

Charitable Financial Planner

Software and User Manual (Version 2003.10)

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Section 1: Using the Charitable Financial Planner

How to Use the Manual

Menu Bar

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How to Use the Manual

Use this manual as a reference guide to the different calculation models. The manual contains actual text and discussion of several IRS rulings. It also has extensive help on the theory behind some of the calculations.

The first section of the manual, Using the Charitable Financial Planner, is filled with information on how to access the different functions of the program and a definition for all the functions. The second section of the manual, Calculation Reference, has specific information about each calculation model. It also provides a discussion on reports or background information which is used throughout most of the calculation models. The last section, Reference Information, provides actual text and discussions of several IRS Rulings.

Review the sub-section **Common Criteria & Reports** on page 15 before starting to use the program.

Menu Bar

The menu bar contains all of the program's features and functions. It has six menus:

- File Menu
- Inputs Menu
- Tools Menu
- Options Menu
- Help Menu

File Menu

The Charitable Financial Planner **File Menu** allows you to handle files in a number of different ways, by creating, opening, saving or preparing a document for printing. The following is explanations of the functions under the File Menu.

New

Displays a new file that has the default input settings. The new file is called "UNTITLED."

Open

Accesses already saved files. When the Open window appears, select the directory where the file is located if it is different from the current directory. Enter the name of the file you wish to open or select the file name from the files listed.

Save

Saves current inputs into a file. When the Save window appears, select the directory in which the file should be located and enter a name for the file.

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Save As

Saves the current file while allowing any or all of the following variables:

- Change the name of the file.
- Change the location of the file.
- Change the extension of the file.

Open DOS CHAR File

Accesses files from the DOS version of the Charitable Financial Planner. If any changes are made to a DOS file, it must be saved with the Windows extension (.CFP) otherwise the new data will be lost.

Open EZ-Gift File

Accesses files from the EZ-Gift program. If any changes are made to an EZ-Gift file, the file must be saved with the Windows extension (.CFP) otherwise the new data will be lost.

Page Setup

Accesses the settings for the layout of the reports. Allows for customization of margins, fonts, and footers.

Print

Accesses the program's printing options. Allows customization of the margins, the fonts styles and sizes, the heading which can include the date and time, and also the footer.

Page Setup

Accesses the settings for the layout of the reports. Allows for customization of margins, fonts, and footers.

File Location

Allows you to select the default folder to which files will be saved and from which they will be read.

Reopen File

Allows you to open quickly the five files you worked on most recently.

Inputs Menu

The **Inputs Menu** provides an extra section to enter client information, two ways to perform calculations, and a feature to clear all data input fields.

Tax Assumptions

Used to enter Income Tax data which the program uses to calculate the Income Tax report. Some of the values entered into the Tax Assumptions window are automatically inserted into the Income Tax tab. If the Tax Assumptions worksheet is not completely filled out, the results for the income tax will be inaccurate.

Exhaustion Test

The Charitable Lead Annuity Trust, Charitable Remainder Annuity Trust, Grantor Retained Annuity Trust, and Charitable Gift Annuity calculations all need to perform an exhaustion test. This test can be performed using one of two different methods:

- **The IRS Annuity Factor Method:** This is the method which appears to have been used by the IRS in §25.7520-3(b)(2)(v), Example 5. It uses published annuity factors to determine when the trust exhausts, and what the payment is in the last period of the trust.
- **The Exact Method:** This method creates the schedule of payments based on the assumption that the trust will grow at a rate equal to the 7520 rate. From the schedule, it is able to determine exactly when the trust exhausts and how much the final payment is.

NOTE: The program default is to use the IRS Annuity Factor method which best reflects the §25.7520-3(b)(2)(v), Example 5. See the Reference Section for more information on this ruling.

Clear Inputs (F7)

Removes all inputs from the screen and returns to the default inputs.

Calculation Menu

The **Calculation Menu** provides a link to each of the calculation screens. The following calculation models are presented in the program.

- Charitable Remainder Annuity Trust
- Charitable Remainder Unitrust
- Pooled Income Fund
- Charitable Remainder in Residence/Farm
- Charitable Lead Annuity Trust
- Charitable Lead Unitrust
- Charitable Gift Annuity
- Qualified Personal Residence Trust
- Grantor Retained Annuity Trust
- Grantor Retained Unitrust
- Interrelated Estate Tax

Tools Menu

The **Tools Menu** has four tools: the AFR Rates table which stores AFR rates and then places them in the program, the Comparison Graph which allows you to create different scenarios for one client using a calculation model or several different calculation models, the Age Calculator which calculates the age of the client, and a basic Windows calculator.

AFR Rates

Selecting AFR Rates from the Tools menu opens the Applicable Federal Mid-Term 120% Annual Rates window which shows a list of available rates starting from January 1989 through the present month. The rate changes monthly and is reported in The Wall Street Journal. (See the Federal Interest Rates in the Money and Investing section of the Journal, generally between the 18th and 23rd of the preceding month.) This rate can often be found earlier on Brentmark's web site at <http://www.brentmark.com/AFRs.htm>.

Note: If the §7520 Rate input field shows 30%, the AFR table must be updated. Thirty percent is the default value that appears when there is not a current AFR available for the chosen Transfer Date. Download or manually update your AFR table.

You can manually enter the new rate into the table or you can download it into the program from the Brentmark's web site. On the Applicable Federal Mid-Term 120% Annual Rates window there are two ways to obtain AFR Rates.

1. Click the Download Latest AFRs button. A confirmation window appears. Click Yes, and the rates will download into the program.

Note: If you have internet access through a commercial proprietary service (i.e., AOL, CompuServe, Prodigy) you must establish a connection before selecting this option from the menu. If you are connected through a network or a cable modem, your internet connection is already established.

2. Click the button with the image of the world on it. The following options are available:

Download Latest AFR Rates

Click on this menu option to download the AFR rates from Brentmark's AFR Rates web site. The Downloading AFR rates window will indicate that the downloading is in process. It may take a moment to complete the download. The new AFR rate(s) will appear on the table.

Note: If you have internet access through a commercial proprietary service (i.e., AOL, CompuServe, Prodigy) you must establish a connection before selecting this option from the menu. If you are connected through a network or a cable modem, your internet connection is already established.

Go to AFR Web Page

Click on this menu option and you will automatically connect to the AFR Rates page on Brentmark's web site. You can view the rates from the web site or take the rates and manually enter them into the program.

Comparison Graph

Creates a graph to compare the FMV and the deduction of up to five trusts. The comparison graph feature allows you to take a deduction from a particular calculation and insert it into the graph. The advantage of using the comparison graph is that you can view up to five different calculations or up to five different scenarios of one calculation at the same time.

Click the **Take Data from Current Calculation** button to import the data from the current calculation. When this is done, the information is displayed as a bar graph in the top panel and it displayed in the second panel as a description chart. For each calculation description that is imported into the comparison graph, there are three features which can be performed to it.

- Applying the **visible** feature to a calculation description allows a specific bar graph to appear or disappear in the first panel. Click within the area under the Visible column to activate or inactivate the feature.
- Applying the **link** feature to a calculation description enables it to be updated automatically as any changes are made to that particular calculation. Turn off Link to compare several scenarios from the same calculation. Click within the area under the Link column to activate or inactivate the feature.
- Click the name of the present scenario under the **Calculation Description** column to rename a scenario. Double-click the description. When the cursor appears, type the new name. Hit Enter. The new description appears in the first panel under the allotted bar graph and it replaces the old name.

The following examples will guide you in using the comparison graph to its fullest capacity.

How to Compare Different Calculations

Use the comparison graph to view a comparison between deductions from different calculations.

For example, to compare the deduction from a Charitable Remainder Annuity Trust, a Charitable Gift Annuity, and a Pooled Income Fund. (use your own values for the calculation or use the default settings) complete the following case:

1. Select the Charitable Remainder Annuity Trust calculation by clicking the text on the right side of the screen or select the calculation from the **Calculation** menu.
2. Select **Comparison Graph** from the Tools menu (or click the **Comparison Graph** button located under the Menu Bar).
3. Click the **Take Data from Current Calculation** button and on the first panel, a bar graph will appear showing the FMV and the deduction of that trust. This information will also appear on the second panel in the form of a description chart.
4. In the description chart, click the area under the Visible column until an “X” appears for the CRAT. Be sure not to click the area under the Link column. Leave it blank to disable the Link feature.

5. Click the **Close** button.
6. Repeat steps 2-5 for the Charitable Gift Annuity and the Pooled Income Fund.

How to Compare Different Scenarios of the Same Calculation

Use the comparison graph to view a different scenario for the same calculation.

For example, to compare different Charitable Remainder Annuity trusts (use your own values for the calculation or use the default settings of the program.) complete the following case:

1. Select the Charitable Remainder Annuity Trust calculation by clicking the Hotspot on the right side of the screen or select the calculation from the **Calculation** menu.
2. Select **Comparison Graph** from the Tools menu (or click the **Comparison Graph** button located under the Menu Bar).
3. Click the **Take Data from Current Calculation** button and on the first panel, a bar graph will appear showing the FMV and the deduction of that trust. This information will also appear on the second panel in the form of a description chart.
4. In the description chart, click the area under the Visible column until an “X” appears for the CRAT. Be sure not to click the area under the Link column. Leave it blank to disable the Link feature.
5. Click the **Close** button.
6. Make the desired changes on the Charitable Remainder Annuity Trust calculation (i.e., change the Percentage Payout to 5%).
7. Follow Steps 2 through 4, but this time activate the Link feature. Now that this scenario is linked, when you return to the CRAT calculation, you can make other changes to alter the results. This allows you to see how the original scenario looks compared to any new changes made to the calculation.

NOTE: To use the Link feature, you must always Link the last scenario that is created. Therefore if you are comparing five scenarios only link the fifth one; otherwise, you will delete the information from one of the other present scenarios.

Age Calculator

This calculator assists in determining the age that will be used in the **Ages** data input field. To access the Age Calculator, select Age Calculator from the Tools menu.

- 1) Enter the client’s **Date of Birth**.
- 2) Enter the **Transfer Date**.

A **Calculated Age** appears. Once the calculator has determined the Calculated Age, you can transfer the information into the **Ages** data input field by clicking the **Use Age** button.

Note: Before accessing the calculator you must remember to place the cursor within the **Ages** data input field. Otherwise, the Use Age button will not work.

Calculator

This is the basic on-screen calculator that comes with Windows. See your Windows manual for more information on this calculator.

Options Menu

The Charitable Financial Planner **Options Menu** provides commands that allow customization of the program.

16 Color Display

Provides the option to view the screen with only 16 colors.

Delete Registry Settings

Allows changes to the default settings of the program. For further information on registry settings, read your Windows manual.

Create Desktop Icon

Create a shortcut on your desktop by selecting this feature. This allows access to the program through the shortcut on the desktop rather than through the Start menu.

Help Menu

The Charitable Financial Planner **Help Menu** provides ways to find information about the program and its functionality. This menu can browse the contents of the online help system or it can give information for a specific calculation. It also contains company and product information screens.

Tool Bar

The Charitable Financial Planner uses the following buttons located in the Tool Bar to access some of the most common features of the program.

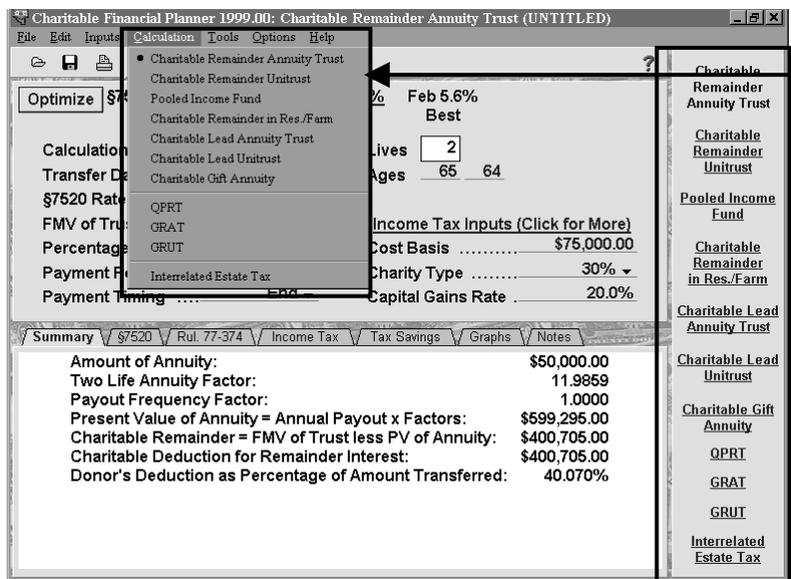
BUTTON	FUNCTION
	Saves current information in a data file.
	Accesses the program's printing options.
	Accesses the Comparison Graph.
	Opens data files that have been previously saved.
	Accesses the Tax Assumption screen.

Charitable Financial Planner

	Accesses the AFR Rates chart.
	Accesses the online help for the active calculation.

Other Navigation Tools

Access the Calculations from the Hotspots on the right side of the screen or from the **Calculation** menu.



The screenshot shows the Charitable Financial Planner interface. A 'Calculation' pull-down menu is open, listing various calculation types such as Charitable Remainder Annuity Trust, Charitable Remainder Unitrust, Pooled Income Fund, Charitable Remainder in Res./Farm, Charitable Lead Annuity Trust, Charitable Lead Unitrust, and Charitable Gift Annuity. Below the menu, there are input fields for 'Lives' (set to 2) and 'Ages' (65 and 64). The main window displays a summary of calculations for a Charitable Remainder Annuity Trust, including the amount of annuity (\$50,000.00), annuity factors, and present value. On the right side, a vertical list of 'Hotspots' is visible, with arrows pointing to the 'Calculation Pull-down menu' and the 'Hotspots' list.

The following combination of keystrokes will provide an alternative method for navigating through the report tabs of each calculation. Press **Ctrl+Tab** to move through the report tabs from left to right. Press **Ctrl+Shift+Tab** to move through the report tabs from right to left.

Press the **Page Up** and **Page Down** keys to scroll up and down within any of the report tabs.

Press the **Tab** key to move from one data input field to another. Or, press **Shift+Tab** to move backwards through the data input fields.

**Section 2:
Calculation Models**

Common Criteria & Reports

Charitable Remainder Annuity Trust (CRAT)

Charitable Remainder Unitrust

Pooled Income Fund

Charitable Remainder in Residence/Farm

Charitable Lead Annuity Trust (CLAT)

Charitable Lead Unitrust

Charitable Gift Annuity

Qualified Personal Residence Trust (QPRT)

Grantor Retained Annuity Trust (GRAT)

Grantor Retained Unitrust (GRUT)

Interrelated Estate Tax

Common Criteria & Reports

There are areas in this program where the same information is used to perform calculations or to represent results. Those areas are discussed in this section of the manual. You may want to refer back to this section (as a reminder) as you work your way through the different calculation models.

Interest Rates

Prior to May 1, 1989, a 10% interest rate was used to generate IRS factors (for annuities, life estates, remainders, etc.) for valuing split interest charitable transfers. For May 1, 1989 or later transfers, the applicable interest rate changes each month. This floating rate is determined by reference to the 120% Annual Mid-term Applicable Federal Rate.

For split-interest charitable transfers, you are allowed to use the rate for the current month or for one of the previous two months. This is why the program automatically displays three interest rates after you enter a Transfer Date.

For the §7520 Rate data input field, the program automatically rounds the 120% Annual Mid-term Applicable Federal Rate to the nearest two-tenths of one percent. When the announced rate falls exactly in the middle, the program follows the IRS practice of rounding the rate up (example: 10.10% rounds to 10.20%).

