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# It Pays to Give It Away - Sometimes: Inter Vivos Charitable Remainder Unitrusts in Estate Planning

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## I. Introduction

The concept of charitable giving by individuals is well-rooted in our nation's social and economic fiber. There is little doubt that individual generosity plays a vital role in the continued existence of such socially beneficial and humanitarian institutions as religious organizations, universities, hospitals, and medical research foundations. Donations to such organizations not only take the form of outright current contributions, but often include delayed or testamentary bequests as part of a comprehensive estate plan.

The underlying assumption when suggesting the incorporation of charitable planning ideas in an individual's estate plan is that the individual is predisposed to give away assets in fulfillment of some philanthropic desire. This is not an unreasonable assumption, given the obvious fact that the donor is giving something away to charity that would otherwise be of some benefit to the donor and/or the donor's family and heirs. This assumption of donative intent remains reasonable even when potential tax benefits of charitable gifts are factored in, since something of value is still being given away, albeit at a tax-reduced cost to the donor. Indeed, the trend of tax legislation, beginning with the Economic Recovery Tax Act of 1981 and culminating with the Tax Reform Act of 1986, has been to increase the after tax cost of charitable gifts by reducing tax benefits associated therewith.[1]

This comment suggests that the consideration of charitable giving in the estate planning context should not be limited to individuals exhibiting strong philanthropic desires. Charitable bequests through an inter vivos charitable remainder unitrust, combined with an irrevocable life insurance trust, can be a viable component of an estate plan for individuals having little or no predisposed charitable inclination. This comment first provides the operational framework of the inter vivos charitable remainder unitrust, with special consideration given to the Tax Reform Act of 1986, and irrevocable life insurance trust. Next, it examines the interplay of attributes and ramifications of

1. Donaldson & Osteen, *The Unkindest Cut: Tax Reforms are Shrinking Charitable Giving*, Tr. & Est., Mar. 1986, at 46.

these trusts. In particular, this comment illustrates how an estate plan utilizing charitable bequests not only provides gifts to charity, but also provides more wealth to the individual and the individual's heirs than an estate plan not utilizing charitable bequests.

## II. The Framework of Inter Vivos Charitable Remainder Unitrust and Irrevocable Life Insurance Trust

The concept of estate planning encompasses more than the mere preparation of an individual's will.[2] Comprehensive estate planning often includes such objectives as providing adequate lifetime needs for retirement, disabilities, children's education, as well as insuring proper estate distribution at death while incurring the least possible estate dilution.[3]

A comprehensive estate plan may also include inter vivos and/or testamentary gifts to charity.[4] There are numerous estate planning devices available to facilitate gifts to charity. Two such devices, the inter vivos charitable remainder unitrust and the irrevocable life insurance trust, are the foci of this comment. The ramifications of using such devices in the estate planning context are numerous, and the interplay of these ramifications can create financially advantageous opportunities even for those individuals not predisposed to philanthropy.

Before discussing such interplay, the operational framework of the inter vivos charitable remainder unitrust and the irrevocable life insurance trust must be examined. The following discussion is not intended as an exhaustive study of all of the requirements, conditions, and aspects of the inter vivos charitable remainder unitrust or the irrevocable life insurance trust but, rather, serves to identify the major implications of their use.[5]

### A. *The Inter Vivos Charitable Remainder Unitrust*

Probably the most traditional concept of charitable giving involves an outright gift to charity. This form of giving requires the current relinquishment of the full benefit of an asset.[6] However, another

2. H. WEINSTOCK, PLANNING AN ESTATE § 1.1 (2d ed. 1982).
3. *Id.* §§ 1.2-1.4.
4. *Id.* § 14.1.
5. For an excellent discussion of charitable remainder trusts, see Lichter, *Charitable Remainder Trusts* in 1 ESTATE TAX TECHNIQUES § 10A (J.K. Lasser Tax Inst. 1987); Stern, Sullivan & Schumacher, Charitable Giving and Solicitation (P-H) ¶¶ 23,001-23,097 (1985). For excellent discussions of irrevocable life insurance trusts, see Lawrence, *Structuring Irrevocable Trusts in Light of Tax Changes and Proposals*, 44 N.Y.U. INST. ON FED. TAX'N § 55.01 (1986); Manterfield, *The Revocable Irrevocable Trust*, 1987 RES GESTAE 452.
6. Stern, Sullivan & Schumacher, *supra* note 5, at ¶ 22,002.

concept of charitable giving benefits the donor and/or other noncharitable individuals as well as the charity. Known as "split interest" charitable giving, the concept allows a single gift to effectively be split into two or more interests: one interest retained for the benefit of the donor and/or other individuals, and the other interest for the benefit of charity.[7] This split interest concept is attractive to "persons interested in charitable giving because the donor and the donor's family . . . [are] not completely cut off from the beneficial enjoyment of the charitable donation."[8] A charitable remainder trust is one such split interest vehicle.

The charitable remainder trust is an irrevocable trust[9] created by the grantor's transfer of money or property.[10] It may be an inter vivos trust, established during the grantor's life, or a testamentary trust, established at the death of the grantor.[11] The inter vivos charitable remainder trust, in its simplest form, provides the grantor with benefits in the form of payments for a period of years or for the grantor's lifetime.[12] This component is referred to as the noncharitable beneficiary interest.[13] At the end of the period of years or on the death of the grantor, the balance remaining in the trust goes to charity.[14] This is referred to as the qualified charitable remainder interest (charitable remainder interest).[15]

The charitable remainder trust is a flexible planning device: at the option of the grantor, the charitable remainder trust may benefit only the grantor, persons other than the grantor, or both the grantor and other persons.[16] For example, the charitable remainder trust may make payments to the grantor for life and then, at the death of the grantor, to the surviving spouse for life.[17]

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7. H. WEINSTOCK, *supra* note 2, § 14.22.
8. 4 A. CASNER, ESTATE PLANNING 1587-88 (4th ed. 1980).
9. Treas. Reg. §§ 1.664-1(a)(1)(i), -2(a)(6)(i) (as amended in 1984), -3(a)(6)(8), (1972).
10. *Id.* § 1.664-1(a)(4), (5) (as amended in 1984).
11. *Id.* This comment focuses on the inter vivos charitable remainder trust.
12. I.R.C. § 664(d)(1)(A), (d)(2)(A) (1982); Treas. Reg. §§ 1.664-1(a)(1)(i), -2(a)(5)(i) (as amended in 1984), -3(a)(5)(i) (1972).
13. I.R.C. § 2056(b)(8)(B)(i) (1982).
14. *Id.* § 664(d)(1)(C), (d)(2)(C); Treas. Reg. §§ 1.664-2(a)(6)(i) (as amended in 1984), -3(a)(6)(i) (1972).
15. I.R.C. § 2056(b)(8)(B)(ii) (1982).
16. *Id.* § 664(d)(1)(A), (d)(2)(A); Treas. Reg. §§ 1.664-2(a)(3)(i) (as amended in 1984), -3(a)(3)(i) (1972).
17. *See, e.g.*, Weithorn, *Using the Charitable Remainder Trust as a Sophisticated Contribution Technique*, 43 N.Y.U. INST. ON FED. TAX'N § 17.01 (1985) ("A donor transfers . . . [property] to a unitrust with an . . . annual payout requirement, first for the

There are two basic types of charitable remainder trusts: the charitable remainder annuity trust (annuity trust) and the charitable remainder unitrust (unitrust).[18] The annuity trust must pay, at least annually,[19] a fixed dollar amount to the noncharitable beneficiary equal to at least 5% of the original fair market value of the assets contributed to the trust.[20]

Similarly, a unitrust must make annual payments to the noncharitable beneficiary.[21] However, the amount payable by a unitrust is based on a fixed percentage, at least 5%, of the annually recomputed fair market value of the trust assets.[22] Although the annual payout percentage remains fixed, the actual payout per year varies with the trust's asset value. In contrast, the annuity trust payment remains the same regardless of the trust's asset value.[23] A variation of the regular unitrust is the "net income unitrust," which allows the trust to make payments to the noncharitable beneficiary to the lesser of the stated percentage or the unitrust's income.[24] The net income unitrust may contain a "makeup" feature facilitating the payment of higher amounts in some years to "make up" for lesser amounts paid in prior years due to the trust income limitation.[25]

To qualify as a charitable remainder unitrust, the trust must meet the requirements of Internal Revenue Code section 664 and the related Treasury Regulations.[26] Additionally, Revenue Ruling 72-395,[27] as modified and clarified by Revenue Rulings 80-123,[28] 82-128,[29] and 82-165,[30] requires that certain rules from section 664 and the regula-

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life of the donor and thereafter for the life of the donor's spouse, if then surviving." *Id.* § 17.02[2][b][i]). *But see* Treas. Reg. §§ 1.664-2(a)(5)(i) (as amended in 1984), -3(a)(5)(i) (1972) (restrictions on combining payments for the life of one noncharitable beneficiary and payments for a period of years to another noncharitable beneficiary); *infra* note 33.

18. This comment focuses on the charitable remainder unitrust rather than the charitable remainder annuity trust.

19. I.R.C. § 664(d)(1)(A) (1982); Treas. Reg. § 1.664-2(a)(1)(i) (as amended in 1984).

20. I.R.C. § 664(d)(1)(A) (1982); Treas. Reg. § 1.664-2(a)(2)(i) (as amended in 1984).

21. I.R.C. § 664(d)(2)(A) (1982); Treas. Reg. § 1.664-3(a)(1)(i)(a) (as amended in 1984).

22. I.R.C. § 664(d)(2)(A) (1982); Treas. Reg. § 1.664-3(a)(1)(i) (as amended in 1984).

23. Treas. Reg. § 1.664-2(a)(1)(i) (as amended in 1984). "[T]he trust shall pay a sum certain . . . ." *Id.* A "sum certain" is defined as a "[s]tated dollar amount which is the same . . . for each year . . . ." *Id.* § 1.664-2(a)(1)(ii) (as amended in 1984).

24. I.R.C. § 664(d)(3)(A) (1982); Treas. Reg. § 1.664-3(a)(1)(i)(b)(1) (1972).

25. I.R.C. § 664(d)(3)(B) (1982); Treas. Reg. § 1.664-3(a)(1)(i)(b)(2) (1972).

26. Treas. Reg. § 1.664-1(a)(2) (as amended in 1984). "A trust is a charitable remainder trust only if it is either a charitable remainder annuity trust in every respect or a *charitable remainder unitrust in every respect.*" *Id.* (emphasis added). *See infra* notes 32-35 and accompanying text for discussion of charitable remainder trust requirements.

