PARTIAL INTERESTS IN PROPERTY. --

170(f)(3)(A) IN GENERAL. --In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

170(f)(3)(B) EXCEPTIONS. --Subparagraph (A) shall not apply to --

170(f)(3)(B)(i) a contribution of a remainder interest in a personal residence or farm,

170(f)(3)(B)(ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and

170(f)(3)(B)(iii) a qualified conservation contribution.

If you look up just slightly in §170(f), you'll find the text below:

170(f)(2) CONTRIBUTIONS OF PROPERTY PLACED IN TRUST. --

170(f)(2)(A) REMAINDER INTEREST. --In the case of property transferred in trust, no deduction shall be allowed under this section for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664), or a pooled income fund (described in section 642(c)(5)).

170(f)(2)(B) INCOME INTERESTS, ETC. --No deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying section 671. If the donor ceases to be treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution. The Secretary shall

prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

170(f)(2)(C) DENIAL OF DEDUCTION IN CASE OF PAYMENTS BY CERTAIN TRUSTS. --In any case in which a deduction is allowed under this section for the value of an interest in property described in subparagraph (B), transferred in trust, no deduction shall be allowed under this section to the grantor or any other person for the amount of any contribution made by the trust with respect to such interest.

170(f)(2)(D) EXCEPTION. --This paragraph shall not apply in a case in which the value of all interests in property transferred in trust are deductible under subsection (a).

When we look at §664, we find two types of trusts defined:

- Charitable remainder annuity trust (defined at §664(d)(1))
- Charitable remainder unitrust (defined at §664(d)(2))

The first type of trust (annuity trust) provides a constant payment over a period of years or for life to one or more persons. At the end of trust, the balance remaining goes to a charitable organization.

The second type of trust works similarly, except that trust pays out a percentage of its value each year to the beneficiaries (though the payout can be limited to the income of the trust for the year, with or without later “catch” distributions, per the terms of the trust). Again, at trust termination the balance goes to the charitable organization.

These trusts offer some unique advantages. Generally, the trust itself is exempt from income taxes pursuant to §664(c) so long as it has no unrelated business taxable income.¹ Distributions are taxed based on pools of income “held” inside the trust as the income is incurred, essentially coming out of the following four pools

- Ordinary income recognized by the trust in the current or prior years (to the extent not previously distributed)
- Capital gains for the the current and prior years (to the extent not previously distributed)
- All other income (such as tax exempt interest) (to the extent not previously distributed)
- Trust corpus²

Where we often see this device used is when a client meets the following criteria:

¹ Note that if the trust does have such income, then it is fully subject to income taxes—so UBIT is something generally to be avoided in a CRT because not just the UBIT becomes subject to tax.

² §664(b)

- The client has substantial assets that are highly appreciated and
- The client generally has charitable intent and
- The client wants to convert the appreciated assets that may not be generating income into a stream of income and/or wants to diversify the set of investments without losing up front principal to taxes and
- The client is not one with a low tolerance for complexity in tax matters or who is very reluctant to pay for professional advisers and administrative fees.

Substantial assets are needed because the cost of creating and operating a charitable remainder trust make it not a practical option for someone with a modest amount they wish to use in a form like this.³ Appreciated assets are useful because the CRT will not pay income taxes when it sells those assets (which it almost always does immediately) and then reinvests the proceeds.

As well, the donor gets a charitable contribution deduction for the present value of the remainder interest in the year in which the trust is funded.

The Problem the IRS Discovered Last Year

One of the requirements to qualify as a CRT is that no amounts other than the distributions described above may go to anyone except a charity described in §170(c), a proscription found in §§ 664(d)(1)(B) (for annuity trusts) and 664(d)(2)(B) (for unitrusts).

The IRS last year released Revenue Procedure 2005-24 describing a problem that had just occurred to them. In certain states a surviving spouse might have the right, on the death of the grantor to the CRT, to claim an *elective share* of the trust. Elective shares are meant to protect the spouse from being disinherited by the other spouse leaving the survivor destitute, and so are meant to allow the survivor to override the decedent's dispositions and claim a share in lieu of what the documents otherwise provide.

