

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

(Also: Part I, §§ 170, 642(c), 2055, 2522; §§ 1.170A-6, 20.2055-2, 25.2522(c)-3)

Rev. Proc. 2007-45

SECTION 1. PURPOSE

This revenue procedure contains annotated sample declarations of trust and alternate provisions that meet the requirements for an inter vivos charitable lead annuity trust (CLAT) providing for annuity payments payable to one or more charitable beneficiaries for the annuity period followed by the distribution of trust assets to one or more noncharitable remaindermen.

SECTION 2. BACKGROUND

The Internal Revenue Service (Service) is issuing sample forms for CLATs; annotations and alternate sample provisions are included as further guidance. In addition to the sample trust instruments for inter vivos CLATs that are included in this revenue procedure, a sample is provided in a separate revenue procedure for a

testamentary CLAT (see Rev. Proc. 2007-46).

SECTION 3. SCOPE

A CLAT is an irrevocable split-interest trust that provides for a specified amount to be paid to one or more charitable beneficiaries during the term of the trust. The principal remaining in the trust at the end of the term is paid over to, or held in a continuing trust for, a noncharitable beneficiary or beneficiaries identified in the trust. If the terms of a CLAT created during the donor's life satisfy the applicable statutory and regulatory requirements, a gift of the charitable lead annuity interest will qualify for the gift tax charitable deduction under § 2522(c)(2)(B) and/or the estate tax charitable deduction under § 2055(e)(2)(B). In certain cases, the gift of the annuity interest may also qualify for the income tax charitable deduction under § 170(a). The value of the remainder interest is a taxable gift by the donor at the time of the donor's contribution to the trust.

There are two types of inter vivos CLATs: a "nongrantor CLAT" and a "grantor CLAT." The income tax consequences are different for each.

A nongrantor CLAT is subject to the provisions of part I, subchapter J of chapter 1 of subtitle A of the Internal Revenue Code (Code). Under the provisions of part I of subchapter J, a nongrantor CLAT is allowed a deduction under § 642(c)(1) in determining its taxable income for any amount of gross income paid for purposes specified in § 170(c). Generally, the donor is not entitled to any income tax charitable deduction.

Section 4 of this revenue procedure provides a sample declaration of trust for a

nongrantor CLAT with a term of years annuity period that is created by an individual who is a citizen or resident of the United States. Section 5 of this revenue procedure provides annotations to the provisions of the sample trust. Section 6 of this revenue procedure provides samples of certain alternate provisions concerning: (.01) an annuity period for the life of an individual; (.02) retention of the right to substitute the charitable lead beneficiary; (.03) apportionment of the annuity amount in the discretion of the trustee; (.04) the annuity amount as a specific dollar amount; and (.05) designation of an alternate charitable beneficiary in the trust instrument. If a trust is substantially similar to the sample trust in section 4 of this revenue procedure or properly integrates one or more alternate provisions from section 6 into a document substantially similar to the sample trust in section 4, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other deductibility requirements are satisfied, the value of the charitable lead interest will be deductible under § 2522(c)(2)(B) and/or § 2055(e)(2)(B) and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by § 642(c)(1). In addition, a nongrantor CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust and/or provides for a different disposition of trust assets upon the termination of the annuity period.

A CLAT is a grantor CLAT if the donor, who is a citizen or resident of the United

States, is treated as the owner of the entire CLAT under subpart E, part I of subchapter J, chapter 1, subtitle A. The value of the charitable lead annuity interest in a grantor CLAT may be deductible by the donor under § 170(a) for the year in which the donor made the contribution to the trust, provided that the other requirements of § 170(f)(2)(B) and the regulations thereunder are satisfied. During the term of the grantor CLAT, all trust income and capital gains are taxed to the donor and the donor is entitled to no further charitable deduction for income tax purposes as the charitable annuity payments are made to charitable organizations each year.

Section 7 of this revenue procedure provides a sample declaration of trust for a grantor CLAT that is created by an individual who is a citizen or resident of the United States. Section 8 of this revenue procedure provides annotations to the provisions of the sample trust. Section 9 of this revenue procedure provides samples of certain alternate provisions concerning: (.01) an annuity period for the life of an individual; (.02) retention of the right to substitute the charitable lead beneficiary; (.03) apportionment of the annuity amount in the discretion of the trustee; (.04) the annuity amount as a specific dollar amount; (.05) designation of an alternate charitable beneficiary in the trust instrument; and (.06) restriction of the charitable beneficiary to a public charity. If a trust is substantially similar to the sample trust in section 7 of this revenue procedure or properly integrates one or more alternate provisions from section 9 into a document substantially similar to the sample trust in section 7, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other requirements for deductibility are satisfied, the value of the charitable lead

annuity interest will be deductible under §§ 170(a), 2522(c)(2)(B) and/or 2055(e)(2)(B). In addition, a grantor CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it: (i) reflects the choice of a different power or provision sufficient to make the donor the owner of the entire CLAT under subpart E, part I, subchapter J, chapter 1, subtitle A, provided that the power or provision selected is consistent with the requirements of a CLAT; (ii) defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust; and/or (iii) provides for a different disposition of trust assets upon the termination of the annuity period.