27. 1972-2 C.B. 340.

28. 1980-1 C.B. 205.

29. 1982-2 C.B. 71.

30. 1982-2 C.B. 117.

tions thereunder be expressly incorporated in the trust instrument.[31] The trust must have at least one noncharitable individual beneficiary to which the trust must pay, at least annually, "a fixed percentage (which is not less than 5 percent) of the net fair market value of its assets, valued annually . . . ."[32] The period of payment to the noncharitable beneficiary must be either "for a term of years (not in excess of twenty years) or for the life or lives of" the individual noncharitable beneficiary.[33] The individual noncharitable beneficiary must, as a general rule, be living at the time the trust is created.[34] Furthermore, "following the termination of the payments . . . [to the noncharitable individual(s)], the remainder interest in the trust . . . [must be] transferred to, or for the use of, [a charitable] organization described in section 170(c) . . . ."[35]

There are several attributes or ramifications flowing from the unitrust that affect income, estate, and gift taxes as well as various economic aspects of the parties involved. As previously mentioned, the unitrust concept is that of a split interest gift having both charitable and noncharitable beneficiaries. The single most important factor in the analysis of the attributes flowing from a unitrust is the valuation of the charitable and noncharitable interests. The valuation of the two interests is made at the time the trust is established and is equal

31. Rev. Rul. 72-395, 1972-2 C.B. 340. The ruling provides language and format samples of provisions that must be included in the trust instrument. Although use of the specific language provided in the ruling is not required, "a general provision stating that the grantor intends to create a charitable remainder trust and incorporating by general reference all necessary requirements of the Internal Revenue Code and regulations will not, by itself, be sufficient." *Id.* at 342; Rev. Rul. 80-123, 1980-1 C.B. 205 (modifying mandatory requirements for testamentary charitable remainder trusts); Rev. Rul. 82-128, 1982-2 C.B. 71 (modifying the requirements such that a trust cannot qualify as a charitable remainder trust "if it is possible that federal and state death taxes may be payable from the trust assets. [But it] . . . will qualify as a charitable remainder trust . . . if a secondary life beneficiary furnishes the funds for the payment of any death taxes for which the trust may be liable."); Rev. Rul. 82-165, 1982-2 C.B. 117 (clarifying mandatory requirements for testamentary charitable remainder trusts and asset valuation dates).

32. I.R.C. § 664(d)(2)(A) (1982); Treas. Reg. § 1.664-3(a)(3)(i) (1972) (specifies noncharitable beneficiary must be an individual). *But see* Rev. Rul. 76-270, 1976-2 C.B. 194 (trust qualified as charitable remainder unitrust when noncharitable beneficiary was a trust for the sole benefit of an incompetent individual).

33. I.R.C. § 664(d)(2)(A) (1982); *see also* Treas. Reg. § 1.664-3(a)(5)(i) (1972). A combination of life-based and term-of-years-based noncharitable interests is possible, but "the period [of the noncharitable interests] may not extend beyond either the life or the lives of a named individual or individuals or for a term of years not to exceed 20 years." *Id.*

34. I.R.C. § 664(d)(2)(A) (1982); Treas. Reg. §§ 1.664-3(a)(3)(i), -3(a)(5)(i) (1972).

35. I.R.C. § 664(d)(2)(C) (1982).

to the actuarially determined present value of the fair market value of those interests.[36] The values are based on a combination of the life expectancy of the noncharitable beneficiary, or the life of the trust, and the specified payout percentage of the trust.[37] The Treasury provides publications and tables for determining the values of these interests.[38] The longer the period of benefit to the noncharitable beneficiary and/or the higher the stated trust payout percentage, the higher resulting value of the noncharitable interest and the lower resulting value of the charitable remainder interest.[39]

1. Federal Income Tax Ramifications

*a. The Grantor—Charitable Deduction*

The first attribute associated with a unitrust is the potential federal income tax deduction available to the grantor from money or other property contributed to the unitrust. The grantor is generally entitled to such a deduction in the year in which the unitrust is created[40] and the amount of the deduction is equal to the fair market value of the charitable remainder interest.[41] As previously discussed, the fair market value of the charitable remainder interest is actuarially computed, based on the fair market value of assets at the time they were contributed to the unitrust.[42]

The income tax deduction for the value of the charitable remainder is, however, subject to the same restrictions, limitations, and provisions as regular charitable deductions. First, the remainder beneficiary must be an organization which qualifies as a charitable organization.[43] Additionally, the charitable deduction allowed for an

36. Treas. Reg. § 1.664-4(a) (as amended in 1984).

37. *Id.* § 1.664-4(b) (as amended in 1984).

38. *Id. See* I.R.S. Pub. 723C (Sept. 1984) (determining values of interests where noncharitable interest is payable over two lives).

39. For example, the value of a charitable remainder interest of a unitrust with a 6% payout rate and lasting one year is 94% of the assets' contributed fair market value, whereas the value drops to approximately 29% if the trust were to last twenty years. Treas. Reg. § 1.664-4(b)(5) (as amended in 1984). Similarly, the value of a charitable remainder interest of a unitrust lasting ten years with a 6% payout rate would be approximately 54% of the assets' contributed fair market value, whereas the value would drop to approximately 35% if the payout rate were 10%. *Id.*

40. I.R.C. § 170(f)(2)(A) (1982) (allows charitable deduction when assets transferred to a charitable remainder trust).

41. *Id.*; Treas. Reg. § 1.170A-6(b)(1), -6(b)(2) (as amended in 1984). *But see* I.R.C. § 170(e) (1982 & Supp. III 1985) (limiting valuation of deduction for ordinary income property and certain capital gain property). If property transferred to trust is subject to an encumbrance, the full fair market value is still used as long as the grantor remains liable on the debt. Estate of Gwinn v. Commissioner, 25 T.C. 31, 43 (1955), *acq.*, 1956-1 C.B. 4.

42. Treas. Reg. § 1.170A-6(b)(2) (as amended in 1984) (requires valuation pursuant to treasury regulation § 1.664-4). *See supra* note 36 and accompanying text.

43. I.R.C. § 170(c) (1982); Treas. Reg. § 1.664-3(a)(6) (1972). The main categories of qualified charitable donees include the following: domestic corporations, trusts, com-

individual in any one year is limited to varying percentages of the individual's adjusted gross income depending on the type of property contributed and the nature of the charitable organization eventually benefiting from the gift.[44] The amount of charitable contributions made in a particular year exceeding the deductibility limit for that year can generally be carried forward and deducted in subsequent years, up to a maximum of five years, subject to deductibility limitations in such years.[45]

*b. The Unitrust—Income Taxation*

The unitrust itself is generally not subject to income tax on its earnings including gains from the sale of assets.[46] This can be very important when the unitrust is funded with assets which are highly appreciated in the hands of the grantor and the trust subsequently sells such assets and reinvests the proceeds. The unitrust, in such a situation, would not be subject to income tax on the gain from the sale of the assets,[47] nor on the income earned from the reinvested proceeds.[48] Moreover, just as the trust incurs no income tax liability

munity chests, funds or foundations "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster . . . amateur sports . . . or for the prevention of cruelty to children or animals." I.R.C. § 170(c)(2)(B) (1982). Also included as qualified charitable donees are governmental units. *Id.* § 170(c)(2)(A).

44. *Id.* § 170(b)(1) (1982 & Supp. III 1985); *id.* § 170(b)(1)(A) (individual's charitable contribution limited to 50% of contribution base for contributions to qualified organizations described in I.R.C. § 170(b)(1)(A)(i-viii)); *id.* § 170(b)(1)(B) (West Supp. 1987) (individual's charitable contribution further limited for contributions to qualified organizations other than those described in I.R.C. § 170(b)(1)(A)(i-viii)); *id.* § 170(b)(1)(C) (1982 & Supp. III 1985) (individual's charitable contribution limited to 30% of contribution base for contributions of certain capital gain property to qualified organizations described in I.R.C. § 170(b)(1)(A)(i-viii)); *id.* § 170(b)(1)(D) (Supp. III 1985) (individual's charitable contribution limited to 20% of contribution base for contributions of certain capital gain property to qualified organizations other than those described in I.R.C. § 170(b)(1)(A)(i-viii)). "Contribution base" is generally equal to an individual's adjusted gross income. *Id.* § 170(b)(1)(F). *See also infra* note 146 and accompanying text.

45. I.R.C. § 170(d)(1)(A) (1982); *see also id.* § 170(b)(1)(C)(ii) (capital gain property subject to 30% limitation carries over that same limitation in subsequent years); *infra* notes 146, 150, 153, 156, 159 and accompanying text.

46. I.R.C. § 664(c) (1982); Treas. Reg. § 1.664-1(a)(1)(i) (as amended in 1984). However, I.R.C. § 664(c) (1982) provides that a Trust is subject to income tax on its "unrelated business taxable income (within the meaning of section 512 . . . .)." *Id.* Unrelated business taxable income is typically income derived by a charity from any unrelated business that is not regularly carried on by the charity. *Id.* § 512 (1982 & Supp. III 1985).

47. I.R.C. § 664(c) (1982); Treas. Reg. § 1.664-1(a)(1)(i) (as amended in 1984).

48. I.R.C. § 664(c) (1982); Treas. Reg. § 1.664-1(a)(1)(i) (as amended in 1984).

on the gain realized from the sale of the appreciated property, the grantor who transferred the appreciated property to the unitrust is also not subject to income tax on such gain.[49] In addition, the grantor's charitable deduction is calculated based on the full fair market value of the assets contributed.[50] However, caution must be exercised in this area: the Internal Revenue Service has held that if a trustee of a tax exempt trust (similar to a unitrust) is under an express or implied obligation to sell contributed property and reinvest the proceeds in a particular manner, the trust will be deemed an agent of the grantor, thereby subjecting the grantor to tax on the gain realized from the sale.[51]

#### c. *Noncharitable Beneficiaries—Income Tax on Unitrust Distributions*

Although the unitrust is not taxed on its earnings,[52] the trust's noncharitable beneficiary may be subject to income tax on the annual distributions received from the unitrust.[53] The character of the distributions in the hands of the noncharitable beneficiary is based on a four-tier structure and is treated: (1) as ordinary income to the extent of the unitrust's current and undistributed prior years' ordinary income;[54] (2) as capital gains to the extent of the unitrust's current and undistributed prior years' capital gains;[55] (3) as "other" income (including tax exempt income) to the extent of the unitrust's current and undistributed prior years' "other" income;[56] and (4) as a distribution of trust corpus.[57]

#### d. *The Tax Reform Act of 1986*

The Tax Reform Act of 1986 (Tax Reform Act)[58] is the most recent

49. I.R.C. § 644(e)(3) (1982). *But see id.* § 1011(b); Treas. Reg. § 1.1011-2(a)(3) (as amended in 1980) (recognition by grantor of income from the contribution of appreciated property which is encumbered with a debt such as a mortgage).