The IRS, in that procedure, concluded that the mere existence of that right would serve to void a charitable remainder trust *regardless of whether the survivor actually elected to claim such a share*. The mere fact that the property *could* be claimed by the surviving spouse was enough to render the trust not a trust defined under §664.

As the IRS had not been asserting that position earlier, the IRS did allow in the procedure that trusts formed prior to June 28, 2005 would not be penalized by this rule so long as the spouse did not actually claim an elective share (Revenue Procedure 2005-24, Section 2.01).

³ For a person that meets all other criteria, charitable gift annuities provided by various charities may make a lot more sense to gain a similar, though not identical, result. What is given up primarily with a charitable gift annuity is a certain level of control and customization that is available for a CRT—but at much lower cost.

For trusts created after that date, the procedure provided that the existence would invalidate the trust unless a waiver, valid under the applicable state law, was executed by the spouse of the individual within certain time frames.

Generally, the waiver had to be executed within six months of the due date of the Form 5227, including extensions *actually granted* to file that return, in which the later of the following occurs:

- Creation of trust
- The grantor marries
- The grantor becomes domiciled or resident in a jurisdiction where there exists a right of election that could be satisfied from the assets of the trust
- The effective date of a state law that creates a right of election

Note that if a taxpayer who is not subject to this provision due to living in a state without a right of election (such as a community property state without a right of election) moves to a state with a right of election, the IRS views the trust as losing its status as a CRT unless this ruling was timely complied with.

A number of concerns emerged. First, taxpayers could easily be ignorant of having triggered this obscure election if they had a trust formed in a state without a right of election and then moved to a state with a right of election. Second, since the whole point of the right of election was to prevent a survivor from being disinherited (and then, perhaps, become destitute) it could be problematical or impossible to obtain a waiver that was a valid under state law.

IRS Temporarily Removes this Marriage Penalty

The IRS has now announced in Notice 2006-15 they will indefinitely extend the June 28, 2005 grandfather date until further notice. The IRS also indicated that they are reconsidering the entire approach to this provision.

The IRS does still indicate that if a spouse actually does elect against the trust, *that* will be a disqualifying event for the CRT. But if the spouse does not elect against the trust, the mere fact that he/she could won't cause the trust to be nonqualified—at least for now.

What will the future bring? It's possible the IRS might decide to seek a legislative fix to this one, having Congress amend §664 to eliminate the issue or provide some method of handling an election against the trust. The IRS might actually take another shot at this one, trying to come up with some alternative method they feel works under current law. Or the IRS could just leave this issue in its current state of limbo indefinitely, much like we've been left on the self-employment income status of LLC members.

Extension of June 28, 2005, Safe Harbor Date

Notice 2006-15

The purpose of this notice is to extend the June 28, 2005, grandfather date in Rev. Proc. 2005-24, 2005-16, I.R.B. 909, until further guidance is issued by the Internal Revenue Service.

Rev. Proc. 2005-24 applies to any charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) that is created by the grantor, *G*, if, under applicable state law, *G*'s surviving spouse, *S*, has a right of election exercisable on *G*'s death to receive an elective, statutory share of *G*'s estate, and such share could be satisfied in whole or in part from the assets of the CRAT or CRUT in violation of § 664(d)(1)(B) or (d)(2)(B) of the Internal Revenue Code. Rev. Proc. 2005-24 provides a safe harbor procedure under which the Service will disregard the right of election for purposes of determining whether the CRAT or CRUT meets the requirements of § 664(d)(1)(B) or (d)(2)(B) continuously since its creation, if *S* irrevocably waives the right of election in the manner prescribed in the revenue procedure. For trusts created before June 28, 2005, the Service will disregard the right of election, even without a waiver, but only if *S* does not exercise the right of election.

Commentators have asserted that Rev. Proc. 2005-24 places an undue burden on taxpayers and trustees seeking to comply with the safe harbor rule. Some commentators have recommended that the Service withdraw the revenue procedure. Other commentators have suggested alternative safe harbor rules. The Service and Treasury are reconsidering the approach of Rev. Proc. 2005-24, including the safe harbor rule. The Service and Treasury are also considering alternative safe harbor rules. Consequently, the Service is extending the June 28, 2005, grandfather date. Until further guidance is published regarding the effect of a spousal right of election on a trust's qualification as a CRAT or CRUT, the Service will disregard the existence of such a right of election, even without a waiver as described in Rev. Proc. 2005-24, but only if the surviving spouse does not exercise the right of election.