Except as provided above, a trust that contains substantive provisions in addition to those provided in section 4 or section 7 of this revenue procedure (other than properly integrated alternate provisions from section 6 or section 9, respectively, of this revenue procedure or provisions necessary to establish a valid trust under applicable local law that are not inconsistent with the applicable federal tax requirements), or that omits any of the provisions of section 4 or section 7 of this revenue procedure (unless an alternate provision from section 6 or section 9, respectively, of this revenue procedure is properly integrated), will not necessarily be ineligible for the relevant charitable deduction(s), but neither will that trust (or contributions to it) be assured of qualification for the appropriate charitable deductions. The Service generally will not issue a letter ruling on whether an inter vivos CLAT created by an individual qualifies for income, estate, and/or gift tax charitable deductions. The Service, however, generally will issue letter rulings relating to the tax consequences of the inclusion in a CLAT of

substantive trust provisions other than those contained in sections 4, 6, 7, and 9 of this revenue procedure.

SECTION 4. SAMPLE INTER VIVOS NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

On this ____ day of _____, 20__, I, _____ (hereinafter “the Donor”), desiring to establish a charitable lead annuity trust within the meaning of Rev. Proc. 2007-45, hereby enter into this trust agreement with _____ as the initial trustee (hereinafter “the Trustee”). This trust shall be known as the _____ Nongrantor Charitable Lead Annuity Trust. All references to “section” or “§” in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, et seq.

1. Funding of Trust. The Donor hereby transfers and irrevocably assigns to the Trustee on the above date the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage, and distribute the property under the terms set forth in this trust instrument.

2. Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [number representing the annual annuity percentage to be paid to the designated charitable recipient] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. If [designated charitable recipient] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to

one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [number of years of annuity period] years. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the day preceding the [ordinal number corresponding to the length of the annuity period] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. Proration of Annuity Amount. The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year in which the

annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. Distribution Upon Termination of Annuity Period. At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due to the Charitable Organization under the provisions above) to [remainder beneficiary].

5. Additional Contributions. No additional contributions shall be made to the trust after the initial contribution.

6. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The Trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3). In addition, the Trustee shall not acquire any assets that would subject the trust to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

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

8. Governing Law. The operation of the trust shall be governed by the laws of the State of _____. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the requirements for the charitable deductions available to a charitable lead annuity trust or

for contributions to a charitable lead annuity trust.

9. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the Charitable Organization is a guaranteed annuity interest under §§ 2055(e)(2)(B) and 2522(c)(2)(B) and the regulations thereunder and that payments of the annuity amount to the Charitable Organization will be deductible from the gross income of the trust to the extent provided by § 642(c)(1) and the regulations thereunder.

10. Investment of Trust Assets. Except as provided in paragraph 6 herein, nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

11. Retained Powers and Interests. Notwithstanding any other provision of this trust instrument to the contrary, no person shall hold any power or possess any interest that would cause the Donor to be treated as the owner of any portion of the trust under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Internal Revenue Code.

SECTION 5. ANNOTATIONS REGARDING SAMPLE INTER VIVOS NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 Annotations for Introductory Paragraph and Paragraph 1, Funding of Trust, of the Sample Trust in Section 4.

(1) Types of charitable lead trusts. An inter vivos charitable lead trust may be

established as either a grantor charitable lead trust or a nongrantor charitable lead trust. The sample trust in section 4 is an example of a nongrantor charitable lead trust. The sample trust in section 7 is an example of a grantor charitable lead trust.

- (2) Income taxation of nongrantor charitable lead trusts. A nongrantor CLAT is a complex trust that is taxable as a separate entity under the provisions of subchapter J of the Code. The trustee of the trust must apply for a tax identification number for the trust.
- (3) Deduction under § 642(c)(1) available for amounts paid for a charitable purpose. Under § 642(c)(1), a nongrantor CLAT is allowed a deduction in computing its taxable income for any amount of gross income, without limitation, that under the terms of the trust instrument is paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)) during the taxable year. This deduction is in lieu of the charitable deduction allowed by § 170. Section 642(c)(1) and § 1.642(c)-1(a). An amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in § 170(c)(2) shall be considered paid for a purpose described in § 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any state, the District of Columbia, or any possession of the United States. Section 1.642(c)-1(a)(2). With regard to amounts of income paid to the charitable beneficiary after the close of the taxable year in which the income was

received (but on or before the last day of the next succeeding taxable year), the trustee of a nongrantor CLAT may elect to take the charitable deduction for that payment for the year in which the income was received, rather than for the year in which the payment was made. Section 642(c)(1). The election is made by filing a statement with the income tax return for the taxable year in which the charitable contribution is treated as paid. See § 1.642(c)-1(b).