50. *See supra* note 41 and accompanying text.

51. Rev. Rul. 60-370, 1960-2 C.B. 203. This ruling held gain from the sale of assets within a tax exempt trust was included in the gross income of the transferor where the trustee was "under an express or implied obligation to sell such property and invest the proceeds in tax exempt securities." *Id.* at 203. The service has applied this analogy to areas other than reinvestment of sale proceeds in tax exempt securities. Priv. Ltr. Rul. 80-42-142 (1980).

52. *See supra* note 46 and accompanying text.

53. I.R.C. § 664(b) (1982).

54. *Id.* § 664(b)(1).

55. *Id.* § 664(b)(2). For all intents and purposes, this is treated as ordinary income after December 31, 1986, due to repeal of advantageous taxation of capital gains. Tax Reform Act of 1986, Pub. L. No. 99-514, § 301(a), 100 Stat. 2058, 2085 [hereinafter TRA 86] (repealing I.R.C. § 1202). *See infra* note 62 and accompanying text.

56. I.R.C. § 664(b)(3) (1982).

57. *Id.* § 664(b)(4).

58. TRA 86, Pub. L. No. 99-514, 100 Stat. 2058.

in a line of tax legislation affecting the income tax ramifications of charitable giving.[59] Although the Tax Reform Act does not directly impact the unitrust provisions of the code, some of the changes that it made have important implications in the charitable giving setting. For instance, the Tax Reform Act radically altered the tax rate structure for individuals by reducing the top marginal regular income tax rate from 50% to 28%.[60] However, rate reductions have a dual impact: they not only have the effect of reducing taxes on income, but also have the effect of reducing tax savings derived from deductions. Thus, for charitable contributions of cash or nonappreciated property, the Tax Reform Act effectively makes the after tax cost of those gifts more expensive for individuals paying tax at the highest marginal rate.[61]

The Tax Reform Act also eliminated the favorable tax treatment of long-term capital gains increasing top marginal tax bracket from 20% to 28%.[62] This has the effect of decreasing the after tax cost of charitable gifts of certain appreciated property.[63]

Perhaps the most important change affecting charitable gifts occasioned by the Tax Reform Act, however, concerns gifts of appreciated property.[64] Although the charitable deduction for most appreciated property contributed continues to be the fair market value of such property,[65] the appreciation portion of the fair market value is now considered an item of tax preference,[66] and is added back into in-

59. Donaldson & Osteen, *supra* note 1.

60. TRA 86, § 101, 100 Stat. at 2096 (amending I.R.C. § 1). The 28% marginal tax rate is effective beginning in 1988. *Id. See also* I.R.C. § 1(g) (West Supp. 1987) (effectively increases top marginal tax rate to 33% at certain income levels due to a phase-out of certain items).

61. For example, a qualified charitable gift of $100 at a 50% marginal tax rate produces a $50 tax reduction which makes the after tax cost of the gift $50 ($100 - $50). However, the same gift at a 28% marginal tax rate produces a tax reduction of only $28 making the after tax cost of the gift $72 ($100 - $28), or a 44% increase in after tax cost as compared to gifts at the 50% rate.

62. TRA 86, § 301(a), 100 Stat. at 2085 (repealing I.R.C. § 1202).

63. *See, e.g.*, Sanders & Toolson, *Planning for Charitable Giving After the Tax Reform Act of 1986*, 1987 TAXES 359, 361-62. *But see* TRA 86, § 231(f), 100 Stat. at 2180 (amending I.R.C. § 170(e)(1)(B)). Deductions are further restricted for contributions of tangible *personal* property. *Id.* (emphasis added).

64. TRA 86, § 701(a), 100 Stat. at 2333 (amending alternative minimum tax); *see infra* notes 66-69 and accompanying text.

65. In a unitrust setting, it is the fair market value of the charitable remainder interest. *Supra* note 41 and accompanying text. The deduction is subject, however, to charitable deduction limitations. *Supra* note 44 and accompanying text.

66. TRA 86, § 701(a), 100 Stat. at 2333 (amending I.R.C. § 57(a)(6)).

come for computing the alternative minimum tax.[67] The basic operation of the alternative minimum tax is the application of a flat rate of 21% on income adjusted for certain items and increased by tax preference items.[68] The computed alternative minimum tax is then compared to the regular computed income tax and the individual is liable for the greater of the two.[69]

This new potential application of the alternative minimum tax to contributions of appreciated property has a direct impact on the use of unitrusts. The contribution of appreciated assets to a unitrust, although resulting in no regular income tax to the grantor,[70] may create a tax preference item subjecting the grantor to the alternative minimum tax.[71] The amount of the tax preference, in such a split gift situation, is equal to the total appreciation of the property contributed multiplied by the value of the charitable remainder interest proportionate to the total value of the property contributed.[72] Thus, only "the appreciation proportionate to the remainder interest going to charity will create a tax preference item."[73]

A question arises as to how and when such a tax preference item is recognized in a situation where the amount of a charitable contribution exceeds the deduction limit in a particular year and the excess is carried forward as a deduction in subsequent years. Although not specified in the statute, the explanation of the Joint Committee on Taxation[74] clearly provides that such a tax preference is recognized as the deduction is allowed over the years, rather than being completely recognized in the year of contribution.[75] Additionally, the Committee states that no tax preference is recognized until the chari-

67. I.R.C. § 55(b)(2)(B) (West Supp. 1987).

68. *Id.* § 55(b). The intricacies of the alternative minimum tax are complex, and an in-depth discussion is beyond the scope of the comment.

69. *Id.* § 55(a). The section actually operates to impose a tax, in addition to the regular tax, to the extent the alternative minimum tax exceeds the regularly computed tax. *Id.*

70. *See supra* note 49 and accompanying text.

71. I.R.C. §§ 55(b), 57(a)(6) (West Supp. 1987).

72. STAFF OF THE JOINT COMM. ON TAXATION, 100TH CONG., 1ST SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 444-45 (Joint Comm. Print 1987) [hereinafter JOINT COMM. ON TAXATION]. "In the case of a contribution of less than the taxpayer's entire interest in appreciated property, the preference shall be computed by applying the principles applicable under section 170(e), relating to contributions of ordinary income property. (See Treas. Reg. § 1.170A-4(c))." *Id.* at 444. The regulations at § 1.170A-4(c) provide for apportionment based on relative amounts. Treas. Reg. § 1.170A-4(c)(1) (as amended in 1982).

73. Stern, Sullivan & Schumacher, *supra* note 5, at ¶ 21.1.

74. JOINT COMM. ON TAXATION, *supra* note 72, at 444.

75. *Id.* "Thus, when a portion of a charitable deduction is carried forward because it exceeds the applicable percentage limitation on such contributions, the portion so carried forward cannot increase the amount of the minimum tax preference until it is *allowed as a deduction* for regular tax purposes." *Id.* (emphasis added). *See infra* note 76 for illustration of these provisions.

table deduction allowed exceeds "the relevant basis of the property contributed."[76]

2. Estate and Gift Tax Ramifications

The next major set of attributes or ramifications resulting from the use of a unitrust is found in the area of estate and gift taxes. Indeed, the primary focus of noncharitable estate planning is often in this area.[77]

There are important gift tax implications associated with the initial establishment and transfer of assets to the unitrust. The establishment of the unitrust creates at least two interests: the charitable remainder interest and noncharitable income or distribution interest. Hence, in theory, two transfers are potentially subject to gift tax.[78]

The transfer associated with the charitable remainder interest is not a transfer which is subject to gift tax, assuming the trust qualifies as a charitable remainder unitrust.[79] The transfer associated with the noncharitable beneficiary interest is also not subject to gift tax if

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76. JOINT COMM. ON TAXATION, *supra* note 72, at 444. The application of these rules is illustrated in the following example where real property is contributed to a unitrust.

Assumptions:

| | | |
|---|---|---|
| Fair market value of property contributed | | $100,000 |
| Actuarially determined values of: | | |
| Charitable remainder interest | $60,000 | |
| Noncharitable interest | $40,000 | |
| Basis of property contributed | | $ 10,000 |

The total unapportioned tax preference item associated with the contribution would be $90,000 which is computed by subtracting the property's $10,000 basis from the $100,000 total fair market value of the property. The factor for apportioning the amount of this tax preference to the charitable remainder interest of the unitrust would be 60% which equals the $60,000 value of the charitable remainder interest divided by the $100,000 total value of the property contributed. Therefore, the apportioned tax preference associated with the contribution would be $90,000 multiplied by 60% or $54,000.

The individual's total potential charitable deduction resulting from the contribution of the property would be $60,000, the value of the charitable remainder interest. But assume that the individual's computed charitable contribution limitation in the current year is only $20,000, thereby creating a $40,000 contribution carryover to subsequent years. The amount of tax preference recognized in the current year would be $14,000, the amount of the allowed contribution ($20,000) less the recovery of the property's basis associated with the charitable remainder interest (60% of $10,000). The amount of tax preferences recognized in subsequent years would equal the respective amount of allowed charitable contribution carryover deduction.