The principal author of this notice is Susan H. Levy of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Susan H. Levy at (202) 622-3090 (not a toll-free call).

Revenue Procedure 2005-24

I.R.B. 2005-16, April 18, 2005

SECTION 1. PURPOSE AND SCOPE

.01 This revenue procedure applies to any charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) that is created by the grantor, *G*, if, under applicable state law, *G*'s surviving spouse, *S*, has a right of election exercisable on *G*'s death to receive an elective, statutory share of *G*'s estate, and such share could be satisfied in whole or in part from assets of the CRAT or CRUT in violation of §664(d)(1)(B) or (d)(2)(B) of the Internal Revenue Code. In general, only *inter vivos* CRATs or CRUTs are within the scope of this revenue procedure.

.02 This revenue procedure provides a safe harbor procedure under which the Internal Revenue Service will disregard the right of election for purposes of determining whether the CRAT or CRUT meets the requirements of §664(d)(1)(B) or (d)(2)(B) continuously since its creation if *S* irrevocably waives the right of election in the manner prescribed in this revenue procedure. For trusts created before June 28, 2005, the Service will disregard the right of election, even without a waiver, but only if *S* does not exercise the right of election.

.03 The safe harbor procedure provided by this revenue procedure is not available to a CRAT or CRUT if *S* exercises the right of election.

SECTION 2. BACKGROUND

.01 In general, a testator is free to dispose of property in accordance with the testator's own wishes. However, in most jurisdictions, state statutes protect *S* from disinheritance. In most common law jurisdictions, these statutes are in the form of elective share provisions, many of which are based on the elective share provisions of the Uniform Probate Code (UPC), §§2-201- 2-214 (amended 1993). Elective share statutes provide *S* the right to elect to receive a statutory share of *G*'s estate, regardless of whether *G* made any bequests to *S*. For purposes of this revenue procedure, *S*'s statutory share of *G*'s estate will be referred to as an "elective share" and the right to elect to receive an elective share will be referred to as a "right of election", regardless of what terms different jurisdictions may use to describe these concepts.

.02 In some states, the elective share is based solely on the probate estate but, in others, *G*'s estate is defined more broadly for purposes of computing the elective share and may

include assets of the CRAT or CRUT. In states that have adopted the elective share provisions of the UPC, *S* has the right of election to take a percentage (generally determined by the duration of the marriage, but subject to a minimum dollar amount in some cases) of the “augmented estate” provided that certain requirements are met. UPC §2-202. The augmented estate includes *G*’s net probate estate, as well as certain nonprobate assets of *G*, certain property transferred by *G* to others (including to *S*) during life, and certain other property. UPC §§2-202 and 2-207. The assets of the CRAT or CRUT may be included in the augmented estate and, therefore, may be used to determine and satisfy the elective share amount. UPC §2-209. In some states, the CRAT or CRUT assets may be used to satisfy the elective share only after other property in the augmented estate first has been exhausted.

.03 Sections 664(d)(1)(B) (in the case of a CRAT) and (d)(2)(B) (in the case of a CRUT) provide that no amount other than the annuity payments described in §664(d)(1)(A) or the unitrust payments described in §664(d)(2)(A), respectively, (other than qualified gratuitous payments described in §§664(d)(1)(C) and (d)(2)(C)) may be paid to or for the use of any person other than an organization described in §170(c). The requirements of §§664(d)(1)(B) and (d)(2)(B) are not satisfied in situations in which *S* may exercise the right of election to receive an elective share and the share could include assets of the CRAT or CRUT, because the mere existence of the right of election under applicable law, whether or not exercised, and the resulting possibility that the CRAT or CRUT may be invaded for the benefit of *S*, causes the trust to fail to qualify under §664(d).

.04 The Service believes that, in the interest of sound tax administration and to reduce the burden on taxpayers, it is appropriate to provide a safe harbor procedure that, if followed, will cause the right of election to be disregarded for purposes of determining whether a CRAT or CRUT that is within the scope of this revenue procedure meets the requirements of §664(d) continuously from the date the trust is created. This procedure generally requires that *S* irrevocably waive the right of election with regard to the assets of the CRAT or CRUT to ensure that no part of the trust will be used to satisfy the elective share.