- (4) Charitable lead beneficiary requirements. A deduction is allowed under § 642(c)(1) for any amount of the gross income of a nongrantor CLAT that is paid for a purpose specified in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 642(c)(1) differs from the class of permissible charitable recipients for obtaining a deduction under § 170(a). Compare § 170(c) and § 1.642(c)-1(a)(2).
- (5) Unrelated business taxable income. Under § 681, a nongrantor charitable lead trust's deduction under § 642(c)(1) is disallowed in any year to the extent that the deduction is allocable to the trust's unrelated business taxable income, as defined in § 512, for that taxable year. See § 1.681(a)-2. However, a partial deduction is allowed under § 512(b)(11) for amounts allocable to unrelated business taxable income. Section 512(b)(11). See § 512(b)(12) and § 1.681(a)-2(a).
- (6) Computation of estate and gift tax charitable deductions. In general, the

estate and gift tax charitable deductions available under §§ 2055(e)(2)(B) and 2522(c)(2)(B) with respect to contributions to a CLAT are equal to the present value of the annuity interest. Section 7520 requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See §§ 20.7520-2 and 25.7520-2.

- (7) Trustee provisions. The trust instrument may name alternate or successor trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain administrative provisions relating to the trustee's duties and powers.
- (8) Identity of donor. For purposes of qualification under this revenue procedure, the donor may be an individual or a husband and wife. Appropriate adjustments should be made to the introductory paragraph if a husband and wife are the donors. Terms such as "grantor" or "settlor" may be substituted for "donor."

.02 Annotations for Paragraph 2, Payment of Annuity Amount, of the Sample Trust in Section 4.

- (1) Guaranteed annuity. To qualify for the applicable estate and gift tax charitable deductions, a nongrantor CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See

§§ 2055(e)(2)(B) and 2522(c)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 5.02(4) for a discussion of the permissible term of a nongrantor CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained at the time of the transfer to the trust. Sections 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a sum certain or a fixed percentage of the trust assets (determined annually) is not a guaranteed annuity interest. See §§ 20.2055-2(e)(2)(vi)(b) and 25.2522(c)-3(c)(2)(vi)(b). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88-27, 1988-1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the date of gift exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Sections

20.2055-2(e)(2)(vi)(e) and 25.2522(c)-3(c)(2)(vi)(e). These prohibitions are contained in the sample trust in section 4. See section 5.06 for a further discussion of the 60 percent test. See section 6.04 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

- (2) Payment requirements. CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the trust will realize capital gain on the assets distributed to satisfy part or all of the annuity payment and the trust will be allowed a § 642(c)(1) deduction for the realized capital gains. Rev. Rul. 83-75, 1983-1 C.B. 114.
- (3) Rule against perpetuities. An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with

a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of the measuring lives who are selected to maximize, rather than limit, the term of the trust. Sections 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a).

- (4) Permissible term. Paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for payment of the annuity amount for the life or lives of one or more measuring lives or for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85-49, 1985-1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the date assets are transferred to the trust. Sections 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a). See section 6.01 for an alternate provision that provides for an annuity period based on the life of an individual.
- (5) Permissible recipients. A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the donor from receiving a charitable deduction if the trust

instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c), 2055(a), and 2522(a). Rev. Rul. 78-101, 1978-1 C.B. 301. If it is determined that a deduction under § 2055(a) will not be necessary in any event, all references to § 2055(a) in the trust instrument may be deleted. Note, that if the donor is serving as trustee of the trust, the trustee's power to select the charitable beneficiaries will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c). Further note that if the charitable beneficiary is a private foundation and the donor is an officer or director of the private foundation or possesses certain decision making authority in the private foundation, some or all of the trust property may be included in the donor's gross estate. See § 2036(a)(2). See section 6.02 for an alternate provision that provides for a donor's retained right to substitute the charitable beneficiary. See section 6.03 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable beneficiaries.

- (6) Payment of annuity amount in installments. Paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 specifies that the annuity amount is to be paid in equal quarterly installments at the end of each calendar quarter. Alternatively, the trust instrument may specify that the

annuity amount is to be paid in annual or other equal or unequal installments throughout the year. See §§ 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a). The amount of the charitable deduction will be affected by the frequency of the payment, by whether the installments are equal or unequal, and by whether each installment is payable at the beginning or end of the period. See §§ 25.2512-5 and 20.2031-7.

- (7) Excess income. Trust income in excess of the amount required to pay the annuity may be retained by the trust or distributed currently to the charitable beneficiary. The sample trust in section 4 provides for the retention of excess income by the trust. If, instead, the governing instrument of a nongrantor charitable lead trust provides for the payment of excess income to or for the use of the charitable beneficiary, no additional estate or gift tax charitable deductions are available for the excess amounts of income distributed to the charitable beneficiary. See §§ 20.2055-2(e)(2)(vi)(d) and 25.2522(c)-3(c)(2)(vi)(d). However, the trust is entitled to a charitable income tax deduction under § 642(c)(1) for any amounts of excess income paid to the charitable beneficiary. See Situation 2 of Rev. Rul. 88-82, 1988-2 C.B. 336, for the gift tax consequences of the payment of excess income to a noncharitable beneficiary. See section 5.06 for the private foundation rules applicable to charitable lead trusts.