77. H. WEINSTOCK, *supra* note 2, §§ 1.2-1.4.

78. I.R.C. § 2511(a) (1982).

79. *Id.* §§ 2522(a), (c)(2)(A); Treas. Reg. §§ 25.2522(a)-1(a) (as amended in 1969), (c)-3(c)(2)(v) (as amended in 1986).

the grantor is the sole noncharitable beneficiary of the unitrust.[80] Similarly, there is no transfer subject to gift tax if the grantor's spouse is either the sole noncharitable beneficiary of the unitrust or a noncharitable beneficiary in combination with, or successive to, the grantor.[81] However, if there is a noncharitable beneficiary of the unitrust other than the grantor or the grantor's spouse, for example the grantor's child, there will be a transfer subject to gift tax[82] measured by the value of such interest.[83] The transfer subject to gift tax might be avoided in the latter situation if the grantor retains a testamentary power to revoke the interest of such noncharitable beneficiary.[84]

Another area of concern is the potential estate tax ramifications on the death of the unitrust's grantor. Just as in the gift tax analysis, there are two possible beneficiary interests existing at the time of the grantor's death: the unitrust charitable remainder interest and the interests of any remaining noncharitable beneficiaries of the unitrust who survive the grantor. The charitable remainder interest, at the death of the grantor, is effectively excluded from the grantor's gross estate and thus, not subject to estate taxes.[85] Similarly, the value of a remaining noncharitable beneficiary interest surviving the grantor is also effectively excluded from the grantor's gross estate if the noncharitable beneficiary is the grantor's spouse.[86] However, it is possible that the value of a unitrust noncharitable beneficiary interest surviving the grantor, other than that of the grantor's spouse, might be included in the gross estate of the decedent/grantor.[87]

As indicated above, a situation where the grantor and/or the grantor's spouse are the only noncharitable beneficiaries of the unitrust can provide an important component in the overall effectiveness of the unitrust as an estate planning tool. In such a situation, assets can

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80. I.R.C. § 2511(a) (1982); Treas. Reg. § 25.2511-1 (as amended in 1986). In this situation there is, in effect, no transfer of an interest to someone other than the grantor.

81. I.R.C. § 2523(g) (1982).

82. *Id.* § 2511(a); Treas. Reg. § 25.2511-1 (as amended in 1986).

83. *See supra* notes 36-39 and accompanying text.

84. Treas. Reg. §§ 1.664-3(a)(4) (1972), 25.2511-2(c) (as amended in 1983). *But see infra* note 87 and accompanying text (discussion of estate tax implications of noncharitable beneficiary interests).

85. In actuality, there is both an inclusion and a deduction of interest in the decedent/grantor's estate, thus creating an effective exclusion from the estate. I.R.C. § 2036(a)(1) (1982) (entire value of trust assets is included in decedent/grantor's estate if decedent/grantor retained life interest as noncharitable beneficiary); Rev. Rul. 76-273, 1976-2 C.B. 268 (charitable remainder interest with payout rate above certain percentage included in estate); *see also* I.R.C. § 2055(e)(2)(A) (1982); Treas. Reg. § 20.2055-2(e)(2)(iv) (as amended in 1986) (fair market value of charitable remainder interest deducted from estate).

86. I.R.C. § 2056(b)(8) (1982).

87. *Id.* § 2037. This is the situation in which there was no transfer subject to gift tax upon the contribution of the property to the unitrust because the grantor retained the power, exercisable by will, to revoke a noncharitable beneficiary. *See supra* note 84 and accompanying text.

be transferred to the unitrust without gift tax implications[88] and without estate tax consequences at the death of the grantor.[89]

3. Economic Ramifications

In addition to the income, estate, and gift tax consequences discussed above, the unitrust has various important economic ramifications. The first such ramification concerns the unitrust distributions to the noncharitable beneficiary or beneficiaries. As stated, the distributions received by such beneficiaries are based on a fixed percentage of the fair market value of the trust assets valued annually.[90] The distributions from the unitrust may differ in amount from those which the grantor realized from the assets prior to their transfer to the unitrust. For example, suppose the grantor transfers $100,000 in cash, which was yielding 10% annually, to a unitrust which continues to earn the same 10% annual return. Suppose too, that the grantor chooses a 7% annual rate of distribution from the unitrust. In this situation, the noncharitable beneficiary would receive, in year one, 7% of $100,000 or $7,000 compared to the full 10% or $10,000 that would have been received had the property been retained by the grantor.

The opposite situation may arise, however, where assets in the hands of the grantor, such as raw land or shares of stock paying minimal dividends, generate little or no current return. Such assets contributed to a unitrust can be sold by the unitrust without incurring income tax on any gain[91] and the unitrust could then reinvest the sale proceeds in investment vehicles producing a higher return which would then be available to the grantor for distribution.

The annual distribution from the unitrust to the noncharitable beneficiary is governed by the fixed distribution or payout percentage as selected by the grantor.[92] The amount paid each year from the trust to the noncharitable beneficiary is generally determined by the fixed payout percentage without regard to the actual income earned by the unitrust during the year.[93]

88. *See supra* note 81 and accompanying text.
89. *See supra* note 86 and accompanying text.
90. *See supra* note 22 and accompanying text.
91. *See supra* note 47 and accompanying text.
92. *See supra* note 22 and accompanying text.
93. *See supra* notes 22-23 and accompanying text. If net income type unitrust is selected, annual payout to noncharitable beneficiaries may be limited to the lesser of the stated percentage or the trust's actual income. I.R.C. § 664(d)(3)(A) (1982); Treas. Reg. § 1.664-3(a)(1)(i), (b)(1) (1972).

Since the payout percentage will remain fixed throughout the life of the unitrust,[94] the grantor must balance various economic factors in selecting the payout percentage. Such factors include the financial needs or desires of the noncharitable beneficiaries, importance and usefulness of income tax deductions arising from the charitable contributions,[95] and the amount of desired contribution to charity.

The grantor must also decide who the noncharitable beneficiaries of the unitrust should be. Due consideration should be taken in naming these beneficiaries since the unitrust cannot subsequently be amended to add or delete any noncharitable beneficiary.[96] Furthermore, the grantor must determine the length of time over which the noncharitable beneficiaries will receive payments from the unitrust, according to the financial needs and desires of beneficiaries, tax implications, and the timing and amount of the ultimate gift to charity. The life of the unitrust can be equal to the life of any named noncharitable beneficiary or, alternatively, a set period not exceeding twenty years.[97]

The other major economic consequence of the unitrust once again illustrates the obvious: eventually, the corpus of the trust does go to charity and is, therefore, not available for the grantor or the grantor's heirs.[98] This is an important factor in determining the financial needs and desires of the grantor and/or the grantor's heirs.[99]

### B. *The Irrevocable Life Insurance Trust*

Moving from the charitable remainder trust, this next section focuses on another estate planning device, the irrevocable life insurance trust. When combined with a unitrust, the irrevocable life insurance trust becomes an integral component of an estate plan that is consistent with the general premise of this comment: namely, that it may pay to give it away. Life insurance itself has played an important role in numerous aspects of estate planning and has been widely written about.[100] The traditional role of life insurance in estate planning has been "to provide for the welfare of the insured's family

94. *See supra* note 22 and accompanying text.

95. *See supra* notes 40-45 and accompanying text (amount of potential charitable deduction varies inversely with the payout rate selected); *see also supra* note 39 for an example of deductions resulting from various payout percentages.

96. Treas. Reg. § 1.664-3(a)(4) (1972). "The trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than . . . [a charitable] organization." *Id.*

97. *See supra* note 33 and accompanying text.

98. *See supra* note 14 and accompanying text.

99. The premise of this comment, however, is that the interplay of unitrust attributes can sometimes create opportunities to compensate for the loss of trust corpus to charity.

100. Mohan, *Life Insurance in Estate Planning—Taxation and Uses Today*, 35 DRAKE L. REV. 773, 775-76, 800-01 (1986-1987).

should they be[come] deprived of the insured's earning power by an early death."[101] Another use of life insurance which is particularly germane to this article, is to replace assets that have been given away or otherwise disposed of instead of being devised to heirs.[102] What follows is a brief examination of the major estate and gift tax implications of both life insurance and an irrevocable life insurance trust.

One aspect of life insurance that is so attractive in the estate planning arena is that a beneficiary of a life insurance policy is generally not subject to income tax on proceeds received from the policy which are paid by reason of the death of the insured.[103] On the other hand, a less attractive aspect of life insurance is the question of whether life insurance proceeds are includable in the estate of the decedent/insured and thus subject to potential estate tax liability. As a general rule, the full proceeds from a life insurance policy are included in the gross estate of the decedent/insured, regardless of who the policy beneficiaries are, as long as the decedent/insured was the owner of the policy.[104] One of the main goals of the estate planner, therefore, is to remove the incidents of policy ownership from the insured. The irrevocable life insurance trust is a vehicle that attempts to achieve this and thereby exclude the policy's proceeds from the decedent/insured's estate.[105]

Typically, the irrevocable life insurance trust is established by an individual for the purpose of holding the ownership rights to an insurance policy on his life.[106] The premiums on the policy, held by the trust, are usually paid by the grantor.[107] On the death of the insured, the policy proceeds are paid to the trust and then distributed to the named beneficiaries.[108] The proceeds are not included in the insured's gross estate because someone other than the insured,

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101. Blase, *New Life Insurance Approaches and Products Respond to Recent Legislation, IRS Rulings*, 1985 EST. PLAN. 322.

102. Newman, *Financial Planning Techniques Using Charitable Gifts*, 38 U. S. CAL. TAX INST. ¶ 900, ¶ 901.14, at 9-14 (1986).

103. I.R.C. § 101(a)(1) (1982); Treas. Reg. § 1.101-1(a)(1) (as amended in 1982).

104. I.R.C. § 2042 (1982); Treas. Reg. § 20.2042-1 (as amended in 1979).

105. Lawrence, *supra* note 5, § 55.03[3][a], at 55-52; Manterfield, *supra* note 5, at 452-58; Mohan, *supra* note 100, at 804-05. Other methods are used to remove ownership from an insured including direct ownership by spousal or children beneficiaries. *But see* H. WEINSTOCK, *supra* note 2, § 10.45. Some disadvantages of direct ownership of life insurance policies by children include potential immaturity of children who may misuse rights of ownership, and difficulties with minor children as owners under the Uniform Gifts to Minors Act. *Id.*

106. Lawrence, *supra* note 5, § 55.03[3][b], at 55-53.

107. *Id.* (paid either directly or indirectly).

108. *See generally* Lawrence, *supra* note 5.

namely the irrevocable life insurance trust, is the owner of the policy.[109] In effect, the irrevocable life insurance trust can facilitate the transfer of a substantial asset (life insurance proceeds) to an heir without being subject to estate tax. Probably the most serious obstacle to this arrangement occurs when the insured dies within three years after transferring the life insurance policy to the irrevocable life insurance trust. The insurance proceeds, in such situations, are generally included in the estate of the insured/decedent.[110]

Another important component in the analysis of the irrevocable life insurance trust is the potential application of gift taxes. The transfer of an existing insurance policy to an irrevocable life insurance trust is generally treated as a transfer subject to potential gift tax liability.[111] Similarly, payments of policy premiums by the grantor on a policy either held or purchased by an irrevocable life insurance trust are generally considered taxable transfers.[112] Although gifts of policies and/or premium payments are considered gifts to the trust beneficiaries, as opposed to the trustee,[113] they are generally not considered gifts of present interests qualifying for the annual exclusion from taxable gifts of $10,000 per donee per year.[114] However, gifts of monies to the trust for premium payments may qualify for the annual exclusion if the policy/trust beneficiary is allowed to make certain withdrawals from the trust.[115] Absent the availability of the annual exclusion, no gift tax would actually be payable on transfers of policies or premium monies unless the grantor's unified

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109. Crosley v. Commissioner, 47 T.C. 310 (1966), *acq.*, 1967-2 C.B. 2.