The AFR Rates can be accessed from the Menu Bar (select **AFR Rates** from the **Tools** menu) or by clicking on the **AFRs** button under the Menu Bar. You can also find the rates on the Brentmark Web site at <http://www.brentmark.com/AFRs.htm>. They are also published each month under Fed Interest Rates in the Money & Investing section of The Wall Street Journal seven to ten days prior to the applicable month. You may download the current AFR rate from Brentmark's web site (See page 6 for more information about adding and downloading AFRs.)

Life Expectancies

The program includes the new life expectancies that went into effect on 5/1/89 as well as the old life expectancies that were in effect prior to that date. The new life expectancies are effective for Transfer Dates after 5/1/89 (but see the Transitional Rule). The new life expectancies are built-in to the calculations of Annuity Factors, Remainder Factors, Payment Period Adjustment Factors, R-factors, D-factors, and Lx factors.

Exhaustion Text

The Charitable Lead Annuity Trust, Charitable Remainder Annuity Trust, Grantor Retained Annuity Trust, and Charitable Gift Annuity calculations all need to perform an exhaustion test. This test can be performed using one of two different methods:

- **The IRS Annuity Factor Method:** This is the method which appears to have been used by the IRS in §25.7520-3(b)(2)(v), example 5. It uses published annuity factors to determine when the trust exhausts, and what the payment is in the last period of the trust.
- **The Exact Method:** This method creates the schedule of payments based on the assumption that the trust will grow at a rate equal to the 7520 rate. From the schedule, it is able to determine exactly when the trust exhausts and how much the final payment is.

The program defaults to using the IRS Annuity Factor method to best reflect §25.7520-3(b)(2)(v), example 5. See the Reference section for more information on this ruling.

Types of Calculations

All of the trusts in the Charitable Financial Planner can be distributed for a “term of years” or for “life”. The Charitable Financial Planner handles five lives, but there is no statutory limitation on the number of income beneficiaries a charitable remainder trust may have.

The exceptions to the types of calculation the program performs is with a:

- Pooled Income Fund because it **only** handles Life cases.
- Charitable Gift Annuity because it **only** handles Life cases.
- Grantor Retained Trust because in addition, it also handles Shorter of Life cases.

If a trust is distributed for a term of years, the trust provides periodic distributions to non-charitable beneficiaries for a period not in excess of 20 years.

If a trust is distributed for life, the trust provides periodic distributions to a non-charitable beneficiary for a period not in excess of the life of this individual income beneficiary.

If a trust is distributed for two to five lives, the trust provides fixed periodic distributions to these non-charitable beneficiaries for a period not in excess of the lives of those individual beneficiaries.

If a trust is distributed for Shorter of Term or Life, the trust ends immediately at the donor’s death.

Income Tax Report

This Report tab is used to show a detailed list of what is taken into account to calculate the tax due from the gross income when the trust is taken into account. Many of the calculation models have an Income Tax Report.

The Income Tax Report should be used in conjunction with the Tax Assumption sheet (Inputs menu, Tax Assumptions). Complete the Tax Assumptions worksheet before consulting with the results in the Income Tax Report tab. Some of the figures used in the Tax Assumptions worksheet will automatically appear on the Income Tax Report. The program performs an exact tax calculation for the year referenced on the Tax Assumptions window. For future years, the program uses the entered inflation rate to estimate the income tax. Each year Brentmark Software updates the program with more current tax brackets.

The following figures are used to calculate the tax due:

Adjusted Gross Income (AGI)

The number represents the Gross Income minus any allowable adjustments. The program automatically takes this value from the Tax Assumptions worksheet.

Deductions

Includes any items that reduce income. The program automatically adds the Itemized deductions (from the Tax Assumptions) and the Charitable deductions (from the Summary Report tab), and then displays them on the report.

Adjusted Personal Exemptions

The program adds the Personal Exemptions and the Personal Exemptions Phaseout.

Taxable Income

The net income after claiming all deductions. The program takes the sum of the Deductions and the Adjusted Personal Exemptions and subtracts the total from the Adjusted Gross Income.

Tax Due

The amount appears on the current Income Tax Table.

Average Tax Rate

This is the percentage of the Adjusted Gross Income that is taxed.

Marginal Tax Rate

The amount appears on the current Income Tax Table.

Regular Standard Deduction

The program uses the designated deduction for the current year.

Additional Elderly Deduction

The program uses the designated deduction for the current year.

Standard Deduction

The program adds the Regular Standard Deduction and the Additional Elderly Deduction.

Itemized Deductions

Includes items such as interest, state and local taxes, charitable contributions, and medical deductions.

Charitable Deduction

The program takes this number from the Summary Report Tab.

Deduction Phaseout

The program enters the deduction that is given to high income tax payers.

Adjusted Itemized Deductions

The program adds the Itemized Deductions, the Charitable Deduction, and the Deduction Phaseout.

Personal Exemptions

The program automatically enters the exemption that is given to every taxpayer that is not considered a dependent.

Personal Exemption Phaseout

The program automatically enters the exemption that is given to high income tax payers.

Charitable Remainder Annuity Trust

A Charitable Remainder Annuity Trust provides fixed periodic distributions to one or more beneficiaries with an irrevocable remainder interest going to charity. Most gifts made as a charitable remainder annuity trust qualify for income and gift tax charitable deductions (or in some cases, as an estate tax charitable deduction). A charitable deduction is permitted for the remainder interest gift only if the trust meets certain criteria.

This calculation also provides an Optimize button which calculates the best scenario. The **Optimize** button calculates the highest payout rate that will still pass all the tests (such as the 10% test, and the exhaustion test). It also yields a non-zero deduction.

This trust handles Term and Life Calculations. See page 16 for more information on the different types of calculations.

Charitable Remainder Annuity Trust Qualifications

A trust qualifies as a charitable remainder annuity trust if the following conditions are met:

- The trust pays a specified sum to at least one non-charitable beneficiary who is living when the trust is created. This sum must be paid annually, semiannually, quarterly, monthly, or weekly, regardless of trust income, appreciation or depreciation of the value of the trust's assets.
- The sum paid annually must be 5% or more of the initial net fair market value of the property placed in the trust.
- The payout rate may not exceed 50% of the initial value of the trust assets for all transfers to trust after June 18, 1997 [Code §§664(d)(1)(A)].
- The value of the charitable remainder must be at least 10% of the net fair market value of the assets transferred to the trust on the date of the gift, effective for trusts funded after July 28, 1997.
- No sum is paid to anyone other than the specified non-charitable beneficiary (who must be alive when the trust is created) and a qualified charitable organization.
- When the specified term ends, the remainder interest is transferred to a qualified charity or is retained by the trust for the use of the qualified charity.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Calculation Type – Select Life or Term. For more information on calculation types, see page 16.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

FMV of Trust – Enter the initial net fair market value of the assets placed in the trust when established.

Percentage Payout/Annual \$ Payout – Enter the projected payout that will go to the beneficiary during the life of the trust. The program treats numbers 1-100 as a Percentage Payout and numbers greater than 100 as an Annual \$ Payout. The program performs the 10% Test and the 50% Test on the dollar amount or percentage entered before allowing the amount to be used.

- The 10% Test does not allow the Charitable Remainder interest to be less than 10% of the Fair Market Value (FMV) of the trust. In other words, the charity cannot receive less than 10% of the FMV of the trust. If the Charitable Remainder is less than 10%, a message appears stating; "Does not Pass the 10% Test".
- The 50% Test does not allow the non-charitable beneficiary to receive an annuity that exceeds 50% of the Fair Market Value of the trust.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly).

Payment Timing – Select **Begin** or **End** to indicate when the payment should be made for the selected payment period. This helps to determine what payout frequency factor is used in the calculation.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the number of lives (up to five) that will be used to determine the charitable deduction. This data input field is only available when Life is chosen as the Calculation Type.

Ages – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Income Tax– The Economic Growth and Tax Relief Reconciliation Act of 2001 sunsets in 2011. Indicate whether or not you wish to assume that the income tax provisions of that act will sunset.

Cost Basis – Enter the amount of basis for the asset being placed in the trust.

Charity Type – Choose 50%, 30%, or 20%. All qualified non-profit organizations will fit within one of these types (IRS Publication 78).

Capital Gains Rate – Enter the income tax rate that applies to capital gains property.

Summary Report

When the annuity is annualized, it must not be less than 5% of the initial fair market value of the trust; therefore, the Charitable Financial Planner does not allow the Percentage Payout input field to drop below 5%.

If the annuity is payable other than at the end of the year, the program uses special adjustment factors to do the calculation. The fair market value of the remainder interest of a charitable remainder annuity trust is the net fair market value of the property placed in trust less the present value of the annuity.

The program multiplies the annual dollar payout and the annuity factor to find the annuity. The program automatically selects the factor depending on the Calculation Type used. To find the appropriate factor see the IRS Publication 1457, Actuarial Values Alpha Volume.

Charitable Financial Planner

The summary report shows the direct results from the values that are entered into the data input fields.

Amount of Annuity - A dollar amount of the percentage payout. The annuity must pass the “5% Probability Test”. The test ensures that the trust does not exceed a 5% chance of diminishing to an insufficient amount, leaving no remainder distribution to the charity. If the annuity is payable other than at the end of the year, the program uses special adjustments in the calculation.

(Term or One-Five Lives) Annuity Factor – The annual dollar payout is multiplied times the annuity factor. The Calculation Type used governs the annuity factor that is used. You can find the annuity factor in the IRS Publication 1457, Actuarial Values Alpha Volume.

If the annuity is payable at the end of the payment period, a period adjustment factor (Treasury Reg. § 20.2031-7(b)(3)(i); the period adjustment factor is found in § 20.2031-7(b)(2) is used for transfers prior to May 1989. For transfer dates after April 1989, an adjustment factor from Table K for the appropriate interest rate is used. If the annuity is payable at the beginning of the payment period, a period adjustment factor is used for transfers prior to May 1989, or Table K is used with the product added to the first payment for transfers after April, 1989.

Payout Frequency Factor – Adjusts the Present Value of the annuity. This factor comes from Table K.

Present Value of Annuity - The Amount of the Annuity times the Annuity Factors. Gives the value of the money the beneficiary(ies) receive.

Charitable Remainder – The Fair Market Value of the Trust minus the Present Value of Annuity. In other words, the fair market value of the remainder interest of a charitable remainder annuity trust is the net fair market value of the property placed in the trust minus the present value of the annuity.

Charitable Deduction for Remainder Interest – The dollar amount that is not subject to taxation (income tax).

Donor’s Deduction as Percentage of Amount Transferred – The percentage amount that is not subject to taxation (income tax).

§7520 Report

The §7520 Treasury Regulations Exhaustion Test calculates a limit in the valuation of annuities created a Charitable Remainder Annuity Trust. The Charitable Financial Planner shows the steps used to calculate the value of the exhausted annuity by splitting the annuity into two smaller annuities:

- An annuity that lasts up to but does not include the period when the original annuity exhausts.
- A single payment equal to the final partial payment of the original annuity.

The two parts are then added together. The total is the Value for the §7520 Treasury Regulations Exhaustion Test report.

See the §25.7520-3(b)(2)(v), Example 5 ruling in the Reference section for more information on the exhaustion test.

Income Tax Report

The trust provides an Income Tax Report. See page 17 for more information on this report.

Rule 77-374 Report

The Charitable Financial Planner uses the 5% probability test of Revenue Ruling 77-374, 1977-2 CB 329 in its calculations when the dollar payout is high enough for the ruling to apply. In its calculation results, the program determines whether or not the charitable deduction is allowable under the ruling.

See the Reference Section for the actual text and discussion of Rev. Rul 77-374.

Tax Savings Report

The Tax Savings report illustrates how a Charitable Deduction is distributed over a period of years. The report shows the current year and the next five years, which is the maximum period allowed for distributions.

Multiplying the Charity Type (50%, 30%, or 20%) and the Adjusted Gross Income calculate the amount of deduction taken annually from the trust. The report shows how much of the charitable deduction is used each year, as well as the annual tax savings generated from the charitable deduction.

The **Capital Gain** is derived from the following formula:

$$(\text{FMV} - \text{Cost Basis}) \times \text{Capital Gain Rate}$$

The bar graph shows an annual comparison of the income tax with and without the charitable trust.

Graphs

The graphs tab shows two graphical views of the present scenario:

- Deduction Percent– The pie graph shows the deduction as a percentage of the amount transferred.

Charitable Financial Planner

- Deduction vs. Payout– The bar graph shows the rise and fall of the deduction that the client can receive depending on the percentage payout that is used.

Use the **Increment Percentage Payout by** input to change the increment change of the Payout. Change the number to see a more in depth evaluation of the comparison.

Charitable Remainder Unitrust

A Charitable Remainder Unitrust (CRUT) determines a deduction for a contribution to a charitable remainder unitrust. It also calculates a deduction as a percentage of the amount transferred.

When a Charitable Unitrust is established, a donor transfers cash and /or property to an irrevocable trust but retains (either for himself or for one or more non-charitable beneficiaries) a variable annuity payment that can vary in amount, but is a fixed percentage from that trust. At the end of a specified term, or upon the death of the beneficiary(ies) (the donor and the donor's spouse can be the beneficiaries), the remainder interest in the property passes to the charity the donor has specified.

The principal difference between a charitable remainder unitrust and a charitable remainder annuity trust is that a unitrust pays a varying annuity. In other words, the amount paid is likely to change each year. The payable amount is based on annual fluctuation in the value of the trust's property. As it goes up so does the annuity paid each year. If it drops in value, so will the annuity.

This calculation also provides an Optimize button which calculates the best scenario. The **Optimize** button calculates the highest payout rate that will still pass all the tests (such as the 10% test, and the exhaustion test). It also yields a non-zero deduction.

This trust handles Term and Life Calculations. See page 16 for more information on the different types of calculations.

Charitable Remainder Unitrust Qualifications

A gift to a Charitable Remainder Unitrust will qualify for income and gift tax charitable deductions (or an estate tax charitable deduction) only if the following conditions are met:

- A fixed percentage (not less than 5%, nor more than 50%) of the net fair market value of the assets is paid to one or more non-charitable beneficiaries who are living when the unitrust is established. The charity's actuarial interest must be at least 10% of any assets transferred to the trust.
- The unitrust assets must be revalued each year, and the fixed percentage amount must be paid at least once a year for the term of the trust, which must either be a fixed period of 20 years or less or until the death of the noncharitable beneficiaries, all of whom must be living at the beginning of the trust.
- No sum can be paid except the fixed percentage during the term of the trust and at the end of the term of the trust, the entire balance of the trust assets must be paid to one or more qualified charities.
- Assets in the trust are transferred to the qualified charity or retained in the unitrust for use by the charity.

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The donor receives an immediate deduction for the present value of the remainder interest that will transfer to the charity at the end of the term. The present value of the remainder interest is determined by income tax regulations.

Because a charitable remainder unitrust is exempt from federal income tax, the income and gains of the trust are only taxed when they are distributed to the noncharitable beneficiaries. They are taxed as part of the fixed percentage of trust assets distributed each year. They are frequently used to defer income tax on gains about to be realized. For example, if a donor has an appreciated asset that is about to be sold, the donor can give the asset to a charitable remainder unitrust, reserving the right to receive a fixed percentage of the value of the trust for life, and for the life of the donor's spouse as well. And then, the asset can then be sold by the trust and the proceeds of sale reinvested without payment of any federal income tax on capital gains. The capital gains will be taxable to the donor (or the donor's spouse) only as they are distributed to the donor as part of the annual distributions from the trust.

A variation of the CRUT (which pays a fixed percentage of the value of the trust assets, regardless of income) is the net-income-with-makeup CRUT, or "NIMCRUT," which pays either the fixed percentage or the income actually received by the trust, whichever is less. However, if the income is less than the fixed percentage, the deficiency can be paid in a future year, as soon as the trust has income which exceeds the fixed percentage. An additional variation is a "flip" unitrust, which is a trust that changes from a NIMCRUT to a regular CRUT upon the occurrence of a specific event, such as the sale of a specific asset that was contributed to the trust and was not expected to produce much income.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Calculation Type – Select Life or Term. For more information on calculation types, see page 16.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more

information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

FMV of Trust – Enter the initial net fair market value of the assets placed in the trust when established.