- (8) Payment of part of annuity for private purposes. In general, no part of a

charitable lead annuity interest may be payable for a private purpose before the expiration of all charitable lead annuity interests. However, there are two exceptions to this rule. The first exception arises when the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Sections 20.2055-2(e)(2)(vi)(f) and 25.2522(c)-3(c)(2)(vi)(f). See section 5.06 for the private foundation rules applicable to charitable lead trusts.

.03 Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust in Section 4.

- (1) Prorating the annuity amount. Paragraph 3, Proration of Annuity Amount, of the sample trust in section 4 provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.04 Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of

the Sample Trust in Section 4.

- (1) Generation-skipping transfer tax. If a CLAT has or may have a skip person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax. Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the donor to a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable rate is the inclusion ratio multiplied by the maximum federal estate tax rate. Section 2641(a). The rules for determining the inclusion ratio for a CLAT are set forth in § 2642(e), and confirm that the inclusion ratio is determined at the termination of the annuity period, rather than on the funding of the trust.

.05 Annotation for Paragraph 5, Additional Contributions, of the Sample Trust in Section 4.

- (1) Additions to the trust. For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A CLAT that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.06 Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust in Section 4.

(1) Prohibitions against certain investments and excess business holdings.

Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), are generally required. The sample trust in section 4 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust instrument does not provide for the payment of excess income to a noncharitable beneficiary, the references to §§ 4943 and 4944 may be removed from the trust instrument. Section 4947(b)(3) and §§ 53.4947-2(b)(1)(i), 20.2055-2(e)(2)(vi)(e), and 25.2522(c)-3(c)(2)(vi)(e). See section 5.02(7) for a discussion of the payment of excess trust income to a noncharitable beneficiary. See section 5.02(8) for a discussion of the payment of part of the annuity for a private purpose.

.07 Annotation for paragraph 7, Taxable Year, of the Sample Trust in Section 4.

- (1) Calendar year. The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.08 Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust in Section 4.

- (1) Capital gains. Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law. Even if gains are allocated to principal, they will be deductible under § 642(c)(1) if they are paid to the charitable beneficiary as part of a charitable annuity payment. Rev. Rul. 83-75, 1983-1 C.B. 114.

.09 Annotation for paragraph 11, Retained Powers and Interests, of the Sample Trust in Section 4.

- (1) Trust not a grantor trust. Paragraph 11, Retained Powers and Interests, of the sample trust in section 4 prohibits any person from holding any power or possessing any interest that would cause the donor to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. This prohibition should be included only in nongrantor charitable lead trusts. See section 7 for a sample grantor charitable lead annuity trust.

SECTION 6. ALTERNATE PROVISIONS FOR SAMPLE INTER VIVOS

NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 Annuity Period for the Life of One Individual.

- (1) Explanation. As an alternative to establishing a CLAT for a term of years, the trust instrument of a nongrantor CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as

measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that each measuring life is a lineal ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries if there is a less than 15 percent probability at the time of the contribution to the trust that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031-7. Sections 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a).

- (2) Instruction for use. Replace the fifth and sixth sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following sentences:

The annuity period is the lifetime of [designated measuring life]. The first day of the annuity period shall be the date the property is transferred to the trust and the last day of the annuity period shall be the date of death of [designated measuring life].

.02 Retention of the Right to Substitute the Charitable Lead Beneficiary.

- (1) Explanation. The donor to a nongrantor CLAT may retain the right to substitute another charitable beneficiary for the charitable beneficiary

named in the trust instrument. Note, however, that the retention of this right will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending upon the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c).

- (2) Instruction for use. Replace the third sentence of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

Notwithstanding the preceding sentence, the Donor reserves the right to designate as the charitable annuity recipient, at any time and from time to time, in lieu of [designated charitable recipient], one or more organizations described in §§ 170(c), 2055(a), and 2522(a) and shall make any such designation by giving written notice to the Trustee. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient.

.03 Apportionment of the Annuity Amount in the Discretion of the Trustee.

- (1) Explanation. The donor or the trustee of a nongrantor charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries. See § 674(b)(4).

A power to apportion the annuity amount among a class of qualifying charitable beneficiaries that is retained by the donor or the donor's spouse will not cause the donor to be treated as the owner of the trust for income tax purposes. Section 674(b)(4). Note, however, that a retained power of apportionment by the donor, but not the donor's spouse, will cause the gift of the annuity interest to be incomplete for gift tax purposes and will cause some or all of the trust property to be included in the donor's gross estate.

See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c).

- (2) Instruction for use. Replace the first three sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class comprised of organizations described in §§ 170(c), 2055(a), and 2522(a) (hereinafter, collectively "the Charitable Organization") an annuity amount equal to [number representing the annual annuity percentage to be paid to the Charitable Organization] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee's sole

discretion, from time to time may deem advisable.