110. I.R.C. §§ 2035(a), (b)(2), (d)(2), 2042 (1982). This applies whether an existing policy is transferred to an irrevocable life insurance trust within three years of death or the insurance was purchased by the trust immediately after the trust was established. Detroit Bank and Trust Co. v. United States, 467 F.2d 964, 965-66 (6th Cir. 1972) (insurance proceeds included in estate of grantor/insured where death was within three years of purchase of policy by trust). *See* Lawrence, *supra* note 5, § 55.03[3][g], at 55-57; Manterfield, *supra* note 5, at 455; *see also* First Nat'l. Bank of Oregon v. United States, 488 F.2d 575 (9th Cir. 1973) (life insurance proceeds included in insured's estate when insured died within three years of purchase of policy by trust to which insured had made gifts of premiums); Estate of Clay v. Commissioner, 86 T.C. 1266 (1986); *cf.* Estate of Kurihara v. Commissioner, 82 T.C. 51 (1984) (court deemed trustee as agent of insured, thereby including proceeds in estate, when insurance was the trust's sole asset and insured gifted money for trustee to pay premiums). *But see* Hope v. United States, 691 F.2d 786 (5th Cir. 1982) (insurance proceeds not included when insured/grantor died within three years of trust purchasing policy as long as trustee purchased on his own initiative and was not acting as insured's agent in purchasing the policies).

111. Treas. Reg. § 25.2511-1(a) (as amended in 1986).

112. Priv. Ltr. Rul. 80-06-109 (1980).

113. Helvering v. Hutchings, 312 U.S. 393, 396 (1941).

114. Ryerson v. United States, 312 U.S. 405, 408-09 (1941); I.R.C. § 2503(b) (1982); Treas. Reg. § 25.2503-3(c) (Example (2)) (as amended in 1984).

115. Crummey v. Commissioner, 397 F.2d 82, 88 (9th Cir. 1968); *see also* Manterfield, *supra* note 5, at 456.

credit had been fully exhausted.[116]

## III. Why it May Pay to Give it Away: The Interplay of Attributes

As indicated above, numerous attributes are associated with the use of a unitrust and an irrevocable life insurance trust. These attributes not only have ramifications in the areas of income, estate, and gift taxation, but also affect certain economic factors. Viewed in a vacuum, some of these attributes may prove beneficial in an estate planning environment while others may not. One may naturally question the viability of the unitrust with its numerous complexities as an effective estate planning device, especially in situations where an individual does not wish to benefit charity at the expense of family or manifests no philanthropic inclinations. For such individuals, the key to the continued viability of the unitrust as an estate planning tool is in understanding the interplay of attributes, the give and take of benefits, which can sometimes produce an overall net benefit to the individual and the individual's heirs.

This section focuses on the interplay of the attributes flowing from the use of a unitrust and an irrevocable life insurance trust. The first part of this section analyzes this interplay in a conceptual framework. The second part of this section analyzes the interplay using a comprehensive case illustration and makes comparisons to alternatives not utilizing a unitrust or irrevocable life insurance trust.

### A. *Conceptual Analysis of Interplay*

The underlying motive, assumed throughout this analysis, is the individual's desire to provide the greatest possible wealth to the individual and the individual's heirs.

The establishment of the unitrust and transfer of assets thereto is probably the first stage which needs to be examined. The transfer of assets to the unitrust is generally not a transfer subject to gift taxes as long as the grantor and/or the grantor's spouse are the only noncharitable beneficiaries of the unitrust.[117] A positive economic benefit to the grantor arising from the transfer is the potential creation of wealth derived from income tax savings.[118] This benefit is immedi-

116. I.R.C. § 2505 (1982). The lifetime unified credit equals $192,800 for gifts made in years after 1986. *Id.*

117. *See supra* notes 80-81 and accompanying text.

118. *See supra* notes 40-42 and accompanying text. The degree of tax savings real-

ately available, even though the actual gift of the unitrust's remainder to charity, from which the tax benefit is derived, may not take place until some years later. As noted, the deduction is based on the full fair market value of the property's charitable remainder interest.[119] The transfer of assets to the unitrust, however, also signals the eventual economic loss, to the grantor and/or the grantor's heirs, of the assets transferred in favor of disposition to charity.

After the unitrust has been established, the noncharitable beneficiary distribution phase begins. Just as tax savings derived from the contribution of assets to the unitrust could be viewed as at least partially offsetting the eventual economic loss in transferring the assets to charity, the unitrust's annual distributions to noncharitable beneficiaries could be viewed in the same manner. The annual distributions from the unitrust, although potentially subject to income tax in the hands of the beneficiary,[120] might be higher than the annual return available from the assets in the hands of the grantor prior to contribution to the unitrust.[121] This is most apparent when highly appreciated but low-yielding assets are contributed to the unitrust. Unlike the individual grantor, the unitrust can generally sell such assets free of tax[122] and reinvest the full sale proceeds into assets producing a higher current return. This higher return can then be distributed to the unitrust's noncharitable beneficiaries via the required annual distributions.[123] Additionally, since the unitrust generally pays no income tax,[124] amounts earned by the unitrust in excess of the required annual distributions effectively benefit from tax-free compounding, thereby increasing the unitrust's asset value. In turn, this increases distributions to noncharitable beneficiaries in subsequent years.

As indicated, the economic benefits of tax savings plus increased yearly cash flow at least partially offsets the eventual loss of underlying assets to charity. Indeed, the case has been made that the interplay of these factors alone can produce an overall net benefit to certain individuals, namely those without the need and/or desire to

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ized by the grantor depends on numerous factors including (1) the selected unitrust payout rate, *see supra* note 37 and accompanying text; (2) the actuarial lives of the noncharitable beneficiaries or the term of years of the unitrust, *see supra* note 37 and accompanying text; (3) the grantor's income tax bracket; (4) application of the alternative minimum tax, *see supra* notes 66-73 and accompanying text; and (5) charitable deduction limitations, *see supra* notes 43-45 and accompanying text.

119. *See supra* note 41 and accompanying text.

120. *See supra* notes 53-57 and accompanying text.

121. *See supra* note 47 and accompanying text.

122. *See supra* notes 46-47 and accompanying text.

123. *See supra* note 22 and accompanying text.

124. *See supra* note 46 and accompanying text.

furnish support to children.[125] However, for those individuals concerned about providing for heirs and/or those individuals with little or no charitable inclination, the eventual loss of assets to charity will once again loom in the forefront. This is where the final component, the irrevocable life insurance trust, becomes germane.

The irrevocable life insurance trust can be used as a device to replace assets that have been given away or otherwise disposed of.[126] In certain circumstances, the proceeds from the life insurance can be paid to beneficiaries undiluted by any estate tax.[127] In the context of an estate plan utilizing a unitrust, the life insurance can serve to replace those assets originally contributed to the unitrust that will eventually go to charity. The impact is even more dramatic when one considers that assets retained by an individual, who may be reluctant to contribute them to a unitrust, would generally be included in the individual's gross estate at death[128] and thus subject to possible dilution by estate taxes.[129]

Since life insurance is not free, how the premiums can be paid without further draining an individual's assets becomes a key question. The answer lies in connecting the aforementioned attributes arising from the unitrust. Tax savings resulting from the charitable deduction,[130] combined with a potential increase in cash flow from the unitrust distributions,[131] can be used to pay premiums on the policy held by the irrevocable life insurance trust.

To complete the picture, the payment of premiums by the irrevocable life insurance trust grantor may not trigger gift tax depending on the premium amount, any powers to withdraw by trust beneficiaries, and the amount of any unused gift/estate tax unified credit.[132]

The combined effect of the interplay of these ramifications is a potentially higher level of income to the unitrust beneficiaries during their lifetime (or for the life of the unitrust) a comparable amount of wealth passing to heirs as a result of the life insurance (paid for by

125. Newman, *supra* note 102, ¶ 901.13, at 9-12 to 9-14 (note, however, cited article illustrations prepared using pre-Tax Reform Act of 1986 tax rates).

126. *See supra* note 102 and accompanying text.

127. *See supra* note 109 and accompanying text.

128. I.R.C. § 2033 (1982). "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." *Id.*

129. *Id.* § 2001 (applies tax on taxable estate). The taxable estate is composed of the gross estate less certain deductions. *Id.* § 2051.

130. *See supra* notes 40-45 and accompanying text.

131. *See supra* note 47 and accompanying text.

132. *See supra* notes 111-116 and accompanying text.

tax savings and unitrust distributions) and, lest it be forgotten, an unexpected gift to charity.

*B. Comprehensive Case Illustration and Alternative Comparisons*

The following hypothetical case illustrates the interplay of the various attributes associated with the use of a unitrust and an irrevocable life insurance trust, and makes a comparison with other estate planning alternatives not utilizing charitable giving. This illustration is not intended to encompass all potential aspects or methods of estate planning but, rather, is intended to identify the more salient aspects of utilizing a unitrust and irrevocable life insurance trust as part of an estate plan.

1. Hypothetical Case Background and Assumptions

Husband (H) and wife (W), ages 62 and 61 respectively, have recently retired from their respective jobs. They are both in good health and plan to lead active retirement lives. They anticipate yearly income, all 100% taxable, in the following amounts:

| | Amount Per Year |
|---|---|
| Wife pension (for life) | $ 70,000 |
| Husband pension (for life + 2 years) | 40,000 |
| Interest income | 25,500 |
| Rental income from raw land (see below) | 20,000 |
| Total yearly income | $155,500 |

H and W have indicated that although this level of yearly income is adequate for their living needs, they desire additional income if possible. However, they both feel strongly that they do not want to dilute or deplete any of their assets in order to have more spendable cash. Their current net worth is composed of the following assets, which are not subject to any liabilities:

| Description of Asset | Cost Basis | Current Fair Market Value |
|---|---|---|
| Residence | $115,000 | $ 285,000 |
| Raw land | 250,000 | 1,000,000 |
| Savings accounts | 340,000 | 340,000 |
| Other assets | 500,000 | 500,000 |
| Total assets | | $2,125,000 |

All assets are assumed to be owned equally by both H and W except for the raw land which is H's separate property. They do not want to dilute these assets because they have a strong desire to leave as much of their wealth as possible to their three adult children. Neither H nor W has previously made any taxable gifts.