.05 No waiver of the right of election is required if the applicable state law does not provide *S* with a right of election, exercisable at the time of *G*’s death, to receive an elective share of *G*’s estate. For example, in community property jurisdictions, elective share provisions are generally unnecessary because *S* typically has vested ownership in one-half of the community property. Additionally, no waiver is required if, under applicable state law, *S*’s elective share of *G*’s estate may not include any assets of the CRAT or CRUT (other than the annuity or unitrust interest payable to *S* as the named recipient). For example, no waiver is required if, under applicable state law, the trust’s

property is excluded from the base for computing the elective share by reason of *G*'s receipt of adequate and full consideration for the transfer or the written consent to or joinder in the transfer by *S* and, in fact, the consideration is paid or the consent or joinder is given.

SECTION 3. APPLICATION OF SAFE HARBOR

.01 *In General.* With respect to any CRAT or CRUT within the scope of this revenue procedure, *S*'s right of election to receive an elective share of *G*'s estate, if the share could include any assets of a CRAT or CRUT created or funded by *G*, will be disregarded for purposes of determining whether the CRAT or CRUT has met the requirements of §664(d)(1)(B) or (d)(2)(B) continuously since its creation if all of the requirements of section 3 of this revenue procedure are satisfied. For CRATs and CRUTs within the scope of this revenue procedure created by *G* on or after June 28, 2005, the failure of *S* to waive the right of election in accordance with the requirements of this revenue procedure will result in the CRAT or CRUT failing to qualify under §664(d) continuously since its creation, whether or not *S* exercises the right of election. For CRATs and CRUTs within the scope of this revenue procedure created by *G* before June 28, 2005, the failure of *S* to waive the right of election, combined with *S*'s exercise of that right of election, will result in the CRAT or CRUT failing to qualify under §664(d) continuously since its creation. Thus, for all CRATs and CRUTs, regardless of when they were created, a waiver under this revenue procedure of *S*'s right of election will provide certainty that the right of election will not cause the trust to fail to qualify under §664(d) continuously since its creation.

.02 *Waiver Effective Under State Law.* *S* must irrevocably waive the right of election to whatever extent necessary to ensure that no part of the trust (other than the annuity or unitrust interest of which *S* is the named recipient under the terms of the trust) may be used to satisfy the elective share. A valid waiver of the elective share or right of election will satisfy the requirements of the preceding sentence if the waiver is valid under applicable state law, in writing, and signed and dated by *S*. This revenue procedure does not require a waiver of *S*'s right as the named recipient to receive the annuity or unitrust payment from the CRAT or CRUT.

.03 *Timing of Waiver.* For CRATs or CRUTs created by *G* on or after June 28, 2005, section 3.02 of this revenue procedure must be satisfied on or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of Form 5227, Split-Interest Trust Information Return, for the year in which the later of the following occurs:

- (1) the creation of the trust;
- (2) the date of *G*'s marriage to *S*;
- (3) the date *G* first becomes domiciled or resident in a jurisdiction whose law provides a right of election that could be satisfied from assets of the trust; or
- (4) the effective date of applicable state law creating a right of election.

.04 *Trustee To Retain Copy.* A copy of the signed waiver must be provided to the trustee of the CRAT or CRUT. The trustee must retain the copy in the official records of the trust so long as the contents thereof may become material in the administration of any internal revenue law. See §1.6001-1(e) of the Income Tax Regulations.

SECTION 4. EXAMPLES

In each of the following examples, *G* created a CRAT that provides an annuity to *G* for *G*'s life. Upon *G*'s death, the remainder of the trust will pass to an organization that meets the requirements of §170(c). In each example (except *Example 3*), at the time the CRAT is created, applicable state law provides *S* a right of election to receive an elective share of *G*'s estate and the share would include (and could be satisfied from) assets of the trust.