Percentage Payout – Enter the projected payout (percentage) that should go to the beneficiary during the life of the trust.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly).

Months Valuation Precedes Payout – Enter a value to indicate the number of full months by which the valuation date precedes the first payout. The program will only allow valid input values according to which Payment Period was selected on the previous input field.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the number of lives (up to five) that will be used to determine the charitable deduction. This data input field is only available when Life is chosen as the Calculation Type.

Ages – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Income Tax – The Economic Growth and Tax Relief Reconciliation Act of 2001 sunsets in 2011. Indicate whether or not you wish to assume that the income tax provisions of that act will sunset.

Cost Basis – Enter the amount of basis for the asset being placed in the trust.

Charity Type – Choose 50%, 30%, or 20%. All qualified non-profit organizations will fit within one of these types (IRS Publication 78).

Capital Gains Rate – Enter the income tax rate that applies to capital gains property.

Summary Report

The fair market value of a remainder interest in a charitable remainder unitrust is its present value. The present value is determined under Treas. Reg. §1.664-4(a)(1).

An adjusted payout rate is determined by multiplying the fixed percentage payout by the appropriate payout sequence factor. The payout sequence factor can be found in the IRS Publication 1458, Actuarial Values Beta Volume. If the adjusted payout rate is between rates shown in the table, a linear interpolation is required. When the remainder factor is computed, the present value of the remainder interest is obtained by multiplying the factor times the fair market value of the trust assets.

The summary tab shows the direct results from the values that are entered into the input fields.

Payout Sequence Factor – It is used to calculate the payout rate (the frequency of payments). The factor is found in Table F(1) (for transfers prior to May, 1989) or Table F for the appropriate interest rate (for transfers after April, 1989) which corresponds to the number of months by which the valuation date precedes the payout date. The tables can be found in the IRS Publication 1458, Actuarial Values Beta Volume.

Adjusted Payout Rate – An adjusted payout rate is determined by multiplying the fixed percentage payout by the appropriate payout sequence factor. If the adjusted payout rate is between the rates shown in the table, a linear interpolation is required.

Term of Years Remainder Interest – The present value of the remainder interest is obtained by multiplying the factor times the fair market value of the trust assets. A number that is derived from IRS tables depending on the term of years.

Present Value of Remainder Interest – The present value of remainder interest is its fair market value. The present value is determined under Treasury Regulations §1.664-4(a)(1).

Donor's Deduction– The dollar amount that is not subject to taxation (income tax).

Donor's Deduction as Percentage of Amount Transferred– The percentage amount that is not subject to taxation (income tax).

Income Tax Report

The trust provides an Income Tax Report. See page 17 for more information on this report.

Tax Savings Report

The Tax Savings report illustrates how a Charitable Deduction is distributed over a period of years. The report shows the current year and the next five years, which is the maximum period allowed for distributions.

Multiplying the Charity Type (50%, 30%, or 20%) and the Adjusted Gross Income calculate the amount of deduction taken annually from the trust. The report shows how much of the charitable deduction is used each year, as well as the annual tax savings generated from the charitable deduction.

The **Capital Gain** is derived from the following formula:

$$(\text{FMV} - \text{Cost Basis}) \times \text{Capital Gain Rate}$$

The bar graph shows an annual comparison of the income tax with and without the charitable trust.

Graphs

The graphs tab shows two graphical views of the present scenario:

- Deduction Percent– The pie graph shows the deduction as a percentage of the amount transferred.
- Deduction vs. Payout– The bar graph shows the rise and fall of the deduction that the client can receive depending on the percentage payout that is used.

Use the **Increment Percentage Payout by** input to change the increment change of the Payout. Change the number to see a more in depth evaluation of the comparison.

Pooled Income Fund

A Pooled Income Fund is an irrevocable trust that is maintained by a charitable organization to which many individuals contribute property. The fund provides an annuity to a non-charitable income beneficiary(ies) for a period measured by the life expectancy of one person (up to five persons).

Charitable Financial Planner

Donors retain a life-income interest in the property for one or more beneficiaries who receive an annual income dependent on the trust's rate of return for the year. At the death of the last beneficiary, the remaining value of the gift belongs to the charity.

Calculation Type

A Pooled Income Fund **only** handles Life calculations. The Charitable Financial Planner handles one to five lives.

Pooled Income Fund Requirements

In order for a fund to qualify as a Pooled Income Fund it must meet the following requirements:

- The property transferred by each donor must be combined with the property transferred by other donors.
- The fund cannot be used to invest in tax-exempt securities.
- Neither the donors nor the income beneficiary can be a trustee.
- The donor must maintain a life income interest.
- The beneficiary(ies) is entitled to receive a pro rata share of the income, annually, based on the rate of return that is earned by the trust.

If these qualifications are met, the donor will receive an income, gift or estate tax deduction.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

Value of Property – Enter the fair market value of the property contributed by the donors.

Highest Rate of Return for Three Preceding Years – Enter the highest rate of return earned by the fund in any one of the three years preceding the year of the contribution.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the number of lives (up to five) that will be used to determine the distribution. The Pooled Income Fund only handles Life scenarios.

Ages – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Income Tax – The Economic Growth and Tax Relief Reconciliation Act of 2001 sunsets in 2011. Indicate whether or not you wish to assume that the income tax provisions of that act will sunset.

Cost Basis – Enter the amount of basis for the asset being placed in the trust.

Charity Type – Choose 50%, 30%, or 20%. All qualified non-profit organizations will fit within one of these types (IRS Publication 78).

Capital Gains Rate – Enter the income tax rate that applies to capital gains property.

Summary Report

The fair market value of a remainder interest in property transferred to a pooled income fund is the value of the property contributed (the value is determined under Treasury Reg. §1.642(c)-6(a)(1)). The program selects a remainder factor which is determined by the number of lives and the transfer date which is used. (The Charitable Financial Planner handles one to five lives.) These factors may be found in the IRS Publication 1457, Actuarial Values Alpha Volume for transfer dates after April, 1989 and IRS Publication 723D for transfer dates prior to May 1989.

If the transfer date 5/89 or 6/89 is used, the **Old or New Expectancy?** data input field appears. Under a transitional rule for Transfer Dates of 5/89 or 6/89, you may optionally use newer life expectancy assumptions or older life expectancy assumptions that were in use prior to May 1989. See Notice 89-24, 1989-1 CB 600 for more information on this ruling.

If you entered a Transfer Date prior to May 1989, the program will automatically enter **Old** and will skip over this input. If you entered a date after June 1989, the program will automatically enter **New** and skip over this input

If the yearly rate of return is a percentage which is between those rates for which returns are provided in the table, a linear interpolation is required. The present value of the remainder interest is determined by multiplying the remainder factor times the fair market value of the property contributed.

Charitable Financial Planner

Highest Rate of Return for Three Preceding Years – This number is imported from the input field section of this calculation. It is the highest rate of return earned by the fund in any one of the three years preceding the year of the contribution. If the fund has been in existence less than three years, a presumed rate of return must be used. For funds created before May 1989, the presumed rate is 9.0%. For later periods, the IRS determines the presumed rate. This presumed rate for new funds is expected to be 9.4% for funds created after April 1989 and before 1990; and 9.8% for funds created in 1990 or 1991.

If the yearly rate of return is a percentage that is between those rates for which returns are provided in the table, a linear interpolation is required.

Remainder Factor – This factor changes depending on the number of lives used for this calculation.

Charitable Deduction for Remainder Interest – The dollar amount of the property value that is not subject to taxation (income tax). The present value of the remainder interest is determined by multiplying the remainder factor times the fair market value of the property contributed. The fair market value of a remainder interest in property transferred to a pooled income fund is the value of the property contributed.

Donor's Deduction as Percentage of Property Transferred - The percentage amount of the property value that is not subject to taxation (income tax).

Income Tax Report

The trust provides an Income Tax Report. See page 17 for more information on this report.

Tax Savings Report

The Tax Savings report illustrates how a Charitable Deduction is distributed over a period of years. The report shows the current year and the next five years, which is the maximum period allowed for distributions.

Multiplying the Charity Type (50%, 30%, or 20%) and the Adjusted Gross Income calculate the amount of deduction taken annually from the trust. The report shows how much of the charitable deduction is used each year, as well as the annual tax savings generated from the charitable deduction.

The **Capital Gain** is derived from the following formula:

$$(\text{FMV} - \text{Cost Basis}) \times \text{Capital Gain Rate}$$

The bar graph shows an annual comparison of the income tax with and without the charitable trust.

Charitable Remainder in Residence/Farm

A Charitable Remainder in Personal Residence/Farm provides a gift to charity of a future interest in a personal residence or farm with the donor(s) reserving the right to live in or use the property for a term of years or for a life span. In other words, an irrevocable trust is established with the trustee directed to pay to the grantor the income from the trust for a specified number of years. When the grantor's trust interest terminates, the property in the trust is distributed outright to family members. In some cases, the trust continues for their benefit or makes a distribution to a uniform gifts minors account or IRC §2503(c) trust from them.

This trust handles Term and Life Calculations. See page 16 for more information on the different types of calculations.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Calculation Type – Select Life or Term. For more information on calculation types, see page 16.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

Land Value – Enter the appropriate value of the land as of the date of the gift. If the valuation is for estate or gift tax purposes and you take the position that depreciation is considered only for income tax purposes, you would enter the total value of the property transferred here and enter zero for the following two depreciable property value inputs.

Charitable Financial Planner

Estimated Useful Life in Years – Enter the estimated year span (beginning with the date of the contribution) over which the depreciable property is going to be used.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the number of lives (up to five) that will be used to determine the distribution. The Pooled Income Fund only handles Life scenarios (see page 16).

Ages – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Depreciable Property Value on Date of Gift – Enter the value of the depreciable part of the property as it is on the date of the gift. The sum of the Land Value and the Depreciable Property Value on Date of Gift should equal the fair market value of the property.

Depreciable Property Value at End of Useful Life – Enter the value that is expected at the end of the estimated useful life. The program will not accept the entry of a value higher than the Depreciable Property Value on Date of Gift.

Income Tax – The Economic Growth and Tax Relief Reconciliation Act of 2001 sunsets in 2011. Indicate whether or not you wish to assume that the income tax provisions of that act will sunset.

Cost Basis – Enter the amount of basis for the asset being placed in the trust.

Charity Type – Choose 50%, 30%, or 20%. All qualified non-profit organizations will fit within one of these types (IRS Publication 78).

Capital Gains Rate – Enter the income tax rate that applies to capital gains property.

Summary for a Term Case

The summary report shows the direct results from the values that are entered into the input fields.

Total Value of Property – This number is the sum of the Land Value and the Depreciable Property Value on the Date of Gift.

Depreciable Part (DP) – Indicates the dollar value of the property that is depreciable. Use the following formula to attain the value:
(DP Value On Date of Gift – DP value At End of Useful Life) x (Payment Years or DP Value At End of Useful Life* / DP Value At End of Useful Life)

NOTE: Use the smallest value of the two: Payment Years or DP Value At the End of Useful Life.

Nondepreciable Part – Indicates the dollar value of the property that does not depreciate in value. Use the following formula to attain the value:

$$\text{(Land Value – DP Value At End of Useful Life)}$$

Remainder Factor – This factor is used to calculate the charitable deduction. The program derives this number from the Calculation Type used and the ages entered for each life (if a Life calculation is used.).

Remainder Interest – This factor is used to calculate the charitable deduction. The program derives this number from the **Estimated Useful Life in Years** input (1-99 years), the number of lives used and the ages entered for each life. When valuing the remainder interest, if part of the real property is depreciable, the adjusted value is subtracted from the value of the depreciable part.

Charitable Deduction for Remainder Interest – This is the charitable deduction that is derived from the following formula:

$$\text{(Nondepreciable Part x Remainder Factor) + (Depreciable Part x Adjusted Remainder Factor)}$$

Summary for a Life Case

The summary tab shows the direct results from the values that are entered into the input fields.

Total Value of Property – This number is the sum of the Land Value and the Depreciable Property Value on the Date of Gift.

Depreciable Part – This number represents the dollar value of the part of the property which depreciates over time. The result is obtained from the following equation:

$$\text{[On Date of Gift – At End of Useful Life]}$$

Non-depreciable Part – This number represents the dollar value of the part of the property which does not depreciate over time. The result is obtained from the following equation:

$$\text{[Land Value – At End of Useful Life]}$$

Remainder Factor – This number is obtained from column 4 of Table A for transfer dates prior to May 1989. Use column 4 of Table S (obtained from the IRS Publication 1457, Actuarial Values Alpha Volume) for transfer dates after April 1989. It is applied to the non-depreciable part of the property.

Adjustment Factor – The adjustment factor is determined by dividing (i) by (ii):

- (i) is the difference between:
 - (A) the R-factor in column 2 of Table C opposite the initial age of the life tenant in column 1.
 - (B) the R-factor in column 2 of such Table opposite the terminal age in column 1.
- (ii) is the product of:
 - (A) the estimated useful life of the depreciable property.
 - (B) the D-factor in column 3 of the Table opposite the initial age of the life tenant in column 1.

This adjustment factor is carried to five decimal places. Different R-factors and D-factors are used for transfers after April 1989, as opposed to those used for transfers prior to May 1989.

Charitable Deduction for Remainder Interest – Valuation of a remainder interest in real property following one life is determined under IRS rules (§ 25.2512-5(d) for transfers after November 30, 1983). The remainder interest is obtained from the following formula:

$$\frac{(\text{Depreciable Part Remainder Factor} - \text{Adjustment Factor}) + \text{Remainder Factor} \times \text{Nondepreciable Part}}{\text{Remainder Factor}}$$

Income Tax Report

The trust provides an Income Tax Report. See page 17 for more information on this report.

Tax Savings Report

The Tax Savings report illustrates how a Charitable Deduction is distributed over a period of years. The report shows the current year and the next five years, which is the maximum period allowed for distributions.

Multiplying the Charity Type (50%, 30%, or 20%) and the Adjusted Gross Income calculate the amount of deduction taken annually from the trust. The report shows how much of the charitable deduction is used each year, as well as the annual tax savings generated from the charitable deduction.

The **Capital Gain** is derived from the following formula:

(FMV – Cost Basis) x Capital Gain Rate

The bar graph shows an annual comparison of the income tax with and without the charitable trust.

Charitable Lead Annuity Trust

A Charitable Lead Trust is created when a donor provides income-producing property. The trust then provides fixed periodic distributions to a charity followed by a non-charitable remainder or reversionary interest. In other words, the charity receives payment throughout the length of the trust. At the end of the period, the trust assets are paid back to the donor or a non-charitable beneficiary(ies). The difference with this trust is that the charity's interest comes before the non-charitable interest.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Calculation Type – Select Life or Term. For more information on calculation types, see page 16.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

FMV of Trust – Enter the initial net fair market value of the assets placed in the trust when established.

Charitable Financial Planner

Percentage Payout/Annual \$ Payout – Enter the projected payout that will go to the beneficiary during the life of the trust. The program treats numbers 1-100 as a Percentage Payout and numbers greater than 100 as an Annual \$ Payout. The program performs the 10% Test and the 50% Test on the dollar amount or percentage entered before allowing the amount to be used.

- The 10% Test does not allow the Charitable Remainder interest to be less than 10% of the Fair Market Value (FMV) of the trust. In other words, the charity cannot receive less than 10% of the FMV of the trust. If the Charitable Remainder is less than 10%, a message appears stating; “Does not Pass the 10% Test”.
- The 50% Test does not allow the non-charitable beneficiary to receive an annuity that exceeds 50% of the Fair Market Value of the trust.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly, and Weekly).