The largest single asset, the raw land, currently earns 2% or $20,000 per year (see above) from lease revenues. The property has been appreciating at the rate of approximately 2% per year and they expect future appreciation to continue at that rate. H has received numerous offers from developers to purchase the property but he has not yet decided whether to sell the property.

H and W's residence, which they definitely want to retain, has been appreciating at the rate of approximately 4% per year which they anticipate will continue. Their "other assets" are composed of various items which H and W do not expect to appreciate in value.

According to their current estate plans, the couple intends that the first spouse to die will make a testamentary bequest of their property interest to the surviving spouse. They have also provided for the establishment of a trust, to become effective on the death of the first spouse, into which sufficient assets will be transferred to fully utilize the decedent spouse's available unified estate tax credit.[133] The trust will then provide income to the surviving spouse for life with the remainder to H and W's children.

Further, W has expressed a desire to benefit her college alma mater in some way but is not sure whether they can afford to make a significant contribution. H is opposed to any charitable gifts if it means depletion of any wealth available to their children.

H and W's income tax picture, in addition to income amounts specified above, assumes $15,000 per year in itemized deductions which do not include charitable contributions.[134] It is assumed, for purposes of this illustration, that there are no state or local income, estate, or gift taxes.

2. Case Analysis

The three potential scenarios illustrated are as follows:

Scenario I. H and W hold on to all their assets until their deaths, at which time the assets pass to their children by will.

Scenario II. The raw land is currently sold for $1,000,000, the net after-tax proceeds from which are reinvested in savings accounts, yielding a 7.5% annual return. At the death of H and W, all assets pass to their children by will.

Scenario III. H currently contributes the raw land to a charitable remainder unitrust. H selects a 6% annual trust distribution rate payable to him for the remainder of his life and then to W, if still living, for her life. The unitrust subsequently sells the property for

133. H. WEINSTOCK, *supra* note 2, §§ 5.1, 5.2.

134. It is assumed for purposes of this case illustration that the deductions also qualify as alternative minimum tax itemized deductions. *See* I.R.C. § 56(b)(1) (West Supp. 1987).

$1,000,000 and reinvests the proceeds[135] in savings accounts earning an annual 7.5% return. H and W also establish an irrevocable life insurance trust which purchases a joint survivorship type life insurance policy with a face value of $1,000,000 insuring the joint lives of H and W.[136] H and W will make annual gifts, for nine years, to the irrevocable life insurance trust to satisfy policy premium requirements.[137] The life insurance proceeds, which are payable at the death of the last surviving spouse,[138] are to be paid by the irrevocable life insurance trust to H and W's children. The balance of H and W's assets pass to their children by will.

For purposes of these illustrations, it is assumed that H and W live for another eight and ten years, respectively.

### a. *Lifetime Benefits to H and W*

The following is a year-by-year comparison analysis, until W's death, of the projected spendable cash available to H and W under the three alternative scenarios.

| | Scenario I | Scenario II | Scenario III |
|---|---|---|---|
| Year 1:[139] | | | |
| Pension income (W) | $ 70,000 | $ 70,000 | $ 70,000 |
| Pension income (H) | 40,000 | 40,000 | 40,000 |
| Rental income (land) | 20,000 | 0[140] | 0[141] |
| Interest income | 25,500 | 84,750[142] | 25,500 |

135. The full $1,000,000 is considered reinvested since the unitrust is not subject to any tax on the gain from the sale. *See supra* notes 46-47 and accompanying text. It is assumed, for purposes of this illustration, that the sale was not arranged prior to the contribution of the land to the unitrust. *See supra* note 51 and accompanying text.

136. Mohan, *supra* note 100, at 781. " 'Survivorship whole life' is a joint policy that insures two lives, however, the insurance proceeds are only paid out upon the second death." *Id. See* Blase, *supra* note 101, at 322-23; Meltzer, *Implications of Survivorship Whole Life in Estate Planning*, TR. & EST., Aug. 1984, at 48.

137. This abbreviated premium payment type policy is referred to as a "vanishing premium" policy. Mohan, *supra* note 100, at 781. These types of "policies involve the reinvestment of [policy] dividends so that eventually the owner will no longer need to make premium payments." *Id.* The premiums for purposes of this case illustration are $22,630 for eight years, $21,425 in year nine and no payments thereafter. Insurance figures are from Crown Life Insurance Company, Nov. 5, 1987, courtesy of Shipley/Hoffman Associates, 1305 Del Norte Rd., Camarillo, Cal. (insurance quote on file with author). It is assumed, for purposes of this case illustration, that the irrevocable life insurance trust has certain beneficiary withdrawal provisions enabling the gifts of the premiums by H and W to qualify as gifts of current interests, thereby allowing annual exclusions from gift taxes. *See supra* notes 114-115 and accompanying text.

138. *See supra* note 136.

139. For purposes of this case illustration, year one is assumed to be 1988.

140. No rental income since land was sold under this scenario.

141. No rental income since land was sold under this scenario.

142. Interest income is calculated by applying 7.5% rate on H and W's total savings. The total savings are a combination of their $340,000 prior to the sale of the land and the net after-tax proceeds from the sale of the land. The net after-tax proceeds from the sale of the land is computed as follows:

| | | | |
|---|---|---|---|
| Unitrust distributions | 0 | 0 | 60,000[143] |

| | | |
|---|---|---|
| Gross sales price | | $1,000,000 |
| Less taxes: | | |
| Sales price | $1,000,000 | |
| Less: basis | 250,000 | |
| Taxable gain | $ 750,000 | |
| Tax at 28% | | −210,000 |
| Net after tax proceeds from sale | | $ 790,000 |

The total cash in savings of $1,130,000 ($790,000 + $340,000) would earn $84,750 at 7.5%. *See infra* note 145 for reflection of income tax in year one from gain on sale of land.

143. Each year the unitrust pays out 6% of the trust assets, as valued annually, to the noncharitable beneficiary. The unitrust earns 7.5% annually on the trust's assets. The trust assets consist of the $1,000,000 proceeds from the sale of the contributed land. The following schedule shows the yearly earnings of the unitrust, the annual payout to the noncharitable beneficiary, and the end of year unitrust asset value for years one through ten.

| Year | Beginning Value | Earnings At 7.5% | Payout At 6% | Ending Value |
|---|---|---|---|---|
| 1 | $1,000,000 | $75,000 | $60,000 | $1,015,000 |
| 2 | $1,015,000 | $76,125 | $60,900 | $1,030,225 |
| 3 | $1,030,225 | $77,267 | $61,814 | $1,045,678 |
| 4 | $1,045,678 | $78,426 | $62,741 | $1,061,364 |
| 5 | $1,061,364 | $79,602 | $63,682 | $1,077,284 |
| 6 | $1,077,284 | $80,796 | $64,637 | $1,093,443 |
| 7 | $1,093,443 | $82,008 | $65,607 | $1,109,845 |
| 8 | $1,109,845 | $83,238 | $66,591 | $1,126,493 |
| 9 | $1,126,493 | $84,487 | $67,590 | $1,143,390 |
| 10 | $1,143,390 | $85,754 | $68,603 | $1,160,541 |

Unitrust distributions (payout) in this case illustration would all be considered ordinary income in the hands of the noncharitable beneficiary since the distributions are paid in full from unitrust earnings which are ordinary income. *See supra* text accompanying notes 52-57.

| | | | |
|---|---|---|---|
| Less: income taxes | −37,616[144] | −50,330[145] | −31,461[146] |

144. The regular individual income tax is calculated based on taxable income. I.R.C. § 1 (West Supp. 1987). Taxable income is generally "gross income" less certain deductions. *Id.* § 63(a). Gross income "means all income from whatever source derived, including (but not limited to) the following items: . . . [i]nterest . . . [r]ents . . . [p]ensions . . . ." *Id.* § 61(a) (1982). Itemized deductions are allowed as deductions in computing taxable income. *Id.* § 161. "Personal exemptions" are also allowed as a deduction in computing taxable income. *Id.* § 151(a). The amount of the personal exemption is $1,950 per person in 1988 and $2,000 thereafter, indexed for inflation. *Id.* § 151(d) (West Supp. 1987). Note, for purposes of this case illustration, it is assumed that there is no indexing for inflation.

For year one, the income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Rental income | 20,000 | |
| Interest | 25,500 | $155,500 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (2 × 1,950) | | − 3,900 |
| Taxable income | | $136,600 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 37,616 |

145. *See supra* note 144 for tax computation procedures.

For year one, the income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest (*supra* note 142) | 84,750 | $194,750 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (2 × 1,950) | | − 3,900 |
| Taxable income | | $175,850 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 50,330 |

Note that the computed income tax does not reflect the gain from the sale of the land. Such gain is subject to tax and has been reflected in computing the "net" proceeds from the sale of land for purposes of computing yearly interest income so as to avoid distorting year one's net cash flow. *See supra* note 142.

146. *See supra* note 144 for tax computation procedures.

For year one, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 60,000 | $195,500 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | −58,650 |
| Personal exemptions (2 × 1,950) | | − 3,900 |
| Taxable income | | $117,950 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 31,461 |

The total potential charitable contribution deduction is based on a combination of the unitrust payout rate and the life expectancies of H and W. *See supra* notes 36, 37 and accompanying text. The charitable contribution factor for a unitrust with a 6% payout over H's and W's life is 27.779%. I.R.S. Pub. 723C (Sept. 1984). The total potential charitable deduction equals 27.779% of the contributed property's fair market value of $1,000,000 or $277,790. *See supra* notes 40-42 and accompanying text. The $58,650 above reflects the charitable contribution deduction allowable in year one as limited by 30% of the adjusted gross income of $195,500. I.R.C. § 170(b)(1)(C)(i) (Supp. III 1985) (capital gain property contributed by I.R.C. § 170(b)(1)(A) qualified charitable

| | | | |
|---|---|---|---|
| Less: life insur. prem. | 0 | 0 | −22,630[147] |
| Year 1 net cash flow | $ 117,884 | $ 144,420 | $ 141,409 |

organization). The amount of unused charitable deduction carried over to succeeding taxable years, pursuant to I.R.C. § 170(d)(1)(A) (1982), is as follows:

| | |
|---|---|
| Total potential deduction | $277,790 |
| Less: amount utilized yr. 1 | −58,650 |
| Amount available in yr. 2 | $219,140 |

Since charitable deductions of appreciated property can produce tax preference items, see *supra* note 66 and accompanying text, the regular tax must be compared with the alternative minimum tax to determine actual income tax liability. *See supra* note 69 and accompanying text. Total potential tax preference associated with the total potential charitable deduction equals $208,342 ($750,000 appreciation component of land multiplied by the charitable contribution factor of 27.779%). *See supra* notes 72-73 and accompanying text. The relevant basis of the contributed property, for purposes of determining the timing of tax preference recognition, *see supra* note 76 and accompanying text, equals $69,448 ($250,000 basis of property multiplied by the charitable contribution factor of 27.779%). Since the tax preference arising from contributions of appreciated property is recognized only as the charitable deduction is allowed, *see supra* note 75 and accompanying text, and no preference is recognized until the charitable deduction allowed exceeds the property's relevant basis, *see supra* note 76 and accompanying text, no preference would be recognized in year one since the deduction allowed ($58,650) does not exceed the property's relevant basis ($69,448). The alternative minimum tax is, therefore, not applicable in year one, and the regularly computed tax would apply.