.01 *Example 1.* *G* creates the trust in 2007 while married to *S*. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, *S* irrevocably waives *S*'s right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

.02 *Example 2.* *G* creates the trust in 2006, and is unmarried on the date the trust is created. On May 1, 2007, *G* marries *S*. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, *S* irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

.03 *Example 3.* *G* creates the trust in 2008 while married to *S*. Under applicable state law in effect on the date that *G* creates the trust, the elective share does not include the assets in the trust. Effective on March 1, 2009, applicable state law is amended to give *S* the right of election to receive an elective share of the "augmented estate," which, by definition, includes the assets of the trust. On or before the date that is 6 months after the

due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2009, *S* irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

In each of *Examples 1* through *3*, assuming that *S*'s timely waiver of the right of election is valid under applicable state law and satisfies the other requirements of this revenue procedure, the existence of the right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation as a CRAT under §664(d)(1)(B). Further, in each of *Examples 1* through *3*, the result would be the same if, instead of executing only a partial waiver, *S* had waived the full right of election with respect to all assets in *G*'s augmented estate.

.04 *Example 4.* *G* creates the trust in 2007 while married to *S*. Under applicable state law in effect on the date that *G* creates the trust, the elective share includes the assets in the trust. Later in the same year, applicable state law is amended to provide that the augmented estate does not include the assets of a CRAT or CRUT and the amendment applies retroactively to include the trust created by *G*. Accordingly, no waiver of the right of election is required with respect to the assets of the trust in order for the trust to continue to qualify as a CRAT.

.05 *Example 5.* The facts are the same as in *Example 2* except that the waiver is contained in, or is signed pursuant to the requirements of, a prenuptial agreement. Unless the agreement as a whole (or only the waiver) is subsequently found to be invalid or unenforceable, the waiver will satisfy the requirements of this revenue procedure.

.06 *Example 6.* The facts are the same as in *Example 1*, except that *S* dies in 2010. In 2012, *G* marries *S2*. *S2* refuses to waive *S2*'s right to receive an elective share with regard to the assets in the trust. The existence of *S*'s right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation up until *G*'s marriage to *S2*, as a CRAT under §664(d)(1)(B). However, because *S2* did not timely and irrevocably waive *S2*'s right to receive an elective share with regard to the assets in the trust, the trust does not qualify as a CRAT under §664(d)(1)(B).

If, in these examples, *G* had instead created a CRUT, the results would be the same for purposes of §664(d)(2)(B).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective as of March 30, 2005.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1936.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 3. This information is required to be collected and retained in order to ensure that a trust meets the requirements of §664(d)(1) or (d)(2). This information will be used to determine whether the eligibility requirements under those statutes for treatment as a CRAT or CRUT have been met. The collection of information is required to obtain a benefit. The likely respondents are individuals.

The estimated total annual reporting burden is 150,000 hours.

The estimated annual burden per respondent varies from 1 hour to 2 hours, depending on individual circumstances, with an estimated average burden of 1 1/2 hours to complete the statements required under this revenue procedure. The estimated number of respondents is 100,000.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Susan H. Levy. For further information regarding this revenue procedure contact Susan H. Levy on (202) 622-3090 (not a toll free call) or Bradford R. Poston on (202) 622-3060 (neither a toll free call).

IRC SEC. 664. CHARITABLE REMAINDER TRUSTS.

664(a) GENERAL RULE. —Notwithstanding any other provision of this subchapter, the provisions of this section shall, in accordance with regulations prescribed by the Secretary, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

664(b) CHARACTER OF DISTRIBUTIONS. —Amounts distributed by a charitable remainder annuity trust or by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of a beneficiary to whom is paid the annuity described in subsection (d)(1)(A) or the payment described in subsection (d)(2)(A):

664(b)(1) First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years;

664(b)(2) Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

664(b)(3) Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

664(b)(4) Fourth, as a distribution of trust corpus.

For purposes of this section, the trust shall determine the amount of its undistributed capital gain on a cumulative net basis.

664(c) EXEMPTION FROM INCOME TAXES. —A charitable remainder annuity trust and a charitable remainder unitrust shall, for any taxable year, not be subject to any tax imposed by this subtitle, unless such trust, for such year, has unrelated business taxable income (within the meaning of section 512, determined as if part III of subchapter F applied to such trust).