.04 Annuity Amount as a Specific Dollar Amount.

(1) Explanation. As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may instead be stated as a specific dollar amount.

(2) Instructions for use.

(a) Replace the first sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [the stated dollar amount].

(b) Delete the last sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 concerning the incorrect valuation of trust assets.

.05 Designation of an Alternate Charitable Beneficiary in the Trust Instrument.

(1) Explanation. The sample trust in section 4 provides that in the event the charitable beneficiary designated in the trust instrument is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the trustee shall distribute such payments to one or more organizations described in

§§ 170(c), 2055(a), and 2522(a) as the trustee shall select. As an alternative, the trust instrument may specifically designate one or more alternate charitable beneficiaries.

- (2) Instruction for use. Replace the second sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

If [designated charitable recipient] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to [designated substitute charitable recipient]. If neither [designated charitable recipient] nor [designated substitute charitable recipient] is an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

SECTION 7. SAMPLE INTER VIVOS GRANTOR CHARITABLE LEAD ANNUITY TRUST

On this ____ day of _____, 20__, I, _____ (hereinafter "the Donor"), desiring to establish a charitable lead annuity trust within the meaning of Rev. Proc. 2007-45 hereby enter into this trust agreement with _____ as the

initial trustee (hereinafter “the Trustee”). This trust shall be known as the _____ Grantor Charitable Lead Annuity Trust. All references to “section” or “§” in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, et seq.

1. Funding of Trust. The Donor hereby transfers and irrevocably assigns to the Trustee on the above date, the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage, and distribute the property under the terms set forth in this trust instrument.

2. Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [number representing the annual annuity percentage to be paid to the designated charitable recipient] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. If [designated charitable recipient] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee’s sole discretion. The term “the Charitable Organization” shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [number of

years of annuity period] years. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the day preceding the [ordinal number corresponding to the length of the annuity period] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

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

4. Distribution Upon Termination of Annuity Period. At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due to the Charitable Organization under the provisions above) to [remainder beneficiary].

5. Additional Contributions. No additional contributions shall be made to the

trust after the initial contribution.

6. Prohibited Transactions. The Trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The Trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3). In addition, the Trustee shall not acquire any assets that would subject the trust to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

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

8. Governing Law. The operation of the trust shall be governed by the laws of the State of _____. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the requirements for the charitable deductions available for contributions to a charitable lead annuity trust.

9. Limited Power of Amendment. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the Charitable Organization is a guaranteed annuity interest under §§ 170(f)(2)(B), 2055(e)(2)(B), and 2522(c)(2)(B) and the regulations thereunder.

10. Investment of Trust Assets. Except as provided in paragraph 6 herein,

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

11. Retained Powers and Interests. During the Donor's life, [individual other than the donor, the trustee, or a disqualified person as defined in § 4946(a)(1)] shall have the right, exercisable only in a nonfiduciary capacity and without the consent or approval of any person acting in a fiduciary capacity, to acquire any property held in the trust by substituting other property of equivalent value.

SECTION 8. ANNOTATIONS REGARDING SAMPLE INTER VIVOS GRANTOR

CHARITABLE LEAD ANNUITY TRUST

.01 Annotations for Introductory Paragraph and Paragraph 1, Funding of Trust, of the Sample Trust in Section 7.

- (1) Types of charitable lead trusts. An inter vivos charitable lead trust may be established as either a grantor charitable lead trust or a nongrantor charitable lead trust. The sample trust in section 7 is an example of a grantor charitable lead trust. The sample trust in section 4 is an example of a nongrantor charitable lead trust. In order for the donor to a charitable lead trust to claim an income tax charitable deduction under § 170(a) in the year of the donor's contribution to the trust for the present value of the annuity interest passing to charity, the trust must be structured as a grantor charitable lead trust. See § 170(f)(2)(B). The rules governing grantor charitable lead trusts are similar to those relating to nongrantor

charitable lead trusts. The most significant difference is the income tax treatment of the trust income. A charitable lead trust is a grantor charitable lead trust if the donor to the trust is treated as the owner of the entire trust for income tax purposes. See section 8.09 for a discussion of the types of powers that may be used to create a grantor charitable lead trust.

- (2) Income taxation of grantor charitable lead trusts. The donor to a grantor charitable lead annuity trust may claim a federal income tax charitable deduction under § 170(a) in the year that assets are irrevocably transferred to the trust. During the charitable lead annuity period, the donor is taxed on all income earned by the trust and does not receive any charitable deduction under § 170 for the annuity payments to the charitable beneficiary as they are made. In addition, the trust does not receive a charitable deduction under § 642(c)(1). See § 1.671-4 for the income tax reporting requirements for a grantor charitable lead annuity trust.
- (3) Income tax deductibility limitations. The donor to a grantor charitable lead trust may claim an income tax charitable deduction under § 170(a) equal to the present value of all future payments that are to be made to the charitable beneficiary. Section 1.170A-6(c). However, a contribution of a charitable income interest in property for which a deduction is allowable under § 170(a) is considered to be made “for the use of” rather than “to” a