147. Insurance premiums are $22,630 for year one through year eight and $21,425 for year nine. *See supra* note 137 and accompanying text.

| | | | |
|---|---|---|---|
| Year 2 net cash flow | $ 117,917[148] | $ 144,420[149] | $ 142,134[150] |

148. Net cash flow is computed in the same manner as computed for year one (total income less income taxes). Total income under this scenario remains at $155,500 for year one through year ten.

For this year, the income tax is computed as follows (*see supra* note 144 for tax computation procedure):

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Rental income | 20,000 | |
| Interest | 25,500 | $155,500 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $136,500 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 37,583 |

Net cash flow equals total income of $155,500 less taxes of $37,583, or $117,917.

149. Net cash flow is computed in the same manner as computed for year one (total income less income taxes). Total income under this scenario remains at $194,750 for year one through year ten.

For this year, the income tax is computed as follows (*see supra* note 144 for tax computation procedure):

| | | |
|---|---|---|
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest (*supra* note 142) | 84,750 | $194,750 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $175,750 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 50,330 |

Net cash flow equals total income of $194,750 less taxes of $50,330, or $144,420.

150. *See supra* note 144 for tax computation procedures.

For year two, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 60,900 | $196,400 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | −58,920 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $118,480 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 31,636 |

The $58,920 charitable contribution deduction allowable in year two is the remaining carryover contribution of $219,140, *see supra* note 146, limited by 30% of the adjusted gross income of $195,500. I.R.C. § 170(b)(1)(C)(ii) (Supp. III 1985) (capital gain property subject to 30% limitation carries over that same limitation in subsequent years). The amount of unused charitable deduction carried over to succeeding taxable years, pursuant to I.R.C. § 170(d)(1)(A) (1982), is as follows:

| | |
|---|---|
| Carryover from prior year (*see supra* note 146) | $ 219,140 |
| Less: amount utilized yr. 2 | −58,920 |
| Amount available in yr. 3 | $ 160,220 |

The amount of tax preference recognized in year two equals $48,122 (total deduction of $58,920 less unrecovered relevant basis of $10,798). *See supra* note 146. The tentative alternative minimum tax, computed pursuant to I.R.C. § 55 (West Supp. 1987), equals $28,509. *See supra* note 68 and accompanying text. Since the tentative alterna-

| | | | |
|---|---|---|---|
| Year 3 net cash flow | $ 117,917[151] | $ 144,420[152] | $ 142,837[153] |
| Year 4 net cash flow | $ 117,917[154] | $ 144,420[155] | $ 143,550[156] |

tive minimum tax is less than the regularly computed tax, the regularly computed tax would apply. *See supra* note 69 and accompanying text.

Net cash flow equals total income of $196,400 less taxes of $31,636, less insurance of $22,630, *see supra* note 147, or $142,134.

151. *See supra* note 148. All calculations are identical.

152. *See supra* note 149. All calculations are identical.

153. *See supra* note 144 for tax computation procedures.

For year three, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 61,814 | $197,314 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | −59,194 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $119,120 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 31,847 |

The $59,194 charitable contribution deduction allowable in year three is the remaining carryover contribution of $160,220, *see supra* note 150, limited by 30% of the adjusted gross income of $197,314. I.R.C. § 170(b)(1)(C)(ii) (Supp. III 1985) (capital gain property subject to 30% limitation carries over that same limitation in subsequent years). The amount of unused charitable deduction carried over to succeeding taxable years, pursuant to I.R.C. § 170(d)(1)(A), is as follows:

| | |
|---|---|
| Carryover from prior year (*see supra* note 150) | $ 160,220 |
| Less: amount utilized yr. 3 | −59,194 |
| Amount available in yr. 4 | $ 101,026 |

The amount of tax preference recognized in year three equals $59,194. *See supra* note 146. The tentative alternative minimum tax, computed pursuant to I.R.C. § 55 (West Supp. 1987), equals $31,582. *See supra* note 68 and accompanying text. Since the tentative alternative minimum tax is less than the regularly computed tax, the regularly computed tax would apply. *See supra* note 69 and accompanying text.

Net cash flow equals total income of $197,314 less taxes of $31,847, less insurance of $22,630, *see supra* note 137, or $142,837.

154. *See supra* note 148. All calculations are identical.

155. *See supra* note 149. All calculations are identical.

156. *See supra* note 144 for tax computation procedures.

For year four, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 62,741 | $198,241 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | −59,472 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $119,769 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 32,061 |

| | | | |
|---|---|---|---|
| Year 5 net cash flow | $ 117,917[157] | $ 144,420[158] | $ 138,267[159] |
| Year 6 net cash flow | $ 117,917[160] | $ 144,420[161] | $ 125,669[162] |

---

The $59,472 charitable contribution deduction allowable in year four is the remaining carryover contribution of $101,026, *see supra* note 153, limited by 30% of the adjusted gross income of $198,241. I.R.C. § 170(b)(1)(C)(ii) (Supp. III 1985) (capital gain property subject to 30% limitation carries over that same limitation in subsequent years). The amount of unused charitable deduction carried over to succeeding taxable years, pursuant to I.R.C. § 170(d)(1)(A), is as follows:

| | |
|---|---|
| Carryover from prior year (*see supra* note 153) | $101,026 |
| Less: amount utilized yr. 4 | −59,472 |
| Amount available in yr. 5 | $ 41,554 |

The amount of tax preference recognized in year four equals $59,472. *See supra* note 146. The tentative alternative minimum tax, computed pursuant to I.R.C. § 55 (West Supp. 1987), equals $31,826. *See supra* note 68 and accompanying text. Since the tentative alternative minimum tax is less than the regularly computed tax, the regularly computed tax would apply. *See supra* note 69 and accompanying text.

Net cash flow equals total income of $198,241 less taxes of $32,061, less insurance of $22,630, *see supra* note 137, or $143,550.

157. *See supra* note 148. All calculations are identical.

158. *See supra* note 149. All calculations are identical.

159. *See supra* note 144 for tax computation procedures.

For year five, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 63,682 | $199,182 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | −41,554 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $138,628 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 38,285 |

The $41,554 charitable contribution deduction allowable in year five is the remaining carryover contribution of $101,026. *See supra* note 156. The remaining deduction is less than 30% of adjusted gross income so the limitation of I.R.C. § 170(b)(1)(C)(ii) is not applicable. There is no remaining unused charitable deduction available in subsequent years.

The amount of tax preference recognized in year five equals $41,554. *See supra* note 146. The tentative alternative minimum tax, computed pursuant to I.R.C. § 55 (West Supp. 1987), equals $32,073. *See supra* note 68 and accompanying text. Since the tentative alternative minimum tax is less than the regularly computed tax, the regularly computed tax would apply. *See supra* note 69 and accompanying text.

Net cash flow equals total income of $199,182 less taxes of $38,285 less insurance of $22,630, *see supra* note 137, or $138,267.

160. *See supra* note 148. All calculations are identical.

161. *See supra* note 149. All calculations are identical.

162. *See supra* note 144 for tax computation procedures.

For year six, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 64,637 | $200,137 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | − 0 |
| Personal exemptions (2 × 2,000) | | − 4,000 |

| | | | |
|---|---|---|---|
| Year 7 net cash flow | $ 117,917[163] | $ 144,420[164] | $ 126,367[165] |
| Year 8 net cash flow | $ 117,917[166] | $ 144,420[167] | $ 127,076[168] |

---

| | |
|---|---|
| Taxable income | $181,137 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | $ 51,838 |

There is no remaining charitable contribution deduction. *See supra* note 159. Similarly, the alternative minimum tax does not apply since there are no tax preferences. *See supra* note 146.

Net cash flow equals total income of $200,137 less taxes of $51,838 less insurance of $22,630, *see supra* note 137, or $125,669.

163. *See supra* note 148. All calculations are identical.

164. *See supra* note 149. All calculations are identical.

165. *See supra* note 144 for tax computation procedures.

For year seven, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 65,607 | $201,107 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | − 0 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $182,107 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 52,110 |

There is no remaining charitable contribution deduction. *See supra* note 159. Similarly, the alternative minimum tax does not apply since there are no tax preferences.

Net cash flow equals total income of $201,107 less taxes of $52,110 less insurance of $22,630, *see supra* note 137, or $126,367.

166. *See supra* note 148. All calculations are identical.

167. *See supra* note 149. All calculations are identical.

168. *See supra* note 144 for tax computation procedures.

For year eight, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 66,591 | $202,091 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | − 0 |
| Personal exemptions (2 × 2,000) | | − 4,000 |
| Taxable income | | $183,091 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 52,385 |

There is no remaining charitable contribution deduction. *See supra* note 159. Similarly, the alternative minimum tax does not apply since there are no tax preferences.

Net cash flow equals total income of $202,091 less taxes of $52,385 less insurance of $22,630, *see supra* note 137, or $127,076.

| | | | |
|---|---|---|---|
| Year 9 net cash flow | $ 116,160[169] | $ 144,420[170] | $ 129,000[171] |
| Year 10 net cash flow | $ 116,160[172] | $ 144,420[173] | $ 151,154[174] |
| Total net cash flow for years 1-10 | $1,175,623 | $1,444,200 | $1,367,463 |

The contribution of the raw land to the unitrust, scenario III, produces higher net cash flows in each year when compared with scena-

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169. Net cash flow is computed in the same manner as computed for all previous years (total income less income taxes). Total income under this scenario remains at $155,500 for year one through year ten.