Payment Timing – Select **Begin** or **End** to indicate when the payment should be made for the selected payment period. This helps to determine what payout frequency factor is used in the calculation.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the number of lives (up to five) that will be used to determine the charitable deduction. This data input field is only available when Life is chosen as the Calculation Type.

Agers – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Summary Report

The deduction for a charitable contribution of a guaranteed annuity interest is limited to the fair market value of such interest for transfers after November 30, 1983 (Treas. Reg. §1.170A-6(c)(3)(1); the value is computed under §20.2031-7).

The annuity factor is multiplied by the annual dollar payout to calculate the present value of the annuity. The annuity factor varies according to when the annuity is paid. The program automatically enters the factor that should be used from the information you entered on the data input fields. (Factors may be found in IRS Publication 1457, Actuarial Values Alpha Volume or IRS Publication 723E.

For interest rates other than 10%, other adjustment factors must be used. The deduction for the annuity interest cannot exceed the value of property transferred to the trust.

§7520 Report

The §7520 Treasury Regulations Exhaustion Test calculates a limit in the valuation of annuities created a Charitable Remainder Annuity Trust. The Charitable Financial Planner shows the steps used to calculate the value of the exhausted annuity by splitting the annuity into two smaller annuities:

- An annuity that lasts up to but does not include the period when the original annuity exhausts.
- A single payment equal to the final partial payment of the original annuity.

The two parts are then added together. The total is the Value for the §7520 Treasury Regulations Exhaustion Test report.

See the §25.7520-3(b)(2)(v), Example 5 ruling in the Reference section for more information on the exhaustion test.

Graphs

The graphs tab shows two graphical views of the present scenario:

- Deduction Percent– The pie graph shows the deduction as a percentage of the amount transferred.
- Deduction vs. Payout– The bar graph shows the rise and fall of the deduction that the client can receive depending on the percentage payout that is used.

Use the **Increment Percentage Payout by** data input field to change the increment change of the Payout. Change the number to see a more in depth evaluation of the comparison.

Charitable Lead Unitrust

A Charitable Lead Unitrust provides fixed periodic distributions to charity followed by a non-charitable lead or reversionary interest. In other words, the charity receives payment throughout the length of the trust. At the end of the period, the trust assets are paid back to the donor or a non-charitable beneficiary(ies). The difference with this trust is that the charity's interest comes before the non-charitable interest.

One point to remember is that a unitrust pays a varying annuity. The amount paid changes each payment period since the payments are based on periodic fluctuations in the value of the trust.

This trust handles Term and Life Calculations. See page 16 for more information on the different types of calculations.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Calculation Type – Select Life or Term. For more information on calculation types, see page 16.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

FMV of Trust – Enter the initial net fair market value of the assets placed in the trust when established.

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Percentage Payout – Enter the projected payout (percentage) that should go to the beneficiary during the life of the trust.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly).

Months Valuation Precedes Payout – Enter a value to indicate the number of full months by which the valuation date precedes the first payout. The program will only allow valid input values according to which Payment Period was selected on the previous input field.

Payment Years – Enter the duration of the trust, for a period not in excess of 20 years. Valid entries are 1-20. This data input field will only be available when Term is chosen as the Calculation Type.

Lives – Enter the Enter the number of lives (up to five) that will be used to determine the charitable deduction. This data input field is only available when Life is chosen as the Calculation Type.

Ages – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Summary Report

The deduction for a charitable contribution of a unitrust interest is limited to the fair market value of the unitrust interest on the date of contribution (Treasury Reg. § 1.170A-6(c)(3)(ii)). The present value of the unitrust interest is determined by subtracting the present value of all interests in the property other than the unitrust interest from the fair market value of the transferred property (Treasury Reg. § 1.170A-6(c)(3)(ii) and 20.2055-2(f)(2)(v)).

The fair market value of a remainder interest in a charitable remainder unitrust is its present value (Treasury Reg. § 1.664-4(a)(1); the present value is determined under this Section). An adjusted payout rate is determined by multiplying the fixed percentage payout by the appropriate payout sequence factor from Table F(1) (for transfers prior to May 1989) or Table F for the appropriate interest rate (for transfers after April 1989) which corresponds to the number of months by which the valuation date precedes the payout date.

The program automatically enters the remainder factor which is governed by the type of calculation used (Term or Life). You can find the remainder factor in the IRS Publication 1458, Actuarial Values Beta Volume. When the remainder factor is computed, the present value of the remainder interest is obtained by multiplying the factor times the fair market value of the trust assets.

The unitrust income interest is obtained by subtracting the present value of the remainder interest from the fair market value of the trust assets.

Graphs

The graphs tab shows two graphical views of the present scenario:

- **Deduction Percent**– The pie graph shows the deduction as a percentage of the amount transferred.
- **Deduction vs. Payout**– The bar graph shows the rise and fall of the deduction that the client can receive depending on the percentage payout that is used.

Use the **Increment Percentage Payout by** input to change the increment change of the Payout. Change the number to see a more in depth evaluation of the comparison.

Charitable Gift Annuity

A Charitable Gift Annuity donor transfers money or other property to a qualified charitable organization in return for the charity's promise to pay the donor or another fixed and guaranteed payments for life. This transfer is part charitable gift and part purchase of an annuity. For capital gain purposes, the program assumes that the donor is the annuitant.

Calculation Type

The Charitable Gift Annuity **only** uses Life to perform its calculations. The Charitable Financial Planner handles one or two lives.

Data Input Fields

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the day and year of the transfer (dd/mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM if the rate for either month

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is used in the §7520 data input field. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

FMV of Property – Enter the initial net fair market value of the property transferred pursuant to the gift annuity agreement.

Income Tax – The Economic Growth and Tax Relief Reconciliation Act of 2001 sunsets in 2011. Indicate whether or not you wish to assume that the income tax provisions of that act will sunset.

Cost Basis – Enter the long term cost basis of the property on the transfer date. If the value entered is the same as the FMV of the Property, the reports will not include any capital gain treatment.

Prorate – This data input field is irrelevant for deferred gift annuities. Enter **No**, if the first payment is not to be prorated when the period between the Transfer Date and the First Payment Date is less than the interval between future payments. In appropriate cases, **Yes** will result in a proration of the first payment for an immediate annuity when the period is less than the interval between future payments by more than one day.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, and Monthly).

of Contributions – Entering a value greater than 1 causes the program to replace the standard report with a Charitable “IRA” report. This report is available only for transfer dates starting May 1, 1989 or later. For calculation purposes, it is assumed that successive contributions equal to the initial one (i.e., the FMV of Property) are also made on the same Transfer Date in following years.

First Payment Date – Enter the date of the first annuity payment. If you enter zeros or spaces for the date, the program will automatically display the same date that was entered for the Transfer Date data input field.

Recommended Payout – Answer **Yes**, and the program will automatically display the American Council on Gift Annuities uniform gift annuity rate (as adjusted by the uniform interest factor for deferred gift annuities) for the Payout data input field. Answer **No**, if you wish to enter another rate for the Payout data input field. **Note:** The American Council on Gift Annuities has announced new annuity rates. The new rates will be effective July 1, 1999. The new rates remain the same for annuitants over age 60. For annuitants that are 60 or younger, the rates are slightly lower.

Answer **Yes-NY, NJ** if you live in New York or New Jersey. These rates comply with those states' maximum annuity rate requirements. The program will automatically display the American Council on Gift Annuities uniform gift annuity rate for that region. The only difference with these factors is that for deferral periods of 19 years or more, the factors are lower than the factors of all other states. For deferral periods of less than 19 years, the factors are the same as with all other states. This new choice will also go into effect July 1, 1999.

Payout – If the Use Recommended Payout is answered No, enter any value with up to three places after the decimal point.

Apply 7520 Exhaustion Test? – Answer **Yes**, and the program will calculate the §7520 Exhaustion Test and use the result for the present value of annuity. The program only handles the §7520 Exhaustion Test for immediate gifts.

Lives – Enter the number of lives (1 or 2) that will be used to determine the charitable deduction.

Birth Date(s) – Enter the birth date of one of the persons (usually the donor and spouse) whose lives are being used to measure the term of the gift annuity (dd/mm/yyyy). If the annuity is being funded with the donor's separate property and there are capital gain consequences (Basis is less than the FMV of Property), enter the donor's birthday first.

Charity Type – Choose 50%, 30%, or 20%. All qualified non-profit organizations will fit within one of these types (IRS Publication 78).

Capital Gains Rate – Enter the income tax rate that applies to capital gains property.

Summary Report

In terms of its calculations, the gift annuity is more complicated than any other split-interest charitable methods. The program calculations were designed based on research that consulted several sources. In particular, see *Deferred Giving* by Conrad Teitell and publications furnished by the Committee on Gift Annuities: *Tax Implications of an Annuity Gift*, and *Deferred Gift Annuities*.

Calculations will vary depending upon whether an annuity is considered to be immediate (the first payment date is one year or less from the transfer date) or deferred (the first payment date is more than one year after the transfer date). The program automatically handles the different calculation methods for immediate and deferred gift annuities.

The Committee on Gift Annuities recommends the use of its uniform gift annuity rates. These recommended rates are revised from time to time by the Committee. The recommended rates are revised from time to time by the Committee. The

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recommended rates are intended to produce, on the average, a gift to the charitable organization of approximately 50% of the amount transferred to the charity. The uniform rates used by the program were adopted by the Conference on Gift Annuities on May 5, 1983 and were reconfirmed by the 19th Conference on Gift Annuities on May 1, 1986. As recommended by the Committee, the recommended rates for immediate annuities are also adjusted by a uniform interest factor for deferred annuities. As adopted by the Committee on Gift Annuities, the program uses a recommended payout rate for deferred gift annuities which is .5% higher than previously for Transfer Dates of 4/6/89 through 6/30/92. For Transfer Dates of 7/1/92 and later, the program uses a uniform interest factor for deferred annuities that is 1% higher than the period from 4/6/89 through 6/30/92.

The program performs a 90% test to see whether the annuitant's investment in the contract equals or exceeds 90% of the principal. Less than 90% passes the test. If the test is failed, the charity will be taxed on income from the transferred property as unrelated business taxable income.

The program handles Federal income tax consequences including capital gain treatment and partial payment years. Table V Expected Return Multiples (Reg. § 1.72-9) and appropriate adjustment factors are applied by the program to determine an exclusion ratio. The program, to determine the amount of the annual annuity that is excludable for income tax purposes as well as the amount that is taxable, uses this ratio. The printed report also shows detail for any partial payment that may occur in the year of first payment. If the fair market value of the property transferred exceeds the cost basis, the capital gain consequences are indicated. The printed report shows greater detail including any capital gain when there is a partial payment in the year of the first payment as well as the capital gain for the final reporting year.

§7520 Report

The §7520 Treasury Regulations Exhaustion Test calculates a limit in the valuation of annuities created a Charitable Remainder Annuity Trust. The Charitable Financial Planner shows the steps used to calculate the value of the exhausted annuity by splitting the annuity into two smaller annuities:

- An annuity that lasts up to but does not include the period when the original annuity exhausts.
- A single payment equal to the final partial payment of the original annuity.

The two parts are then added together. The total is the Value for the §7520 Treasury Regulations Exhaustion Test report.

See the §25.7520-3(b)(2)(v), Example 5 ruling in the Reference section for more information on the exhaustion test.

Income Tax Report

The trust provides an Income Tax Report. See page 17 for more information on this report.

Tax Savings Report

The Tax Savings report illustrates how a Charitable Deduction is distributed over a period of years. The report shows the current year and the next five years, which is the maximum period allowed for distributions.

Multiplying the Charity Type (50%, 30%, or 20%) and the Adjusted Gross Income calculate the amount of deduction taken annually from the trust. The report shows how much of the charitable deduction is used each year, as well as the annual tax savings generated from the charitable deduction.

The **Capital Gain** is derived from the following formula:

$$(\text{FMV} - \text{Cost Basis}) \times \text{Capital Gain Rate}$$

The bar graph shows an annual comparison of the income tax with and without the charitable trust.

Graphs

The graphs tab shows two graphical views of the present scenario:

- **Deduction Percent**– The pie graph shows the deduction as a percentage of the amount transferred.
- **Deduction vs. Payout**– The bar graph shows the rise and fall of the deduction that the client can receive depending on the percentage payout that is used.

Use the **Increment Percentage Payout by** input to change the increment change of the Payout. Change the number to see a more in depth evaluation of the comparison.

Assumptions and Limitations

The program uses various Assumptions and Limitations to perform this particular calculation.

For capital gains calculations, the program assumes that the gift annuity is not assignable and that the donor is the annuitant. This results in the gain being reportable over the donor's life expectancy. If the donor is not the annuitant, the capital gain must be reported in the year of the transfer.

For a deferred gift annuity, the capital gain would not be reportable until payments start if the donor is the annuitant. At that time, the capital gain would be reportable

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over the donor's life expectancy using the expected return multiple in effect will be the current one. If the donor is not the annuitant, the capital gain must be reported in the year of the transfer.

When the Transfer Date, the amount of the first payment is added to determine the Present Value of the Annuity. If the first payment is not prorated and occurs before the normal interval, the program increases the Present Value of the Annuity by the difference between the actual first payment and what would have been the prorated amount.

The expected return multiple is required to be adjusted in certain cases. This adjustment factor is used when the payment is not monthly. Teitell's material refers to this factor as the Table 9 value and the Committee on Gift Annuities materials refers to it as their Schedule 3A value. These adjustment factors are the same as found in Treas. Reg. §1.72-5(a)(2)(i). The regulations base the selection of the adjustment factor on number of whole months from the annuity starting date to the first payment date. If this is read literally, one might argue that a period from February 1 to April 1 is two full months, but that a period from February 1 to March 31 is only one full month. However, in the gift annuities area, the position taken is that both of these periods comprise two full months. Therefore, the program measures full months by allowing one month less a day to qualify as a full month.

The program performs a deferred annuity calculation when the first payment date is more than one year after the transfer date. It performs the immediate annuity calculation when the First Payment Date is no more than one normal interval (as measured in full months) after the Transfer Date. This leaves a gray area where the program will not perform a calculation. Therefore, the program will not calculate in the following cases: semiannual payments where the First Payment Date is not less than 7 full months after the Transfer Date, quarterly payments where the First Payment Date is not less than 4 full months after the Transfer Date, and monthly payments where the First Payment Date is not less than 2 full months after the Transfer Date.

Several calculations depend on the age of a person on some given date. As per IRS rules, the age is based on the age as of the nearest birthday. The program uses the age of the birthday within 183 days. If two birthdays fall within 183 days, the program uses the later one.

In prorating the first payment for short interval periods, the program bases the proration on actual days. Other methods of proration are equally valid.

Qualified Personal Residence Trust (QPRT)

With the Qualified Personal Residence Trust (QPRT), the grantor retains an income interest in irrevocably transferred property, and the remainder interest is passed on to the grantor's beneficiaries.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

Principal – Enter the fair market value of the assets placed in the trust.

Grantor's Current Age – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Second Age (0 if None) – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Term of Trust – Enter the number of years the trust will provide income to the grantor.

After-Tax Growth Rate – Enter the after-tax growth rate of the trust assets.

Combined Death Tax Bracket – Enter a bracket which takes into account both the state and federal death taxes.

Summary Report

The Summary Tab displays the taxable portion of a QPRT. To calculate this value, the calculation determines the value of the interest retained by the grantor (income interest plus reversion). It then subtracts the value of the grantor's retained interest from the principal placed into the trust. The result is the taxable portion of the QPRT. The Taxable Gift, the Value of Property after three years, and the Potential Death Tax Savings (Combined Bracket times [value of Property minus Taxable Gift]) are also shown in the results.

Highest Rate of Return for Three Preceding Years – Calculates the highest rate of return earned by the fund in any one of the three years preceding the year of the contribution. If the fund has been in existence less than three years, a presumed rate of return must be used. For funds created before May 1989, the presumed rate is 9.0%. For later periods, the IRS determines the presumed rate. This presumed rate for new funds is expected to be 9.4% for funds created after April 1989 and before 1990; 9.8% for funds created in 1990 through 1992; 9.4% for 1993; 8.4% for 1994; 6.8% for 1995; 7.2% for 1996.