664(d) DEFINITIONS. —

664(d)(1) CHARITABLE REMAINDER ANNUITY TRUST. —For purposes of this section, a charitable remainder annuity trust is a trust —

664(d)(1)(A) from which a sum certain (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) is

to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

664(d)(1)(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c),

664(d)(1)(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)), and

664(d)(1)(D) the value (determined under section 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

664(d)(2) CHARITABLE REMAINDER UNITRUST. —For purposes of this section, a charitable remainder unitrust is a trust —

664(d)(2)(A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

664(d)(2)(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c),

664(d)(2)(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection

(g)), and

664(d)(2)(D) with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

664(d)(3) EXCEPTION. —Notwithstanding the provisions of paragraphs (2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year —

664(d)(3)(A) the amount of the trust income, if such amount is less than the amount required to be distributed under paragraph (2)(A), and

664(d)(3)(B) any amount of the trust income which is in excess of the amount required to be distributed under paragraph (2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

664(d)(4) SEVERANCE OF CERTAIN ADDITIONAL CONTRIBUTIONS. —If —

664(d)(4)(A) any contribution is made to a trust which before the contribution is a charitable remainder unitrust, and

664(d)(4)(B) such contribution would (but for this paragraph) result in such trust ceasing to be a charitable unitrust by reason of paragraph (2)(D),

such contribution shall be treated as a transfer to a separate trust under regulations prescribed by the Secretary.

664(e) VALUATION FOR PURPOSES OF CHARITABLE CONTRIBUTION. —For purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder annuity trust or charitable remainder unitrust shall be computed on the basis that an amount equal to 5 percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year.

664(f) CERTAIN CONTINGENCIES PERMITTED. —

664(f)(1) GENERAL RULE. —If a trust would, but for a qualified contingency, meet the requirements of paragraph (1)(A) or (2)(A) of subsection (d), such trust shall be treated as meeting such requirements.

664(f)(2) VALUE DETERMINED WITHOUT REGARD TO QUALIFIED CONTINGENCY. —For purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency shall not be taken into account.

664(f)(3) QUALIFIED CONTINGENCY. —For purposes of this subsection, the term “qualified contingency” means any provision of a trust which provides that, upon the happening of a contingency, the payments described in paragraph (1)(A) or (2)(A) of subsection (d) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust.

664(g) QUALIFIED GRATUITOUS TRANSFER OF QUALIFIED EMPLOYER SECURITIES. —

664(g)(1) IN GENERAL. —For purposes of this section, the term “qualified gratuitous transfer” means a transfer of qualified employer securities to an employee stock ownership plan (as defined in section 4975(e)(7)) but only to the extent that —

664(g)(1)(A) the securities transferred previously passed from a decedent dying before January 1, 1999, to a trust described in paragraph (1) or (2) of subsection (d),

664(g)(1)(B) no deduction under section 404 is allowable with respect to such transfer,

664(g)(1)(C) such plan contains the provisions required by paragraph (3),

664(g)(1)(D) such plan treats such securities as being attributable to employer contributions but without regard to the limitations otherwise applicable to such contributions under section 404, and

664(g)(1)(E) the employer whose employees are covered by the plan described in this paragraph files with the Secretary a verified written statement consenting to the application of sections 4978 and 4979A with respect to such employer.

664(g)(2) EXCEPTION. —The term “qualified gratuitous transfer” shall not include a transfer of qualified employer securities to an employee stock ownership plan unless —

664(g)(2)(A) such plan was in existence on August 1, 1996,

664(g)(2)(B) at the time of the transfer, the decedent and members of the decedent's family (within the meaning of section 2032A(e)(2)) own (directly or through the

application of section 318(a)) no more than 10 percent of the value of the stock of the corporation referred to in paragraph (4), and

664(g)(2)(C) immediately after the transfer, such plan owns (after the application of section 318(a)(4)) at least 60 percent of the value of the outstanding stock of the corporation.

664(g)(3) PLAN REQUIREMENTS. —A plan contains the provisions required by this paragraph if such plan provides that —

664(g)(3)(A) the qualified employer securities so transferred are allocated to plan participants in a manner consistent with section 401(a)(4),

664(g)(3)(B) plan participants are entitled to direct the plan as to the manner in which such securities which are entitled to vote and are allocated to the account of such participant are to be voted,

664(g)(3)(C) an independent trustee votes the securities so transferred which are not allocated to plan participants,

664(g)(3)(D) each participant who is entitled to a distribution from the plan has the rights described in subparagraphs (A) and (B) of section 409(h)(1),

Code Sec. 664(g)(3)(E), below, was amended by P.L. 107-16. For sunset provision, see P.L. 107-16, §901, in the amendment notes.