charitable organization. Section 1.170A-8(a)(2). Because the charitable lead interest of a grantor charitable lead trust is considered to be made “for the use of” the charitable beneficiary, the income tax charitable deduction available to an individual taxpayer is generally limited as set forth in § 170(b)(1)(B) to 30 percent of the taxpayer’s contribution base as defined in § 170(b)(1)(G). However, if the property contributed to the CLAT is capital gain property as defined in § 170(b)(1)(C)(iv) and the charitable beneficiary (including any alternate charitable beneficiaries named in the trust instrument or selected by the trustee) is not limited to an organization described in § 170(b)(1)(A) (a “public charity”), the individual taxpayer’s income tax charitable deduction generally is limited as set forth in § 170(b)(1)(D) to 20 percent of the taxpayer’s contribution base. Section 170(b)(1)(D). See §§ 1.170A-8(c) and (d). In addition, the amount of a charitable contribution of certain types of property may be reduced under § 170(e). See § 1.170A-4. See section 9.06 for an alternate provision that restricts the charitable beneficiary to a public charity.

- (4) Charitable lead beneficiary requirements. A deduction is allowed under § 170(a) for contributions to a grantor CLAT only if the charitable lead beneficiary is an organization described in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 170(a) differs from the class of permissible charitable recipients for obtaining a

deduction under § 642(c)(1). Compare § 170(c) with § 1.642(c)-(1)(a)(2).

- (5) Computation of charitable deduction. In general, the income, estate, and gift tax charitable deductions available under §§ 170(a), 2055(e)(2)(B), and 2522(c)(2)(B) with respect to contributions to a CLAT are equal to the present value of the annuity interest. Section 7520 generally requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See §§ 1.7520-2, 20.7520-2, and 25.7520-2. If, however, the circumstances surrounding the transfer to a charitable lead trust suggest that the charitable beneficiary might not receive the beneficial enjoyment of the annuity interest, an income tax deduction will be allowed only for the minimum possible amount that the charity will receive. Section 1.170A-6(c)(3)(iii). If at any time the donor ceases to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code, the donor shall be considered to have received an amount of income equal to the amount of any deduction the donor received under § 170(a) for the contribution to the trust, reduced by the discounted value (as of the date of the contribution to the trust) of all amounts of income earned by the trust and taxable to the donor before the time that the donor ceased to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. Section 170(f)(2)(B).
- (6) Trustee provisions. The trust instrument may name alternate or successor

trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain other administrative provisions relating to the trustee's duties and powers.

- (7) Identity of donor. For purposes of qualification under this revenue procedure, the donor to a charitable lead annuity trust may be an individual or a husband and wife. Appropriate adjustments should be made to the introductory paragraph if a husband and wife are the donors.

Terms such as “grantor” or “settlor” may be substituted for “donor.”

.02 Annotations for Paragraph 2, Payment of Annuity Amount, of the Sample Trust in Section 7.

- (1) Guaranteed annuity. To qualify for the applicable charitable deductions, a grantor CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See §§ 170(c), 2055(e)(2)(B), and 2522(c)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 8.02(4) for a discussion of the permissible term of a grantor CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained at the time of the transfer to the trust. Sections 1.170A-6(c)(2)(i)(A),

20.2055-2(e)(2)(vi)(a), and 25.2522(c)-3(c)(2)(vi)(a). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a sum certain or a fixed percentage of the trust assets (determined annually), is not a guaranteed annuity interest. See §§ 1.170A-6(c)(2)(i)(B), 20.2055-2(e)(2)(vi)(b), and 25.2522(c)-3(c)(2)(vi)(b). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88-27, 1988-1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the date of gift exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Sections 1.170A-6(c)(2)(i)(D), 20.2055-2(e)(2)(vi)(e), and 25.2522(c)-3(c)(2)(vi)(e). These prohibitions are contained in the sample trust in section 7. See section 8.06 for a further discussion of the 60 percent test. See section 9.04 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

- (2) Payment requirements. CLATs are not subject to any minimum or

maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the donor will realize capital gain on the assets distributed to satisfy part or all of the annuity payment.

- (3) Rule against perpetuities. An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. Sections 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a), and 25.2522(c)-3(c)(2)(vi)(a).
- (4) Permissible term. Paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for

payment of the annuity amount for the life or lives of one or more measuring lives or for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85-49, 1985-1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the date assets are transferred to the trust. Sections 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a) and 25.2522(c)-3(c)(2)(vi)(a). See section 9.01 for an alternate provision that provides for an annuity period based on the life of an individual.