(One – Five) Life Remainder Factor – The program automatically enters the factor which correlates to the number of lives used. The tables containing the factor can be found in the IRS Publication 1457, Actuarial Values Alpha Volume. If the yearly rate of return is a percentage that is between those rates for which returns are provided in the table, a linear interpolation is required.

Charitable Deduction for Remainder Interest – The present value of the remainder interest is determined by multiplying the remainder factor times the fair market value of the property contributed.

Donor's Deduction as Percentage of Property Transferred – This amount shows the percentage of the property value that will not be taxed. The percentage is obtained by dividing the Charitable Deduction for Remainder Interest by the Property Value. The Graph Report shows the value using a pie graph.

Factors Report

The Charitable Financial Planner derives a factor from the duration of the trust that is entered in the **Term of Trust** input field. The factor is used to calculate how much income (Remainder Interest) will be paid to the grantor of the trust.

Graph

The bar graph shows the Taxable Gift that would be given to the grantor of the trust depending on the term of the trust and the grantor's age at the end of the term.

Grantor Retained Annuity Trust (GRAT)

A Grantor Retained Annuity Trust (GRAT) provides the grantor with a fixed annuity interest in an irrevocably transferred property. The remainder interest generally passes to the grantor's designated beneficiaries at the end of a specified term or at the earlier of the end of a specified term or the grantor's death.

Optimize Button

The Optimize Button provides two choices for optimization if

- Shorter or Life as the Calculation Type is selected.
- Term as the Calculation Type is selected.

Optimizing for Shorter or Life

The Optimize Button gives you two choices if you select **Shorter** or **Life** as the Calculation Type:

- Optimize for Taxable Gift of Residual Interest in Trust
- Optimize for Taxable Gift Limited by Rev. Rul. 77-454

If you select **Optimize for Taxable Gift of Residual Interest in Trust**, the program near-zeros the Taxable Gift Value of Residual Interest in Trust, without regard to Rev. Rul. 77-454.

If you select **Optimize for Taxable Gift Limited By Rev. Rul. 77-454**, the program calculates the highest Rate of Annuity which results in a Rev. Rul. 77-454 Taxable Gift value which does not exceed the Shorter of Term of Life Taxable Gift value. The program does not perform a near zero-out calculation for the Rev. Rul. 77-454 Taxable Gift since the result would invariably be a nonsensical 99% Rate of Annuity.

Optimizing for Term

The Optimize Button gives you two choices for optimization if you select **Term** as the type of calculation:

- Optimize for Taxable Gift of Residual Interest in Trust
- Optimize for Taxable Gift as per Reg. Section 25-2702-3(e), Ex. 5

If you select **Optimize for Taxable Gift of Residual Interest in Trust**, the program near-zeros the Taxable Gift (based on term interest). This would be an optimum result if Example 5 of Reg. 25.2702-3(e) were not a concern. The resulting Taxable Gift would be correct only if that IRS Regulation (or the IRS interpretation of that regulation) were to be ruled to be invalid.

If you select **Optimize for Taxable Gift as per Reg. Section 25-2702-3(e), Ex. 5**, the program near-zeros the Taxable Gift as per Reg. Sec. 25.2702-3(e), Ex. 5 (which is the shorter of term of life valuation).

Term Calculations and the Regulations

According to the Regulations, the retained annuity interest's value cannot exceed the actuarial value of an annuity for the shorter of the specified term or life, even if the trust instrument itself calls for payment of a term-certain annuity. Therefore, when you run a Term case with the program, you will see three Taxable Gift values. The first is based solely on a Term Interest valuation (Taxable Gift 1) and is not supported by the Regulations. Some commentators suggest that this is the correct approach and that the Regulations are incorrect. The program then shows a Taxable Gift as per Reg. §25.2702-3(e), Ex. 5 (Taxable Gift 2) which is a shorter of term or life valuation. This more conservative value generally is a higher taxable gift value than would result otherwise. Finally, the program shows a Taxable Gift limited by Rev. Rul. 77-454 (Taxable Gift 3). When the exhaustion test of Rev. Rul. 77-454 starts to kick-in, it generally results in an even higher taxable gift value. The possible application of Rev. Rul. 77-454 in Term cases is dependent on the viewpoint that one must use a shorter of term or life valuation to begin with. If one did not need to use such a valuation, there would appear to be no argument for applying Rev. Rul. 77-454 at all.

Actuarially, the Example 5 values are rather straightforward unless you are running a case involving a payment made at the beginning of the period. For such cases, we use a Shorter of Term or Life calculation that has one less payment than usual. This is done to equalize the number of payments for the Shorter case with the Term case. Term cases with a payment at the beginning are valued actuarially by the IRS by simply adjusting the Frequency Adjustment Factor. For example, a two-year semiannual term valuation involves four payments at points 0, ½, 1 and 1½. However, Shorter of Term or Life cases (and for that matter, all cases with life contingencies) with a payment at the beginning of period are valued by the IRS by adding a payment to the normal end of the period valuation. For example, a two year semiannual shorter of term or life calculation involves five payments at points 0, ½, 1, 1½ and 2. Our revised Ex. 5 calculations eliminate the last payment (the one at point 2 in our example) by using a pro-rata valuation for a one-year case and a two-year case to eliminate the last payment. This valuation approach is based on informal consultations with the National Office of the IRS.

For all three GRAT calculation types, the program includes a Rev. Rul. 77-454 test (also known as the “exhaustion” test). The program also shows Taxable Gift if the value of Rev. Rul. 77-454 is ignored (some commentators suggest Rev. Rul. 77-454 is incorrect although it is now part of the §7520 Regs.). It then shows the Taxable Gift limited by Rev. Rul. 77-454. Often the values are the same.

However, if the Rate of Annuity is higher than the Sec. 7520 rate, the Taxable Gift under Rev. Rul. 77-454 will often be higher. In some cases where the Annual

Payment Growth value is negative, the Rev. Rul. 77-454 Taxable Gift value may actually be lower.

For each Calculation Type, the Optimize choices will produce the result which is most consistent with IRS regulations and rulings.

Note

The U.S. Tax Court held Example 5 of Treas. Reg. Section 25.2702-3(e) to be invalid in *Walton v. Commissioner*, 115 T.C. No. 41. (See <http://www.ustaxcourt.gov/InOpHistoric/walton.TC.WPD.pdf>). 12/22/2000.

There is now authority for the proposition that a GRAT can be created for a term of years, with payments to the grantor's estate in the event of the death of the grantor during the term, and the GRAT can be valued using the annuity factors for a term of years (and not the shorter of a term or life). If this decision is correct (and not overturned on appeal), it should be possible to create a GRAT that has a remainder with a value of zero (or very close to zero).

To calculate the annuity percentage that will result in a near-zero remainder, make sure that the "Trust Type" is "Term," then click on the "Optimize" button and select "Optimize for Taxable Gift of Residual Interest in Trust."

If a GRAT is required to pay an annuity that will exhaust the GRAT before the end of the stated term, the literal application of Treas. Reg. Section 25.7520-3(b)(2)(i) might result in a small positive value for the remainder, due entirely to rounding in the calculation.

Finally, please note that the program cannot accurately value the GRAT created by the taxpayer in *Walton*. In order to comply with Treas. Reg. 25.2702-3(b)(3) (as it existed before amendment by T.D. 8899, 65 F.R. 53587), the *Walton* GRAT required payments shortly after December 31 of each year. The trust instrument required an annuity of 49.35% for the first 12 months and 59.22% the second 12 months of the two-year term. Prorating those payments on a daily basis, the trust created on 4/7/1993 required a payment of 36.3703% (269/365ths of 49.35%) on or after 12/31/1993, 56.6241% (96/365ths of 49.35% plus 269/365ths of 59.22%) on or after 12/31/1994, and 15.5757% (96/365ths of 59.22%) on or after 4/7/1995. (According to the Tax Court opinion, the trust actually distributed 36.3703% for 1993 and 56.6240% for 1994). This program is designed to value distributions based on the anniversary of the trust and the valuation of these irregular distributions is beyond the scope of the program.

Edit Payout Rates Button

This button appears only if you select **Yes** for the input data fields named **Varying Annuity Payments**. By editing the rate, you can choose to grow annuity payments by a constant rate or enter your own rate. You can also view the calculated amount

of the annual payout. The program will not allow the entry of a value more than 20% greater than the preceding value.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months) and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

Calculation Type – Select Life, Term or Shorter. For more information on calculation types, see page 16.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly, and Weekly).

Payment Timing – Select **Begin** or **End** to indicate when the payment should be made for the selected payment period. This helps to determine what payout frequency factor is used in the calculation.

Percentage Payout – Enter the projected payout (percentage) that should go to the beneficiary during the life of the trust.

Annual Growth of Principal – Enter the projected growth rate (percentage) for the principal. This does not affect the Taxable Gift Value. This value is only used for the Economic Schedule.

Income Earned by Trust – Enter the projected income earned by the trust (percentage). This value is only used for the Economic Schedule.

Varying Annuity Payments – Answer **Yes**, if the payouts will vary from year to year. This action will activate the **Edit Payout Rates** button. Click the button and change the payout rates. When you indicate that there are varying annuity payments which do not grow by a constant rate, the program always uses the Exact Method for Rev. Rul. 77-454.

Principal – Enter the fair market value of the assets placed in the trust.

Grantor's Current Age – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Second Age (0 if None) – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Term of Trust – Enter the number of years the trust will provide income to the grantor.

With Reversion? – Enter whether or not the assets should revert to the grantor's estate in the event of the grantor's death during the term of the trust. Yes is the most common entry. Trusts which have terms based solely on life expectancy do not include a reversion.

§2702 Applies? – Answer **Yes** to apply §2702. Typically, the §2702 rules apply when both of these apply:

- The transfer is to or for the benefit of a member of the transferor's family.
- The transferor or applicable family member retains the interest in the trust.

Summary Report

This calculation provides detailed analyses of the selected type of GRAT, showing required annuity factors, adjustment factors, and the "subtraction method" of computing the taxable gift value of the residual interest in trust.

The gift tax value of the transferred assets is determined at the time the trust is created and funded using the "subtraction method." The gift tax value is determined

by subtracting the value of the annuity interest (and other retained interests, such as the right to have the assets revert back to the transferor's estate if he or she does not live the entire term of the trust) from the fair market value of the assets transferred in the trust. How the annuity interest and any other retained interests are valued depends on who the remainder beneficiary(ies) is (are) and who retains the annuity and other interests relative to the transferor. There is a more restrictive and less appealing set of valuation rules when family members are beneficiaries and certain family members retain interests in the property both before and after the trust is created than when unrelated parties are involved.

When unrelated parties are involved, all interests are valued according to their actuarial present values using the valuation rules of IRC §7520. These rules mandate the use of a discount rate based on the 120-percent applicable federal annual midterm rate for the month in which the trust is created and funded and the mortality factors from Table 80CNSMT, if the interests have a life contingency. The 120 percent applicable federal annual midterm rate changes monthly and is reported in the IRS's Cumulative Bulletin, in various tax services, and in various financial news publications such as The Wall Street Journal. (See Fed Interest Rates in the Money & Investing section, generally between the 18th and 23rd of the preceding month). You can also obtain this rate by visiting Brentmark's web site at <http://www.brentmark.com/AFRs.htm>.

If family members are involved, the gift tax valuation rules of IRC §2702 may apply. Under these rules, certain types of retained interests, such as the right to have trust assets revert to the transferor's estate in the event of the transferor's premature death, may be valued at zero when computing the gift tax value of the transfer. As a general rule, every retained interest but a "qualified interest" is assigned a value of zero for gift tax valuation purposes. In the case of a GRAT, a qualified interest is the right to receive "fixed amounts" payable annually, more frequently (a fixed annuity), or a qualified remainder interest. That is, any non-contingent remainder interest if all other interests in the trust consist of qualified retained interests (qualified annuities).

The right to receive a "fixed amount" means the annuity must be a specified fixed dollar amount or a fixed percentage of the initial value of the trust payable each year rather than merely the income produced by the assets in the trust. Although fixed payments throughout the term of the trust are the norm, final regulations define the term "fixed amount" more liberally. They would permit the annuity payments to increase or decrease in a systematic manner each year without adverse gift tax consequences. However, the annuity amount may not increase by more than 20 percent over the prior year. For example, if the initial annuity payment is \$1,000, the trust could provide that annuity payments in subsequent years increase by as much as 20 percent, to \$1,200 in the second year, \$1,440 the third year, and so on. If the transferor retains the right to the greater of a fixed amount or the trust income in each year for a term of years, the annuity will still be a qualified annuity. However, the right to the trust income, if any, in excess of the fixed amount is

valued at zero for gift tax purposes. Thus, the retained interest is valued for gift tax purposes as if it did not include any rights to excess income.

Reversion Report

This report calculates the assets that would revert to the grantor's estate in case of the grantor's death during the term of the trust.

Rev. Rul. 77-454 Report

The Rev. Rul. 77-454 is part of the Section 7520 Reg. and it is also known as the "exhaustion test". This report calculates a limit in the valuation of annuities. The Charitable Financial Planner shows the steps used to calculate the value of the exhausted annuity by splitting the annuity into two smaller parts:

- An annuity that lasts up to but does not include the period when the original annuity exhausts.
- A single payment equal to the final partial payment of the original annuity.

The two parts are then added together. The total is the Value for Rev. Rul. 77-454 Test report.

When Rev. Rul. 77-454 may apply for a Shorter of Term or Life calculation, the program includes a year-by-year Rev. Rul. 77-454 schedule. As for the mechanics of the 77-454 test, there are gray areas once you get beyond the simple case of an annual payment at the end of the period. The program uses an approach long followed for the similar Rev. Rul 77-374 test that is applied for Charitable Remainder Annuity Trust life cases. See George H. Moor Est., 43 TCM 1982-299, for the proposition that annual payments are adjusted by a payout frequency factor.

Economic Schedule

The GRAT and GRUT calculations include an Economic Schedule. Its growth and income values are calculated on an average annual basis. This schedule is available to show an assumed future value of the remainder of the trust if capital growth and income were to rise or fall from the assumed income rate. It should be noted that the Annual Growth of Principal and Income Earned by Trust data input fields are only used for the Economic Schedule and are not used for any other part of the GRAT or GRUT calculations.

Graph

This is a graphical (pie graph) view of how the principal is divided into two parts:

- Taxable Gift
- Non-taxable Portion.

Grantor Retained Unitrust (GRUT)

A Grantor Retained Unitrust (GRUT) provides the grantor with a fixed percentage of the value of the irrevocably transferred property (determined annually) for a fixed period of years. The remainder interest generally passes to the grantor's designated beneficiaries at the end of a specified term or at the earlier part of the end of a specified term or the grantor's death.

A grantor retained unitrust may be an effective means for a wealthy client who wants or needs to retain all or most of the income from a high-yielding and rapidly appreciating property to transfer the property to a child or other person with minimal gift or estate tax. GRUTs are particularly indicated where the client has one or more significant income-producing assets that he or she is willing to part with in the future to save federal and state death taxes, to probate costs, to obtain privacy on the transfer, and to protect the asset against the claims of creditors.

A GRUT is created by transferring one or more high-yield assets into an irrevocable trust and retaining the right to an annuity interest for a fixed term of years or for the shorter of fixed term or life. When the retention period ends, assets in the trust (including all appreciation) go to the named "remainder" beneficiary (ies). In some cases, other interests such as the right to have the assets revert back to the transferor's estate in the event of the transferor's premature death, may be included.