664(g)(3)(E) such securities are held in a suspense account under the plan to be allocated each year, up to the applicable limitation under paragraph (7), after first allocating all other annual additions for the limitation year, up to the limitations under sections 415(c) and (e), and

664(g)(3)(F) on termination of the plan, all securities so transferred which are not allocated to plan participants as of such termination are to be transferred to, or for the use of, an organization described in section 170(c).

For purposes of the preceding sentence, the term “independent trustee” means any trustee who is not a member of the family (within the meaning of section 2032A(e)(2)) of the decedent or a 5-percent shareholder. A plan shall not fail to be treated as meeting the requirements of section 401(a) by reason of meeting the requirements of this subsection.

664(g)(4) QUALIFIED EMPLOYER SECURITIES. —For purposes of this section, the term “qualified employer securities” means employer securities (as defined in section

409(l)) which are issued by a domestic corporation —

664(g)(4)(A) which has no outstanding stock which is readily tradable on an established securities market, and

664(g)(4)(B) which has only 1 class of stock.

664(g)(5) TREATMENT OF SECURITIES ALLOCATED BY EMPLOYEE STOCK OWNERSHIP PLAN TO PERSONS RELATED TO DECEDENT OR 5-PERCENT SHAREHOLDERS. —

664(g)(5)(A) IN GENERAL. —If any portion of the assets of the plan attributable to securities acquired by the plan in a qualified gratuitous transfer are allocated to the account of —

664(g)(5)(A)(i) any person who is related to the decedent (within the meaning of section 267(b)) or a member of the decedent's family (within the meaning of section 2032A(e)(2)), or

664(g)(5)(A)(ii) any person who, at the time of such allocation or at any time during the 1-year period ending on the date of the acquisition of qualified employer securities by the plan, is a 5-percent shareholder of the employer maintaining the plan, the plan shall be treated as having distributed (at the time of such allocation) to such person or shareholder the amount so allocated.

664(g)(5)(B) 5-PERCENT SHAREHOLDER. —For purposes of subparagraph (A), the term “5-percent shareholder” means any person who owns (directly or through the application of section 318(a)) more than 5 percent of the outstanding stock of the corporation which issued such qualified employer securities or of any corporation which is a member of the same controlled group of corporations (within the meaning of section 409(l)(4)) as such corporation. For purposes of the preceding sentence, section 318(a) shall be applied without regard to the exception in paragraph (2)(B)(i) thereof.

664(g)(5)(C) CROSS REFERENCE. —

For excise tax on allocations described in subparagraph (A), see section 4979A.

664(g)(6) TAX ON FAILURE TO TRANSFER UNALLOCATED SECURITIES TO CHARITY ON TERMINATION OF PLAN. —If the requirements of paragraph (3)(F) are not met with respect to any securities, there is hereby imposed a tax on the employer maintaining the plan in an amount equal to the sum of —

664(g)(6)(A) the amount of the increase in the tax which would be imposed by chapter 11 if such securities were not transferred as described in paragraph (1), and

664(g)(6)(B) interest on such amount at the underpayment rate under section 6621 (and compounded daily) from the due date for filing the return of the tax imposed by chapter 11.

Code Sec. 664(g)(7), below, was added by P.L. 107-16. For sunset provision, see P.L. 107-16, §901, in the amendment notes.

664(g)(7) APPLICABLE LIMITATION. —

664(g)(7)(A) IN GENERAL. —For purposes of paragraph (3)(E), the applicable limitation under this paragraph with respect to a participant is an amount equal to the lesser of —

664(g)(7)(A)(i) \$30,000, or

664(g)(7)(A)(ii) 25 percent of the participant's compensation (as defined in section 415(c)(3)).

664(g)(7)(B) COST-OF-LIVING ADJUSTMENT. —The Secretary shall adjust annually the \$30,000 amount under subparagraph (A)(i) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning October 1, 1993, and any increase under this subparagraph which is not a multiple of \$5,000 shall be rounded to the next lowest multiple of \$5,000.