- (5) Permissible recipients. A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the donor from receiving a charitable deduction if the trust instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c), 2055(a), and 2522(a). Rev. Rul. 78-101, 1978-1 C.B. 301. If it is determined that a deduction under § 2055(a) will not be necessary in any event, all references to § 2055(a) in the trust instrument may be deleted. Note, that if the donor is serving as trustee of the trust, the trustee's power to select the charitable beneficiaries will cause the gift of the annuity interest to be incomplete for gift tax purposes

and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c). Further note that if the charitable beneficiary is a private foundation and the donor is an officer or director of the private foundation or possesses certain decision making authority in the private foundation, some or all of the trust property may be included in the donor's gross estate. See § 2036(a)(2). See section 8.01(3) for a discussion of the income tax deductibility limitations. See section 9.02 for an alternate provision that provides for a donor's retained right to substitute the charitable beneficiary. See section 9.03 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable beneficiaries. See section 9.06 for an alternate provision that limits the charitable beneficiary to a public charity.

- (6) Payment of annuity amount in installments. Paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 specifies that the annuity amount is to be paid in equal quarterly installments at the end of each calendar quarter. Alternatively, the trust instrument may specify that the annuity amount is to be paid in annual or other equal or unequal installments throughout the year. See §§ 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a), and 25.2522(c)-3(c)(2)(vi)(a). The amount of the charitable deduction will be affected by the frequency of the payment, by whether the

installments are equal or unequal, and by whether each installment is payable at the beginning or end of the period. See §§ 1.170A-6, 25.2512-5, and 20.2031-7.

- (7) Excess income. Trust income in excess of the amount required to pay the annuity may be retained by the trust or distributed to the charitable beneficiary. The sample trust in section 7 provides for the retention of excess income by the trust. If, instead, the governing instrument of a grantor charitable lead trust provides for the payment of excess income to or for the use of the charitable beneficiary, the donor will receive an income tax charitable deduction each year for amounts paid to a charitable beneficiary to the extent that such amounts exceed the guaranteed annuity amount. Section 1.170A-6(d)(2)(ii). However, the donor is not entitled to any additional estate or gift tax charitable deductions for the excess amounts of income distributed to the charitable beneficiary. See §§ 20.2055-2(e)(2)(vi)(d) and 25.2522(c)-3(c)(2)(vi)(d). See Situation 2 of Rev. Rul. 88-82, 1988-2 C.B. 336, for the gift tax consequences of the payment of excess income to a noncharitable beneficiary. See section 8.06 for the private foundation rules applicable to charitable lead trusts.
- (8) Payment of part of annuity for private purposes. In general, no part of a charitable lead annuity interest may be payable for a private purpose before the expiration of all charitable lead annuity interests. However,

there are two exceptions to this rule. The first exception arises when the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Sections 1.170A-6(c)(2)(i)(E), 20.2055-2(e)(2)(vi)(f), and 25.2522(c)-3(c)(2)(vi)(f). See section 8.06 for the private foundation rules applicable to charitable lead trusts.

.03 Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust in Section 7.

- (1) Prorating the annuity amount. Paragraph 3, Proration of Annuity Amount, of the sample trust in section 7 provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.04 Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of the Sample Trust in Section 7.

- (1) Generation-skipping transfer tax. If a CLAT has or may have a skip

person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax.

Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the donor of a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable rate is the inclusion ratio multiplied by the maximum federal estate tax rate. Section 2641(a). The rules for determining the inclusion ratio for a CLAT are set forth in § 2642(e) and confirm that the inclusion ratio is determined at the termination of the annuity period, rather than on the funding of the trust.

.05 Annotation for Paragraph 5, Additional Contributions, of the Sample Trust in Section 7.

- (1) Additions to the trust. For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A charitable lead trust that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.06 Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust in Section 7.

- (1) Prohibitions against certain investments and excess business holdings.

Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3) are generally required. The sample trust in section 7 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust instrument does not provide for the payment of excess income to a noncharitable beneficiary, the references to §§ 4943 and 4944 may be removed from the trust instrument. Sections 4947(b)(3), 53.4947-2(b)(1)(i), 1.170A-6(c)(2)(i)(D), 20.2055-2(e)(2)(vi)(e), and 25.2522(c)-3(c)(2)(vi)(e). See section 8.02(7) for a discussion of the payment of excess trust income to a noncharitable beneficiary. See section 8.02(8) for a discussion of the payment of part of the annuity for a private purpose.

.07 Annotation for paragraph 7, Taxable Year, of the Sample Trust in Section 7.

(1) Calendar year. The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.08 Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust in Section 7.

- (1) Capital gains. Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law.

.09 Annotation for Paragraph 11, Retained Powers and Interests, of the Sample Trust in Section 7.

- (1) Power to substitute trust assets. The donor to a CLAT may claim an income tax charitable deduction under § 170(a) if the donor is treated as the owner of the entire CLAT under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. Paragraph 11, Retained Powers and Interests, of the sample trust in section 7 creates a grantor CLAT through the use of a power to substitute trust assets under § 675(4) that is held by a person other than the donor, the trustee, or a disqualified person as defined in § 4946(a)(1), and is exercisable only in a nonfiduciary capacity. The circumstances surrounding the administration of a CLAT will determine whether a § 675(4) substitution power is exercised in a fiduciary or nonfiduciary capacity. This is a question of fact. Note, that the exercise of a § 675(4) power may result in an act of self-dealing under § 4941.
- (2) Other powers or provisions to create a grantor trust. As noted above, the sample trust in section 7 includes a § 675(4) power that is held by someone other than donor, the trustee, or a disqualified person as defined

in § 4946(a)(1), and that may be exercised only in a nonfiduciary capacity.