If family members are involved, the gift tax valuation rules of IRC §2702 may apply. Under these rules, certain types of retained interests, such as the right to have trust assets revert to the transferor's estate in the event of the transferor's premature death, may be valued at zero when computing the gift tax value of the transfer. As a general rule, every retained interest but a "qualified interest" is assigned a value of zero for gift tax valuation purposes.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Transfer Date – Enter 1 to 12 to indicate the month for the transfer date and then enter the year of the transfer (mm/yyyy). If you enter a two-digit number such as 90, the program will automatically enter it as 1990.

§7520 Rate – The program automatically displays three allowable 120% Midterm Applicable Federal Interest Rates (the current month and two preceding months)

and places the rate that is most favorable in this input. You can override the program's value by entering another rate. In which case, the phrase "Invalid §7520 Rate" appears. In some cases, 30% will appear as a rate. Thirty percent is the default value that appears when there is not a current AFR available for the chosen month. Download or manually update your AFR table. (See page 6 for more information about adding and downloading AFRs.) Check our web site at <http://www.brentmark.com/AFRs.htm> for an updated list of AFR Rates.

Note: For May or June of 1999, you have the choice of using the Mortality Table 80CNSMT or the Mortality Table 90CM. For any dates prior to May 1, 1999, the program will automatically use the 80CNSMT mortality table. For any dates after June 30, 1999, the program will automatically use the 90CM mortality table. See the Reference Information section for more information on this ruling (T.D. 8819; REG-103851-99).

Calculation Type – Select Life, Term or Shorter. For more information on calculation types, see page 16.

Principal – Enter the fair market value of the assets placed in the trust.

Grantor's Current Age – This data input field is only available when Life is chosen as the Calculation Type. Use a value from 0 to 109 to indicate the age of the person whose life is being used to measure the term of the trust. Enter the age of this person(s) using the birth date which is nearest to the transfer date.

Term of Trust – Enter the number of years the trust will provide income to the grantor.

Payment Period – Select the payment schedule that should be followed for each year (Annual, Semiannual, Quarterly, Monthly).

Months Valuation Precedes Payout – Enter a value to indicate the number of full months by which the valuation date precedes the first payout. The program will only allow valid input values according to which Payment Period was selected on the previous input field.

Percentage Payout – Enter the projected payout (percentage) that should go to the beneficiary during the life of the trust.

Annual Growth of Payments – Enter the annual growth of annuity payments, (maximum 20%, minimum -99%).

Annual Growth of Principal – Enter the projected growth rate (percentage) for the principal. This does not affect the Taxable Gift Value. This value is only used for the Economic Schedule.

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Income Earned by Trust – Enter the projected income earned by the trust (percentage). This value is only used for the Economic Schedule.

With Reversion? – Enter whether or not the assets should revert to the grantor's estate in the event of the grantor's death during the term of the trust. Yes is the most common entry. Trusts which have terms based solely on life expectancy do not include a reversion.

§2702 Applies? – Answer **Yes** to apply §2702. Typically, the §2702 rules apply when both of these apply:

- The transfer is to or for the benefit of a member of the transferor's family.
- The transferor or applicable family member retains the interest in the trust.

Summary Report

The Summary Tab includes computations of the economic values as well as the gift tax values (if different because of the rules under §2702) of the component interests of the trust, including the value of the remainder interest, the reversionary interest, if any, and the amount of the taxable gift as a result of the transfer in trust.

In addition, the calculation provides detailed analyses of the selected type of GRUT; showing required annuity factors, adjustment factors, and the "subtraction method" of computing the taxable gift value of the residual interest in trust.

The summary report also shows an annuity payment equal to a fixed percentage of the current value of each year of the assets in trust. In this sense, a GRUT is similar to a variable annuity. The payout rate is fixed, but since the value of the assets can be expected to vary year to year, the dollar annuity payout also varies year to year.

Economic Schedule

The GRAT and GRUT calculations include an Economic Schedule. Its growth and income values are calculated on an average annual basis. This schedule is available to show an assumed future value of the remainder of the trust if capital growth and income were to rise or fall from the assumed income rate. It should be noted that the Annual Growth of Principal and Income Earned by Trust data input fields are only used for the Economic Schedule and are not used for any other part of the GRAT or GRUT calculations.

Graph

This is a graphical (pie graph) view of how the principal is divided into two parts:

- Taxable Gift
- Non-taxable Portion

Interrelated Estate Tax

Estate Tax calculates the Federal Estate Tax and state death taxes (in states where the federal state death tax credit is the same as the state death tax). “Interrelated” Estate Tax calculates the Federal Estate Tax and charitable deduction where each depends on the other.

Data Input Fields

Enter the appropriate values into the data input fields for this calculation model.

Year of Death – Enter the year of death (yyyy).

Gross Estate – Enter the total amount of the Gross Estate.

Deductions – Enter the total amount of allowable deductions. Include estate settlement costs that are deductible, and debts for which the estate is liable.

Adjusted Taxable Gifts – Enter the Adjusted Taxable Gifts (total taxable gifts within the meaning of IRC §2503 made by the decedent after 12/31/76, other than gifts that can be included in the decedent’s gross estate).

Unified Credit – Enter the amount of unified credit remaining. If you enter a number higher than the unified credit allowable for the entered year of death, the allowable number will be used.

Other Credits – Enter any other credits that may apply. This includes the Credit for federal gift taxes on pre-1977 gifts, the Credit for foreign death taxes, and the Credit for tax on prior transfers. It does not include the Credit for state death taxes.

State Death Tax – Enter 0, and the program will use the federal state death tax credit as the state death tax. Enter a number less than the federal state death tax credit, and the program will use a value equal to the federal state death tax credit.

When entering a 0, the program handles all “pick-up” states automatically. For other states, enter the higher state death tax. The program does not handle Nevada cases.

Fixed Non-charitable Bequest – Enter the total amount of the Fixed Non-charitable Bequests. These are specified amounts going to non-charitable beneficiaries.

Fixed Charitable Bequest – Enter the total amount of the Fixed Charitable Bequest. These are specified amounts going to charitable beneficiaries.

Percent of Remainder to Charity – Enter the percentage of the residue or remainder that goes to charity. It is this amount which results in an interrelated calculation.

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Estate Tax Calculations – Recent changes in estate tax law have resulted in higher exemption amounts and other changes affecting estate tax calculations.

Charitable Financial Planner allows you to select between three potential scenarios.

- 2011 Sunset
- 2010 Repeal in 2010+
- 2009 Rates in 2009+ (program default)

These choices will affect program computations for 2010 and later years only.

Explanation:

2011 Sunset (current law with sunset): Assumes repeal occurs in 2010 and prior law returns in 2011 with a 55% top rate and \$1 million exemption. This is way the tax law is currently written. This may be a reasonable assumption if one believes that no changes to the current law are likely and that the sunset provisions will prevail. One of the other two choices may be a better assumption if one believes that the sunset provisions will not be implemented due to future law changes.

2010 Repeal in 2010+ (current law modified to remove sunset and make repeal permanent): Assumes repeal becomes effective in 2010 and stays effective thereafter. This is what was originally intended by the tax writers, but ultimate repeal remains uncertain due to the inclusion of sunset provisions. This may be a reasonable assumption if one believes that the sunset provisions will not be implemented and repeal will ultimately prevail.

2009 Rates in 2009+ (current law modified to continue estate tax with no repeal): Assumes repeal never occurs and last scheduled rates are used in future years. This may be a reasonable assumption if one believes that repeal is unlikely to occur.

Summary Report

These calculations results show the federal estate tax payable if a transfer at death is made. All charitable deductions are subtracted from the gross estate to determine the taxable estate with its tentative tax base. From these figures, the net federal estate tax and the state death tax amounts are calculated.

Section 3: Reference Information

§2702

IRS Notice 89-24

IRS Notice 89-60

Rev. Rul. 77-374

Reg. §25.7520-3(b)(2)(v), Example 5

Treasury Decision 8819

Section 2702

Section 2702 provides that all retained interests in trusts that are not “qualified interests” are valued at zero. The amount of any gift is then determined by

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subtracting from the value of the property the value of the retained interest. The valuation of retained interests in trust under Section 2702, specifically does not apply to incomplete gifts (determine without regard to whether there is consideration), personal residence trust, and charitable lead trusts. This occurs if the only interest other than the remainder or a qualified annuity or unitrust interest is the charitable lead interest.

Section 2702 also does not apply to assignment of remainder interests in trusts if the only retained interest is distribution of income in the sole discretion of an independent trustee, as defined in Code section 674(c), and certain property settlement agreements.

The following definitions apply under Section 2702:

- A member of the family includes the spouse of an individual, the ancestor, lineal descendant, sibling of an individual, the individual's spouse, the spouse of any such person, or the brother or sister of the individual.
- An applicable family member includes the spouse of an individual, an ancestor of the individual or the individual's spouse, or the spouse of any such person.
- A transfer in trust includes a transfer to a new trust or an interest in an existing trust. But, it is not a transfer resulting from exercise of a special power of appointment; exercise, release, or lapse of a power of appointment that would not constitute a taxable gift (e.g., lapse of "Crummey" power which does not exceed "5 or 5" limitation); or a disclaimer.
- A retained interest is one held by the same individual both before and after the transfer to the trust, or a carved out term interest.

IRS Notice 89-24

In Notice 89-24, 1989-1 CB 660, the IRS provides initial guidance and transitional rules for use in determining the present value of an annuity, an interest for life or for a term of years, or a remainder or reversionary interest under Code Sec. 7520.

Text of Notice 89-24

The purpose of this notice is to provide guidance to taxpayers in determining the present value of an annuity, an interest for life or for a term of years, or a remainder or reversionary interest under section 7520 of the Internal Revenue Code. The methods established under section 7520 and this notice apply for valuation purposes under several Code provisions that include sections 170, 642, 664, 2031, 2055, 2512, 2522, and 2624.

Background

In general, actuarial factors used in determining the present value of an annuity, an interest for life, or a remainder or reversionary interest are, for federal estate, gift, and certain income tax purposes, based on two components: the life expectancy of a designated individual or individuals (the “mortality component”) and the assumed rate of return (the “interest rate component”). Valuation factors for determining the present value of interests measured by a term certain are based on two components: a term of years component and an interest rate component. For gifts made before May 1, 1989, and for estates of decedents dying before that date, the mortality component is computed on the basis of Table 1 of United States Life Tables: 1969-71 and the interest rate component is assumed to be 10 percent per annum. Actuarial factors used in the valuation of interests that are measured by one life can be found in sections 1.642(c)-6(d)(3) and 1.664-4(b)(5) of the Income Tax Regulations, section 20.2031-7(f) of the Estate Tax Regulations, and section 25.2512-5(f) of the Gift Tax Regulations. Actuarial factors used in the valuation of interests that are measured by two lives are contained in Internal Revenue Service (Service) Publication 723E (12-83), Actuarial Values II: Factors at 10 Percent Involving One and Two Lives. In addition, actuarial factors used in the valuation of charitable remainder unitrust interests and pooled income fund interests that are measured by two lives are contained in I.R.S. Publication 723C (9-84), Actuarial Values I: Valuation of Last Survivor Charitable Remainders, Part C, and I.R.S. Publication 723D (9-84), Actuarial Values I: Valuation of Last Survivor Charitable Remainders, Part D, respectively. The current method for determining actuarial factors, as described in this paragraph, is applicable to gifts made before May 1, 1989, and estates of decedents dying before May 1, 1989.

Section 5031 of the Technical and Miscellaneous Revenue Act of 1988 ((P.L. 100-647) 102 Stat. 3342) amended the Internal Revenue Code by adding section 7520. Generally, under section 7520, the value of an annuity, interest for life or for a term of years, or remainder or reversionary interest is determined under new tables that are to be prescribed by the Secretary. Section 7520 is applicable to gifts made after April 30, 1989, and to estates of decedents dying after that date.

Interest Rates and Source of Tables for Transfers after April 30, 1989

With respect to the interest rate component, the new valuation tables under section 7520 of the Code are to be based, in part, on the interest rate that the Service announces monthly in a news release and publishes in a revenue ruling in the Internal Revenue Bulletin. This rate is 120 percent of the applicable federal midterm rate compounded annually (rounded to the nearest two-tenths of one percent) in effect under section 1274(d)(1) of the Code for the month in which the valuation date falls. For example, the applicable federal midterm interest rate for February 1989, as set forth in Rev. Rul. 89-15, 1989-6 I.R.B. 9, is 9.42 percent 120 percent of this amount is 11.36 percent. Thus, if section 7520 were effective as of February 1, 1989 (instead of May 1, 1989), then the rate for February under section 7520 would be determined by rounding the rate of 11.36 to 11.4 percent.

With respect to the mortality component, the new valuation tables will be based on the most recent mortality experience available. The Service will publish these tables in publications that may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D.C. 20404.

Charitable Contributions Made after April 30, 1989

Section 7520(a) of the Code provides in part that, if an income, estate, or gift tax charitable contribution is allowed for any part of the property transferred, the taxpayer may use the federal midterm rate for the month of the transfer or for either of the 2 months preceding the month in which the valuation date falls. In the case of transfers of more than one interest in the same property, each interest must be valued on a basis consistent with the valuation of all other such interests. For example, if a taxpayer transfers property to a charitable remainder trust in October 1989, the taxpayer may use an interest rate based upon the federal midterm rate for August, September, or October 1989 however, the taxpayer must use the same rate for both the non-charitable lead interest and the charitable remainder interest. For charitable contributions made in May or June 1989, if the taxpayer elects to use the federal midterm rate for the preceding 2 months, which may include March and April, the valuation factors for March or April that involve the lives of one or more individuals will be computed on the basis of Table 1 of United States Life Tables: 1969-71 and interest at 120 percent of the applicable federal midterm rate for March or April. Thus, the March and April actuarial factors (in the case of contributions made in May or June) will not be based on the new mortality component.

Charitable contribution transfers and other transfers of partial interests in property actually made in March or April 1989 will continue to be valued with actuarial factors based solely on Table 1 of United States Life Tables: 1969-71 and an assumed interest rate of 10 percent per annum.

In the case of gifts made after April 30, 1989, and estates of decedents dying after that date, if no charitable deduction is allowable for any portion of the property

transferred, then all interests therein must be valued on the basis of 120 percent of the applicable federal midterm rate for the month in which the transfer is made.

Initial Guidance on New Valuation Factors

The following choices explain how certain factors (remainder interest, income interest, annuity interest) are computed under different Calculation Types (Term or Life).

- Valuation of Interests Measured by a Term Certain After April 30, 1989
- Valuation of Interests Measured by One or More Lives in the Case of Charitable Contributions Made in May and June 1989

Valuation of Interests Measured by a Term Certain After April 30, 1989

Although the Service publications setting forth the new tables of valuation factors are not yet available, many of these factors may be determined by taxpayers prior to issuance of the publications. Taxpayers who expect to make transfers after April 30, 1989, of partial interests in property measured by a term of years may find applicable term certain factors in commercially available financial publications that contain present value tables computed to six significant figures. Taxpayers may also compute the term certain valuation factors for valuing a remainder interest, an income interest, or an annuity interest. These computations are illustrated by the following examples:

$$\text{RemainderFactor} = \frac{1}{(1+i)^t}$$

Example 1: Computation of a Remainder Interest. Assume that a donor makes a gift of an interest in a trust for an 8-year term certain after April 30, 1989, and needs to value the remainder interest. Assume also that 120 percent of the applicable federal midterm rate for the month is 10.8 percent. The applicable factor for valuing a remainder interest based on a term of years may be determined by use of the following mathematical formula:

here i equals 120 percent of the applicable federal midterm interest rate under section 7520 and the exponential power t equals the number of years in the term.

Based upon interest at 10.8 percent per annum, the present worth of \$1.00 due at the end of 8 years is \$0.440232.