For this year the income tax is computed as follows (*see supra* note 144 for tax computation procedure):

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Rental income | 20,000 | |
| Interest | 25,500 | $155,500 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (1 × 2,000) | | − 2,000 |
| Taxable income | | $138,500 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 39,340 |

Net cash flow equals total income of $155,500 less taxes of $39,340, or $116,160.

170. Net cash flow is computed in the same manner as computed for all previous years (total income less income taxes). Total income under this scenario remains at $194,750 for year one through year ten.

For this year, the income tax is computed as follows (*see supra* note 144 for tax computation procedure):

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest (*supra* note 142) | 84,750 | $194,750 |
| Less: deductions | | |
| Itemized | | −15,000 |
| Personal exemptions (1 × 2,000) | | − 2,000 |
| Taxable income | | $177,750 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 50,330 |

Net cash flow equals total income of $194,750 less taxes of $50,330, or $144,420.

171. *See supra* note 144 for tax computation procedures.

For year nine, the regular income tax is computed as follows:

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 67,590 | $203,090 |
| Less: deductions | | |
| Regular Itemized | | −15,000 |
| Charitable deduction (see below) | | − 0 |
| Personal exemptions (1 × 2,000) | | − 2,000 |
| Taxable income | | $186,090 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 52,665 |

There is no remaining charitable contribution deduction. *See supra* note 159. Similarly, the alternative minimum tax does not apply since there are no tax preferences.

Net cash flow equals total income of $203,090 less taxes of $52,665 less insurance of $21,425, *see supra* note 137, or $129,000.

172. *See supra* note 169. All calculations are identical.

173. *See supra* note 170. All calculations are identical.

174. *See supra* note 144 for tax computation procedures.

For year ten, the regular income tax is computed as follows:

rio I where H and W continue holding onto the property. H and W would realize an aggregate net cash flow benefit of $191,840 ($1,367,463 – $1,175,623) over ten years by contributing the property to the unitrust as opposed to retaining the property. The net cash flow in scenario III decreases in year six, although still higher than that in scenario I, as the tax benefits from the unitrust charitable contribution cease.[175] In scenario III, the dramatic increase in net cash flow after year nine reflects the cessation of insurance premiums.[176] Although scenario II, where the land is sold, produces the highest aggregate cash flow, it exceeds the unitrust scenario by only $76,737 ($1,444,200 – $1,367,463) for the entire ten year period.

### *b. Distribution to Heirs at Death of Surviving Spouse*

The following is a comparison analysis of projected net amounts of wealth available to H and W's children after W's death. The following analysis assumes H and W did not accumulate any net spendable cash flows in the ten years preceding W's death.

| | Scenario I | Scenario II | Scenario III |
|---|---|---|---|
| H and W's assets | | | |
| Residence | $ 421,870[177] | $ 421,870 | $ 421,870 |
| Raw land | 1,218,994[178] | 0[179] | 0 |

---

| | | |
|---|---|---|
| Gross income: | | |
| Pension (W) | $70,000 | |
| Pension (H) | 40,000 | |
| Interest | 25,500 | |
| Unitrust (*supra* note 143) | 68,603 | $204,103 |
| Less: deductions | | |
| Regular Itemized | | –15,000 |
| Charitable deduction (see below) | | – 0 |
| Personal exemptions (1 × 2,000) | | – 2,000 |
| Taxable income | | $187,103 |
| Tax pursuant to I.R.C. § 1 (West Supp. 1987) | | $ 52,949 |

There is no remaining charitable contribution deduction. *See supra* note 159. Similarly, the alternative minimum tax does not apply since there are no tax preferences.

Net cash flow equals total income of $204,103 less taxes of $52,949 less insurance of $0, *see supra* note 137, or $151,154.

175. *See supra* notes 146, 150, 153, 156, 159, 162 and accompanying text.

176. *See supra* note 137 and accompanying text.

177. Present value of residence in year one, $285,000, increased by 4% per year compounded for 10 years equals $421,870. The same computation applies to scenarios II and III.

178. Present value of raw land in year one, $1,000,000, increased by 2% per year compounded for 10 years equals $1,218,994.

179. In Scenarios, II and III the raw land was sold in year one.

| | | | |
|---|---|---|---|
| Savings accounts | 340,000[180] | 1,130,000[181] | 340,000 |
| Other assets | 500,000[182] | 500,000 | 500,000 |
| Total assets | $2,480,864 | $2,051,870 | $1,261,870 |
| Less: estate taxes | −534,389[183] | −342,304[184] | −22,892[185] |
| Plus: insur. proceeds | 0 | 0 | 1,114,839[186] |
| Total available to H and W's children | $1,946,475 | $1,709,566 | $2,353,817 |

H and W's desire to leave as much wealth as possible to their children is best met by utilizing the unitrust and irrevocable life insurance trust as in scenario III. That scenario produces in excess of

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180. Savings account balance, per case assumptions, in year one was $340,000. Since, for purposes of this case illustration, it was assumed that all annual interest earnings from the savings were spent and not saved, the savings account balance at the end of the 10 year period would remain at $340,000 in Scenarios I and III.

181. The savings account balance of $340,000 was increased, in this scenario, to $1,130,000 as a result of the after tax proceeds from the land sale. *See supra* note 142. Since, for purposes of this case illustration, it was assumed that all annual interest earnings from the savings were spent and not saved, the savings account balance at the end of the 10 year period would remain at $1,130,000.

182. For purposes of this case illustration, it was assumed that the "other assets" of $500,000 were to remain constant in value.

183. The estate tax is computed as follows:

| | |
|---|---|
| Taxable estate (I.R.C. § 2051 (1982)) (see below) | $1,880,864 |
| Tentative tax (I.R.C. § 2001 (1982)) | $ 727,189 |
| Less: unified credit (*supra* note 116) | − 192,800 |
| Estate Tax | $ 534,389 |

The "taxable estate" equals the "gross estate" less certain deductions. I.R.C. § 2051 (1982). For purposes of this illustration, it is assumed there are no estate tax deductions. The taxable estate above is computed by taking the total assets of $2,480,864 less the $600,000 which represents the amount of assets equivalent to the $192,800 unified credit which are not included in W's estate. *See supra* text accompanying note 133.

184. The estate tax is computed as follows:

| | |
|---|---|
| Taxable estate (I.R.C. § 2051 (1982)) (see below) | $1,451,870 |
| Tentative tax (I.R.C. § 2001 (1982)) | $ 535,104 |
| Less: unified credit (*supra* note 116) | − 192,800 |
| Estate tax | $ 342,304 |

The taxable estate above is computed by taking the total assets of $2,051,870 less the $600,000 which represents the amount of assets equivalent to the $192,800 unified credit which are not included in W's estate. *See supra* text accompanying note 133.

185. The estate tax is computed as follows:

| | |
|---|---|
| Taxable estate (I.R.C. § 2051 (1982)) (see below) | $ 661,870 |
| Tentative tax (I.R.C. § 2001 (1982)) | $ 215,692 |
| Less: unified credit (*supra* note 116) | − 192,800 |
| Estate tax | $ 22,892 |

The taxable estate above is computed by taking the total assets of $1,261,870 less the $600,000 which represents the amount of assets equivalent to the $192,800 unified credit which are not included in W's estate. *See supra* text accompanying note 133.

186. Insurance proceeds at the end of year 10 equal $1,114,839. Insurance figures are from Crown Life Insurance Company, Nov. 5, 1987, courtesy of Shipley/Hoffman Associates, 1305 Del Norte Rd., Camarillo, Cal. (insurance quote on file with author). The insurance proceeds are not included in the estate because the trust, rather than H and W, is the owner of the policy, *see supra* notes 104-105 and accompanying text, and the insured did not die within three years of the purchase of the policy by the trust. *See supra* note 110 and accompanying text.

$400,000 more wealth to the children than the next closest alternative.

*c. Summary of Benefits to all Parties*

| | Scenario I | Scenario II | Scenario III |
|---|---|---|---|
| Total net cash flow available to H and W during their lives | $1,175,623[187] | $1,444,200 | $1,367,463 |
| Total available to children after both H and W have died | 1,946,475[188] | 1,709,566 | 2,353,817 |
| Total benefits to H, W and children | $3,122,098 | $3,153,766 | $3,721,280 |
| To W's alma mater | 0 | 0 | 1,160,541[189] |
| Total benefits to all parties | $3,122,098 | $3,153,766 | $4,881,821 |

Contribution of the land to the unitrust, in scenario III, produces results that most closely meet H and W's planning goals of increasing cash flow to them, while not diluting the amount of wealth available to their children. In comparison to their current situation, reflected in scenario I, scenario III produces higher net cash flows to H and W while they are living and considerably more wealth for their children. Selling the land, in scenario II, meets H and W's desire for higher income but does so at the expense of diluting the wealth available to their children.

Moreover, scenario III provides a contribution, at W's death, in excess of $1,160,000 to W's college alma mater. Not only did H and W not have to sacrifice wealth to make this contribution possible, they actually realize an increase in wealth as a result.

## IV. CONCLUSION

The philanthropist is, without a doubt, an important element in the continued existence of our nation's charitable organizations. Charitable giving as an estate plan component should not, however, be considered the exclusive domain of those individuals exhibiting strong philanthropic inclinations. Giving to charity and desiring to retain wealth are not necessarily mutually exclusive concepts.

187. Total cash flow for the 10 years was calculated for all three scenarios. *See supra* notes 139-174 and accompanying text.

188. The figure represents the total available to H and W's children for all three scenarios.

189. *See supra* note 143. This represents the balance in the unitrust at the end of the ten years which passes to the unitrust's charitable beneficiary. *See supra* note 14 and accompanying text.

The estate planning devices discussed in this comment, the inter vivos charitable remainder unitrust and the irrevocable life insurance trust, can facilitate an overall economically advantageous estate plan. It is possible, under certain circumstances, that giving away assets to charity can actually produce more wealth to a donor while living, in addition to providing more wealth for distribution to heirs. This seemingly contradictory result comes about, not from a single benefit such as tax savings, but rather, from the interplay of numerous aspects of these estate planning devices.

An individual's potential philanthropic desires may not always be readily apparent in an estate planning setting. He may wish to make some contribution to charity but perhaps feels that it is not financially feasible to do so. Another individual may think charitable giving is a great idea as long as it does not cost anything. As this comment has illustrated, however, charitable giving may not only benefit charity but may benefit the individual as well.

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