The CLAT instrument may instead incorporate a power or provision, other than the one provided in sample trust in section 7, that will cause the donor to be treated as the owner of the entire CLAT under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. See § 671 et seq. However, practitioners should exercise caution when choosing a particular power or provision because certain methods of creating a grantor trust may have unforeseen tax consequences.

SECTION 9. ALTERNATE PROVISIONS FOR SAMPLE INTER VIVOS GRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 Annuity Period for the Life of One Individual.

- (1) Explanation. As an alternative to establishing a CLAT for a term of years, the trust instrument of a grantor CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that each measuring life is a lineal ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries if there is a less than 15 percent probability at the time of the

contribution to the trust that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031-7. Sections 1.170A-6(c)(2)(i)(A), 20.2055-2(e)(2)(vi)(a), and 25.2522(c)-3(c)(2)(vi)(a).

- (2) Instruction for use. Replace the fifth and sixth sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following sentences:

The annuity period is the lifetime of [designated measuring life]. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the date of death of [designated measuring life].

.02 Retention of the Right to Substitute the Charitable Lead Beneficiary.

- (1) Explanation. The donor to a grantor CLAT may retain the right to substitute another charitable beneficiary for the charitable beneficiary named in the trust instrument and still claim a deduction under § 170(a) in the year of the transfer to the CLAT. Note, however, that the retention of this right will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See

§§ 2035, 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c). See section 8.01(3) for a discussion of the income tax deductibility limitations applicable to contributions to a grantor CLAT.

- (2) Instruction for use. Replace the third sentence of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

Notwithstanding the preceding sentence, the Donor reserves the right to designate as the charitable annuity recipient, at any time and from time to time, in lieu of [designated charitable recipient named above], one or more organizations described in §§ 170(c), 2055(a), and 2522(a) and shall make any such designation by giving written notice to the Trustee. The term “the Charitable Organization” shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient.

.03 Apportionment of the Annuity Amount in the Discretion of the Trustee.

- (1) Explanation. The donor or the trustee of a grantor charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries. Note that a retained power of apportionment by the donor will cause the gift of the

annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property to be included in the donor's gross estate.

See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511-2(c).

- (2) Instruction for use. Replace the first three sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class comprised of organizations described in §§ 170(c), 2055(a), and 2522(a) (hereinafter, collectively "the Charitable Organization") an annuity amount equal to [number representing the annual annuity percentage to be paid to the Charitable Organization] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee's sole discretion, from time to time may deem advisable.

.04 Annuity Amount as a Specific Dollar Amount.

- (1) Explanation. As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may be stated as a

specific dollar amount.

(2) Instructions for use.

- (a) Replace the first sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [the stated dollar amount].

- (b) Delete the last sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 concerning the incorrect valuation of trust assets.

.05 Designation of an Alternate Charitable Beneficiary in the Trust Instrument.

- (1) Explanation. The sample trust in section 7 provides that if the charitable beneficiary designated in the trust instrument is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the trustee shall distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the trustee shall select. As an alternative, the trust instrument may specifically designate one or more alternate charitable beneficiaries. See section 8.01(3) for a discussion of the income tax deductibility limitations applicable to contributions to a grantor CLAT.

- (2) Instruction for use. Replace the second sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

If [designated charitable recipient] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to [designated substitute charitable recipient]. If neither [designated charitable recipient] nor [designated substitute charitable recipient] is an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

.06 Restriction of the Charitable Beneficiary to a Public Charity.

- (1) Explanation. Because the charitable lead interest of a grantor charitable lead trust is considered to be made “for the use of” the charitable beneficiary, the income tax charitable deduction available to an individual taxpayer is generally limited as set forth in § 170(b)(1)(B) to 30 percent of the taxpayer's contribution base as defined in § 170(b)(1)(G). However, if the property contributed to the CLAT is capital gain property as defined in § 170(b)(1)(C)(iv) and the charitable beneficiary (including any alternate

charitable beneficiaries named in the trust instrument or selected by the trustee) is not limited to a public charity, the individual taxpayer's income tax charitable deduction generally is limited as set forth in § 170(b)(1)(D) to 20 percent of the taxpayer's contribution base. Section 170(b)(1)(D). See §§ 1.170A-8(c) and (d). In addition, the amount of a charitable contribution of certain types of property may be reduced under § 170(e). See § 1.170A-4.

- (2) Instructions for use. To restrict the charitable beneficiary to a public charity, each and every time the phrase "an organization described in §§ 170(c), 2055(a), and 2522(a) of the Code" appears in the sample trust, replace it with the phrase "an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code.@"

SECTION 10. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephanie N. Bland of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Stephanie N. Bland at (202) 622-3090 or (202) 622-7830 (not a toll free call).