Example 2: Computation of an Income Interest. Assume the same facts as in Example 1, except that the donor needs to value the income interest. The valuation factor for a term certain income interest may be computed by using this formula:

$$\text{Income Factor} = 1.000000 - \text{Remainder Factor}$$

Thus, if 120 percent of the applicable federal midterm rate for the month is 10.8 percent and the remainder factor as computed in Example 1, above, is .440232, the income factor for an income interest in a trust for a term of 8 years is 1.000000 minus .440232, which equals .559768.

Example 3: Computation of an Annuity Interest. Assume that a donor makes a gift of an annuity interest for an 8-year term certain after April 30, 1989. Assume also that 120 percent of the applicable federal midterm rate for the month is 10.8 percent. The valuation factor for a term certain annuity interest may be computed by using this formula:

$$\text{AnnuityFactor} = \frac{\text{IncomeFactor}}{i}$$

...where *i* equals the applicable interest rate under section 7520.

Thus, if 120 percent of the applicable federal midterm rate for the month is 10.8 percent and the income factor, as computed in Example 2 above, is .559768, the valuation factor for an annuity interest for a term of 8 years is .559768 divided by 10.8 percent, which equals 5.1830.

Example 3 may be used to compute term certain valuation factors for charitable remainder annuity interests.

Valuation of Interests Measured by One or More Lives in the Case of Charitable Contributions Made in May and June 1989

In valuing a charitable remainder interest in a transfer that is made to a pooled income fund after April 30, 1989, the federal midterm rate is disregarded. Instead, such interests are valued on the basis of the applicable yearly rate of return of the pooled income fund at the time of the transfer and the applicable mortality table. Taxpayers who plan to make charitable contributions to pooled income funds in May or June 1989 and who wish to rely on the actuarial factors that are applicable for the preceding 2 months, which may include March and April can, in the case of remainder interests that are measured by a single life, obtain the applicable factors from Table G of section 1.642(c)-6(d)(3) of the regulations. Thus, in the case of contributions in May or June, taxpayers are permitted to elect to use actuarial factors for the 2 months preceding the contribution, notwithstanding the fact that the federal midterm rate is disregarded in valuing pooled income funds.

Example 4: Computation of a Remainder Interest Transferred to a Pooled Income Fund. Assume that in May 1989 a donor aged 45, transfers property to a pooled income fund, retaining the income interest for life. Assume also, that at the time of the transfer, the highest yearly rate of return of the fund for its three preceding taxable years is 10.2 percent and 120 percent of the applicable federal midterm rate

for one of the 2 months before May is 11.4 percent. The donor elects to value the transfer based on the prior mortality experience contained in Table G. The applicable yearly rate of return for the fund is used when valuing a remainder interest transferred to a pooled income fund. The applicable valuation factor is .11121 that is found in Table G under the column for 10.2 percent yearly rate of return. The value of the transferred interest multiplied by this factor represents the present worth of the remainder interest in property transferred by a donor, aged 45, to a pooled income fund having a yearly rate of return of 10.2 percent.

The valuation factors for valuing transfers to pooled income funds based on two lives are found in Table G(2) of Service Publication 723D (9-84), cited above.

Taxpayers who make qualifying charitable contributions in May or June 1989 of certain partial interests in property (other than contributions to charitable remainder unitrusts and pooled income funds) that are measured by a single life, and who wish to elect under section 7520(a), can obtain the applicable factors for March and April for valuing many such interests from Table G, cited above.

Example 5: Computation of a Qualifying Remainder Interest in a farm. Assume that a donor, aged 40, makes a gift to a charity of a remainder interest in farmland in May 1989. Assume, for purposes of illustration, that 120 percent of the applicable federal midterm rate for one of the 2 months before May, which the donor elects to use, is 11.4 percent. The applicable remainder interest actuarial factor, which may be found in Table G in the column listing factors for the yearly rate of return of 11.4 percent, is .06828. This is the present worth of \$1.00 due at the death of a person aged 40 based on an interest rate of 11.4 percent.

Taxpayers who plan to make contributions of certain partial interests in property to charity after April 30, 1989, and who wish to value remainder interests that are measured by two lives may obtain the applicable factors for the months of March and April 1989 from Table G(2), cited above.

Administrative Pronouncement

This document serves as an “administrative pronouncement” as that term is described in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Drafting Information

The principal author of this notice is William L. Blodgett of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information about this notice, call Mr. Blodgett at (202) 377-9666.

IRS Notice 89-60

In Notice 89-60, 1989-1 CB 700, the IRS provides guidance in applying tables containing actuarial factors to be used in determining the present value of an annuity, an interest for life or for a term of years, or a remainder or reversionary interest. In accordance with section 7520 of the Internal Revenue Code, this notice provides tables containing actuarial factors to be used in determining the present value of an annuity, an interest for life or for a term of years, or a remainder or reversionary interest. The tables set forth in this notice apply for valuation purposes under several Code provisions including sections 170, 642, 664, 2031, 2055, 2512, 2522, and 2624.

Background

Section 5031 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. No. 100-647, 102 Stat. 3342 (1988)) amended the Internal Revenue Code by adding section 7520. Generally, under section 7520, the value of an annuity, interest for life or for a term of years, or remainder or reversionary interest is determined under new tables that are to be prescribed by the Secretary. Section 7520 is applicable to gifts and certain other transfers made after April 30, 1989, and to estates of decedents dying after April 30, 1989. The new tables prescribed by section 7520 are to be based on an interest rate that is 120 percent of the applicable federal midterm rate for the month in which the valuation date falls and the most recent mortality experience available. Section 7520(c)(3) provides that, no later than December 31, 1989, the Service must revise existing tables to take into account the most recent mortality experience available as of the time of such revision. The Service published Notice 89-24, 1989-10 I.R.B. 16, on March 6, 1989, to provide temporary guidance to taxpayers in planning transfers that would take place after April 30, 1989. Notice 89-24 provides formulas for computing the value of transferred interests based on the appropriate applicable federal midterm interest rate and the prior mortality experience.

Interest Rates and Tables for Transfers after April 30, 1989

The tables set forth below include many single life and term certain factors that are to be used for valuing interests in the case of gifts and certain other transfers taking place after April 30, 1989, and estates of decedents dying after that date. These new tables reflect the mortality experience based on the 1980 census. A complete set of tables, including two life and additional single life factors, will be published by the Service in the near future and will be available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, D.C. 20404.

The new tables contain factors that are based upon several different interest rates. The appropriate factor for any particular transaction will be based on the interest rate the Service announces monthly in a news release and publishes in a revenue ruling in the Internal Revenue Bulletin. The interest rate for a particular month is the rate that is published as 120 percent of the applicable federal midterm rate

(compounded annually) in effect under section 1274(d)(1) of the Code for the month in which the valuation date falls. That rate is then rounded to the nearest two-tenths of one percent. For example, the rate that is published as 120 percent of the applicable federal midterm rate (compounded annually) for May 1989 is 11.68 percent. That rate is then rounded to the nearest two-tenths of one percent, or 11.6 percent, for purposes of section 7520 of the Code.

As stated in Notice 89-24, if an income, estate, or gift tax charitable contribution deduction is allowed for any part of the property transferred, the taxpayer may use the federal midterm rate for the month of the transfer or for either of the two months preceding the month in which the valuation date falls. For charitable contributions made in May or June 1989, if the taxpayer elects to use the federal midterm rate for either of the preceding two months, which may include March and April, the valuation factors for March and April for interests based on the lives of one or more individuals will be computed on the basis of Table 1 of United States Life Tables: 1969-71 and interest at 120 percent of the applicable federal midterm rate for March or April. Thus, the March and April actuarial factors (in the case of charitable contributions made in May or June 1989) will not be based on the new term certain factors and mortality experience.

120 Percent of Applicable Federal Midterm Rate

The rates equal to 120 percent of the applicable federal midterm rate for March, April, and May 1989 are:

Valuation Month	Compounded Annually	Rounded
March	11.22	11.2
April	11.58	11.6
May	11.68	11.6

The following tables are included in this notice:

Table 80CNSMT—Mortality Table based on the 1980 census. This table supersedes Table LN, which is set forth in section 20.2031-7(f) of the Estate Tax Regulations.

Table R(1)—Single Life Remainder Factors for determining the present worth of a remainder interest based on a single life with interest rates between 8.2 percent and 12 percent. This table supersedes Table A, which is set forth in section 20.2031-7(f) of the regulations and section 25.2512-5(f) of the Gift Tax Regulations. Any remainder factor in Table R(1) may be converted to a factor for determining the present worth of an income interest or an annuity interest based on a single life by the method set forth in Notice 89-24. The remainder factors in Table R(1) are also applicable for determining the present worth of the remainder interest in property transferred to a pooled income fund having a yearly rate of return equal to the

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interest rates specified in the table. Table R(1) also supersedes Table G, which is set forth in section 1.642(c)-6(d)(3) of the Income Tax Regulations.

Table K—Adjustment factors based on timing and frequency of payments for annuities payable at the end of each interval. Table K supersedes the payout frequency factors set forth in sections 20.2031-7(b)(2) and 25.2512-5(b)(2) of the regulations.

Table B—Term Certain Remainder Factors for determining the present worth of a remainder interest postponed for a term certain. This table supersedes Table B, which is set forth in sections 20.2031-7(f) and 25.2512-5(f) of the regulations. A remainder factor may be converted to factors for determining the present worth of both an income interest and an annuity interest postponed for a term of years by the method set forth in Notice 89-24.

Table U(1) — Unitrust Single Life Remainder Factors for determining the present worth of a remainder interest in property based on a single life in the case of a transfer to a charitable remainder unitrust with an adjusted payout rate ranging from 4.2 percent to 6 percent. This table supersedes Table E, which is set forth in section 1.664-4(b)(5) of the regulations.

Tables F(10.2—12.0) — Tables of factors for computing the adjusted payout rate for certain charitable remainder unitrust valuations based on interest rates ranging from 10.2 to 12 percent.

Table D – This table is not attached, is set forth in section 1.664-4(b)(5) of the regulations, and will continue to be effective for determining the present worth of a remainder interest postponed for a term of years in a charitable remainder unitrust for transfers made after April 30, 1989.

Effective Date

The tables and formulas contained in this notice apply to the valuation of interests in property for income, estate, gift, and generation-skipping transfer tax purposes in the cases of decedents dying after April 30, 1989, and gifts and certain other transfers made after that date.

Administrative Pronouncement

This document serves as an “administrative pronouncement” as that term is described in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Drafting Information

The principal author of this notice is William L. Blodgett of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information about this notice, call Mr. Blodgett at (202) 377-9661 (not a toll-free call).

Transitional Rule

The following discussion is only relevant for Transfer Dates of May or June 1989. Under a transitional rule, you may optionally use the new Table Rate with the pre-5/89 life expectancies for May 1989 and June 1989 transfers. For example, 5/89 Transfer Dates may use the 5/89 Table Rate (with the new life expectancies) or the 3/89 or 4/89 Table Rates (not 10%) with the old life expectancies. Similarly, 6/89 Transfer Dates may use the 5/89 or 6/89 Table Rates (with the new life expectancies) or the 4/89 Table Rate (not 10%) with the old life expectancies.

Rev. Rul. 77-374

The Charitable Financial Planner uses the 5% probability test of Revenue Ruling 77-374, 1977-2 CB 329 in its calculations when the dollar payout is high enough for the ruling to apply. In its calculations when the dollar payout is high enough for the ruling to apply. In its calculation results, the program determines whether or not the charitable deduction is allowable under the ruling. The text of Rev. Rul. 77-454 is provided below. Following the ruling is a discussion of how the Charitable Financial Planner applies this ruling to its calculations.

Text of Rev. Rul. 77-374

Advice has been requested whether a charitable deduction is allowable under section 2055 of the Internal Revenue Code of 1954 with respect to a remainder interest in a trust that was amended, pursuant to the order of a local court, under the circumstances described below.

The decedent died testate on June 15, 1973. Under the terms of the will, executed on September 15, 1972, the decedent bequeathed the residue of the probate estate, valued at \$400,000, in trust. The trustee was directed to pay to W, a female aged 61 years, \$40,000 each year during W's lifetime. The trust was to have terminated upon the death of W, at which time the principal and any accumulated income would be paid to an organization considered charitable under sections 170(c), 2055(a), and 2522(a) of the Code.

On March 15, 1974, the executor of the decedent's estate filed the Federal estate tax return in which a charitable deduction was claimed in respect of the trust. Six months thereafter, the Internal Revenue Service disallowed the charitable deduction because, in view of W's age and the size of W's annuity, a distinct possibility existed that no trust assets would remain available to charity at W's death. The possibility that W's annuity might entirely consume the trust assets was not so remote as to be a negligible possibility.

Section 2055(e)(3) of the Code was enacted on October 26, 1974, to provide for amendment of certain governing instruments in order to qualify charitable remainder interests passing thereunder for a charitable deduction for Federal estate tax purposes. Shortly thereafter, on December 5, 1974, the executor of the estate, the trustee of the trust, and W obtained from the local probate court an order amending and reforming the trust to provide that W shall receive a reduced annuity of only \$28,000 each year during W's lifetime. After the trust was amended, W

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repaid to the trustee the excess of the amount of the annuity that W had received during the prior year over the amount receivable under the amended trust.

Section 2055(a) of the Code provides that for purposes of the estate tax, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, devises, or transfers to or for the use of charity. Any property interest which increases a charitable bequest as the result of an irrevocable disclaimer of a non-charitable bequest, legacy, devise, transfer, or power will qualify for the charitable deduction “if the disclaimer is made before the date prescribed for the filing of the estate tax return.”

Section 2055(e) of the Code provides, with certain exceptions, that where interests in the same property pass from the decedent to charity and to persons or for uses not qualified as charitable, the charitable deduction is disallowed unless, in the case of a charitable remainder interest, that interest is in a charitable remainder annuity trust or charitable remainder unitrust (described in section 664), or in a pooled income fund (described in section 642(c)(5)). The above requirement with respect to charitable remainder interests is set forth in section 2055(e)(2)(A). If however, a deduction is not allowable because of the requirements of section 2055(e)(2)(A), a deduction may nevertheless be allowable in certain cases pursuant to section 2055(e)(3).

Section 2055(e)(3) of the Code provides, in pertinent part, as follows:

In the case of a will executed before December 31, 1977, or a trust created before such date, if a deduction is not allowable at the time of the decedent's death because of the failure to meet the requirements of subparagraph (A) of paragraph (2) of this subsection, and if the governing instrument is amended or conformed on or before December 31, 1977, or, if later, on or before the 30th day after the date on which judicial proceedings begun on or before December 31, 1977 become final, so that the interest is in a trust which is a charitable remainder annuity trust a deduction shall nevertheless be allowed.

Section 20.2055-2(a) of the Estate Tax Regulations provides that if a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the non-charitable interest. Section 20.2055-2(b) of the regulations provides that in the case of a charitable transfer subject to a condition, no deduction is allowable “unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.”

Section 24.1(c) of the Temporary Estate Tax Regulations describes those situations where a charitable deduction may be obtained by amending a governing instrument pursuant to section 2055(c)(3) of the Code. Section 24.1(c) states, however, that “a governing instrument may not be amended pursuant to this section unless, at the

time of the decedent's death, the interest is an irrevocable remainder interest for which a deduction, but for section 2055(c)(2)(A), would be allowable under section 2055(a) and the regulations thereunder.”

Under section 2031 of the Code and section 20.2031-10 of the regulations, an interest rate of six percent per annum is used for valuation purposes with respect to decedents dying after December 31, 1970. See also section 1.664-4(a)(1)(ii) of the Income Tax Regulations. A fund of \$400,000, invested at 6 percent per annum, yields \$24,000 each year. Therefore, the trustee of the charitable remainder annuity trust would have been required to invade trust principal each year in order to provide W with the \$40,000 annual payment originally provided in the decedent's will. The principal of the trust must also be invaded, but to a lesser extent, to provide W with the reduced annuity of \$28,000 that she is now entitled to receive under the amended trust.

The mathematical formula used to determine the number of years it will take to completely exhaust a fund with an initial value of \$400,000, invested at 6 percent per annum, that is subject to fixed annual payments of \$40,000 out of both income and principal is: $1.06 * \$400,000$ (initial value of corpus) $- \$40,000$ (fixed annual payment) = \$384,000 (value of corpus at end of year after first invasion). By a series of similar successive computations (that is: $1.06 * \$384,000$ (value of corpus at end of first year) $- \$40,000$ (fixed annual payment) = \$367,040 (value of corpus after second invasion), it was determined that the original fund of \$400,000 would be completely exhausted in less than sixteen years. Based on Table LN, which is found in section 20.2031-10(e) of the regulations, the probability that a female aged 61 will be alive sixteen years hence—or stated otherwise, the probability that a female aged 61 will survive to age 77, is greater than 63 percent. See example 12 contained in I.R.S. Publication 723A (12-70), “Actuarial Values II: Factors at 6 Percent Involving One and Two Lives.”

As set forth in Rev. Rul. 70-452, 1970-2 C.B. 199, the charitable deduction is not allowable where the probability exceeds 5 percent that a non-charitable beneficiary will survive the exhaustion of a fund in which charity has a remainder interest. Any possibility in excess of 5 percent that the contingency will occur and defeat charity's interest is not considered so remote as to be negligible within the meaning of section 20.2055-2(b) of the regulations. In this connection, see sections 2037 and 2042 of the Code which specify that 5 percent is the value at which a reversionary interest will be considered significant. The charitable deduction was disallowed in *Moffett v. Commissioner*, 269 F.2d 738 (4th Cir. 1959), where the probability that the fund would be exhausted was 19 percent, and *United States v. Dean*, 224 F.2d 26 (1st Cir. 1955), where the probability was 9 percent.

Section 2055(e)(3) of the Code states only that a trust instrument can be amended if no deduction is allowed because the instrument fails to meet the requirements of section 2055(e)(2)(A), which states that a charitable remainder trust must be in the form of an annuity trust, a unitrust or a pooled income fund. In neither an annuity

trust, a unitrust nor a pooled income fund must the non-charitable beneficiary receive an amount less than the amount that would deplete the trust prior to the death of the non-charitable beneficiary. Sections 1.664-2, 1.664-3, and 1.642(c)-5 of the Income Tax Regulations. Thus, an amendment of a trust to meet the requirement of section 20.2055-2(b)(1) of the Estate Tax Regulations requirement that only a negligible chance exist that the charity will receive nothing is not a change within the purview of section 2055(e)(3) since the purpose of such a change is not compliance with the section 2055(e)(2)(A) requirements.

Additionally, the Senate Finance Committee Report states that the purpose of section 2055(e)(3) of the Code was merely to extend the cut-off date of the Treasury Regulation transitional rules that allow trusts to be amended to comply with the new requirements added by the Tax Reform Act of 1969. S. Rep. No. 93-1063, 93d Cong., 2d Sess. 3 (1974). The Conference Committee report contains a similar statement. H.R. Rep. No. 73-1405, 93 Cong., 2d Sess. 3 (1974). Therefore, to interpret section 2055(e)(3) as affording trusts an opportunity to achieve compliance with the long-standing requirement of section 20.2055-2(b)(1) of the regulations would be inconsistent with its legislative history.

Accordingly, no deduction is allowable under section 2055 of the Code for the amended charitable remainder annuity trust in this case.

END OF RULING

5% Probability Test

Revenue Ruling 77-374 imposes a 5% probability test on charitable remainder annuity trusts that are measured by life expectancies. This is a second test which is quite different from the actuarial test which requires an annual percentage payout of not less than 5% of the initial fair market value of the trust. Under the rationale of Rev. Rul. 77-374, the charitable deduction is not allowable where the probability exceeds 5% that a non-charitable beneficiary will survive the exhaustion of a trust fund in which the charity has a remainder interest. Thus, the ruling may result in the disallowance of a charitable deduction even if a deduction amount has already been actuarially determined. Therefore, the program automatically applies the Revenue Ruling when applicable to one life and two-life charitable remainder annuity trust calculations.

Calculations

The program applies the 5% probability test in the same manner in which it is applied in Rev. Rul. 77-374 and in a tax court case, *George H. Moor Est.*, 43 TCM 1982-299. The formula gleaned from these may be summarized as follows: $((1 + \text{interest rate}) \times \text{initial corpus}) - \text{adjusted payment} = \text{year-end corpus}$. Successive computations lead to the number of years in which the corpus is exhausted. It is clear from the *Moor* case that the payment is adjusted by a payment period factor before the formula is applied. It is interesting to note that both the revenue ruling and the *Moor* case include the year in which the corpus is exhausted. For example,

Rev. Rul. 77-374 used 16 years (not 15) even though the corpus would be exhausted in less than 16 years. This worked to the taxpayer's advantage since 15 years would have resulted in a higher probability. The program determines the number of years to the expiry of the trust in the same manner. If the number of years exceeds 109, the program will indicate the period to be 109+ years.

After the number of years to expiry is determined, it is then added to the age of the person whose life determines the term of the trust to determine the age at the expiry of the trust. The program uses the age input you have entered which is the age as of the nearest birthday. Table LN values are then determined for the age input and the age at the expiry of the trust. When the Table LN value for the age at the expiry is divided by the Table LN value for the age input, the probability of surviving to the expiry of the trust is determined for a one-life charitable remainder annuity trust. For a two-life charitable remainder annuity trust, each probability is first subtracted from 1.0 and then multiplied times each other. The product is then subtracted from 1.0 to determine the probability of at least one survivor at expiry. If this probability exceeds 5%, the charitable deduction may be disallowed.

The 5% probability test of Rev. Rul. 77-374 is automatically applied when the dollar payout is high enough for the ruling to apply. This occurs when the annual percentage payout times the adjustment factor (Table K for transfers after April, 1989) exceeds the Table Rate. In such cases, the program will indicate the number of years to expiry of the trust and the probability of surviving to expiry (or for two lives, the probability of at least one survivor at expiry). The program will indicate whether or not the charitable deduction is allowable under the ruling.

Charitable Deduction Disallowance

You may wonder why the program only indicates the charitable deduction MAY BE DISALLOWED instead of stating that it will be disallowed. This is because one may be able to use the argument that prevailed for the taxpayer in the Moor case. In that case, the court determined that a yield of 6.2% on trust assets could reasonably be anticipated. Based on that assumption, the probability percentages were less than 5%. Based on a 6% yield, the probability percentages had exceeded 5%. Thus, even if you fail the Rev. Rul 77-374 probability test, you may be able to use the Moor rationale to argue that an actual yield of greater than 10% on trust assets may qualify the trust. (The 6% tables were in effect for Moor.)

Alternative Method

Subscribers to Deferred Giving by Conrad Teitell will note that he applies the 5% probability test somewhat differently. He uses an algebraic method where the initial corpus is divided by the annual payout with that result divided by the payment period factor. This method appears to be functionally equivalent to the formula from Rev. Rul. 77-374. However, Teitell then goes to a factor in Table B that is lower than his computed factor and takes the corresponding number of years as the number of years to expiry of the trust. This is a conservative approach that results in one less year than the IRS allowed in Rev. Rul. 77-374 and the Moor case. The

program uses the IRS method. Teitell also uses the age at the last birthday preceding the date of the trust agreement. The program uses the age as of the nearest birthday that is the value you have entered for the age input. Finally, Teitell does note that, in marginal cases, additional calculations resulting in modifications to the number of years and ages may produce a smaller probability.

Reg. §25.7520-3(b)(2)(v), Example 5

Eroding corpus in an annuity trust. The donor, who is age 60 and in normal health, transfers property worth \$1,000,000 to a trust. The trust will pay a 10 percent (\$100,000 per year) annuity to a charitable organization for the life of the donor, and the remainder is to be distributed to the donor's child. The section 7520 rate for the month of the transfer is 6.8 percent. Because the 10 percent annuity payout rate exceeds the 6.8 percent income and growth rate that the trust is expected to experience each year, the annuity payout must be assumed to progressively erode the corpus. Using an interest rate of 6.8 percent, an annuity payout of \$100,000 per year will exhaust a \$1,000,000 trust corpus in 18 years. The final payment at the end of the 18th year will consist of a partial payment of \$32,712. Under section 7520, the standard life annuity factors are based on the assumption that any person may survive until age 110. This means that the standard life annuity factor for age 60 (9.8585) takes into account the separate probabilities that a person age 60 may survive to receive each of 50 different annuity payments. However, in the present case, because of the eroding corpus, the person age 60 can be assumed to receive no more than 17 \$100,000 annuity payments, regardless how long that person might survive. Therefore, the standard life annuity factor for a person age 60 (9.8585) is not applicable in this case, and special section 7520 annuity factors that take into account the 18-year limitation on the annuity payout must be used. The special annuity factor for the present value of the right to receive \$1.00 per year for 17 years or until the prior death of a person age 60 survives is \$.1836. The present value of the charitable annuity interest is \$867,269 ($\$100,000 \times 8.6121$ plus $\$32,712 \times .1836$).

Exhausting Annuities

The value of an exhausting annuity can be calculated by breaking it down into two separate parts. The first part is the portion of the annuity that does not exhaust. The second part is the final payment made in the period that the annuity exhausts.

§25.7520-3(b)(2)(v), example 5 describes a case where a donor, age 60, sets up a \$1,000,000 trust to pay a 10% annuity for the life of the donor. The §7520 rate used is 6.8%. This annuity is calculated to exhaust in 18 years, with a final payment in year 18 equal to \$32,712. To value this annuity, break it down into two separate parts: \$100,000 lasting for 17 years; and a single payment of \$32,712 in the 18th year. Once the pieces are known, value each one individually and then add them together. The annuity factor for an annuity lasting for the shorter of 17 years or until the prior death of a person age 60 is 8.6121. The annuity factor for the shorter of 18 years or until the prior death of a person age 60 is 8.7957. Given these factors

(which can be obtained from example 11 in IRS Pub. 1457), the valuation of the annuity is:

$$\begin{aligned} \text{Value} &= [\$100,000 \times 8.6121] + [\$32,712 \times (8.7957 - 8.6121)] \\ &= \$861,210 + \$6006 \\ &= \$867,216 \end{aligned}$$

Of course, these numbers get more complicated when the annuity is payable more frequently than annually, but the basic methodology is still the same. For example, take the above case, but make it payable quarterly instead of annually. Now the \$100,000 payments only last 16½ years. The final payment, made in the 3rd quarter of the 16th year, is \$5,414.41. Transforming this single payment into an annual amount by multiplying it by the number of payments per year (in this case 4), yields an annuity of \$21,657.64 lasting 16¾ years. Valuing partial-year annuities requires interpolation. An annuity lasting 16½ years is valued by taking ½ the value of the same annuity lasting for 16 years plus ½ the value of it lasting for 17 years. An annuity lasting for 16¾ years is valued by taking ¼ the value of the same annuity lasting for 16 years plus ¾ the value of it lasting for 17 years. Getting back to the example:

$$\begin{aligned} \text{Annuity Factor for } 16\frac{1}{2} \text{ years} &= (\frac{1}{2} \times 8.4055) + (\frac{1}{2} \times 8.6121) = 8.5088 \\ \text{Annuity Factor for } 16\frac{3}{4} \text{ years} &= (\frac{1}{4} \times 8.4055) + (\frac{3}{4} \times 8.6121) = 8.56045 \end{aligned}$$

Of course, the frequency of payments still has to be taken into account. The payout frequency factor from Table K (IRS Pub. 1457) is 1.0252. Therefore, the annuity is valued:

$$\begin{aligned} \text{Value} &= 1.0252 \times [\$100,000 \times 8.5088] + [\$21,657.64 \times (8.56045 - 8.5088)] \\ &= 1.0252 \times (\$850,880 + \$1,118.62) \\ &= \$871,468.99 \end{aligned}$$

The above examples ignore the calculation of both when the annuity exhausts, and the amount of the final payment. These two numbers, however, are critical to calculating a proper annuity valuation. The program provides two different methods for calculating these numbers: the Exact Method and the IRS Annuity Factor Method.

The **IRS Annuity Factor Method** is the method the IRS used in §25.7520-3(b)(2)(v), Example 5), Example 5. This method finds the highest term that yields a term-certain annuity value less than the initial value of the trust. This term is equal to the number of years that full payments last. Repeating this technique for the number of periods in the final year gives us the number of periods in the final year which have full payments. Once the term of the trust is known, the term certain annuity factors are used to calculate the value of the final annuity:

1) Calculate Term Certain Annuity Factors:

$$\text{Factor for } 16\frac{1}{2} \text{ years} = (\frac{1}{2} \times 9.5731) + (\frac{1}{2} \times 9.8999) = 9.7365$$

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$$\text{Factor for } 16\frac{3}{4} \text{ years} = (\frac{1}{4} \times 9.5731) + (\frac{3}{4} \times 9.8999) = 9.8182$$

2) Adjust Annuity Factors for Frequency of Payments:

$$9.7365 \times 1.0252 = 9.9818598$$

$$9.8182 \times 1.0252 = 10.06561864$$

3) Calculate the annuity which corresponds to the final payment:

$$\text{Annuity} = (\$1,000,000 - (\$100,000 \times 9.9818598)) / (10.06561864 - 9.9818598) = \$21,657.65$$

4) To transform this annuity into a single payment, divide by the number of payments per year:

$$\text{Final Payment} = \$21,657.65 / 4 = \$5,414.41$$

The **Exact Method** is an intuitive method of calculating the duration and final payment amount of the annuity. This method assumes the annuity grows at a rate equal to the 7520 rate, and calculates the real payments and growth that would occur each year. The resulting schedule returns the exact amount payable in the final period.

The program defaults to using the IRS Annuity Factor Method. If you select the Exact Method, the program will include a schedule illustrating the exhaustion of the trust. When looking at this schedule, remember that the interest is compounded annually. Using the above example, the growth in the first year would equal $6.8\% \times \$1,000,000 + 6.8\% \times \$900,000 + 6.8\% \times \$800,000 + 6\% \times \$700,000$. This, of course, assumes that the payments are made at the end of each year.

Annuities paid at the beginning of the period are treated in the same manner as annuities paid at the end of each period. First, the trust is reduced by the value of the first payment. The above analysis is then performed for the annuity, assuming payments occur at the end of each period. Finally, the first payment is added to the annuity value.

Treasury Decision 8819

The IRS has issued temporary and proposed regulations that revise the actuarial tables for valuing annuities, interests for life or terms of years, and remainder or reversionary interest to take into account the most recent mortality experience available.

Text of Treasury Decision 8819

This document contains regulations relating to the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. These regulations are necessary because section 7520(c)(3) directs the Secretary to update the actuarial tables to reflect the most recent mortality experience available. These regulations will effect the valuation of inter vivos and testamentary transfers of interests dependent on one or more measuring lives. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject elsewhere in this issue of the Federal Register.

Background

This document contains amendments to the regulations revising certain tables used for the valuation of partial interests in property under section 7520 of the Internal Revenue Code of 1986 (Code) to reflect the most recent mortality experience available.

In General

Section 7520, effective for transfers for which the valuation date is after April 30, 1989, provides that the value of an annuity, an interest for life or a term of years, and a remainder or reversionary interest is to be determined under tables published by the Internal Revenue Service based on a discount rate (rounded to the nearest two-tenths of one percent) equal to 120 percent of the applicable Federal mid-term rate in effect under section 1274(d)(1) for the month in which the valuation date falls. Section 7520(c)(3) directed the Secretary to issue tables not later than December 31, 1989, utilizing the then most recent mortality experience. Thereafter, the Secretary is directed to revise the tables used in valuing interests dependent on mortality experience not less frequently than once each 10 years to take into account the most recent mortality experience available as of the time of the revision.

These regulations incorporate revised Table S (Single Life Remainder Factors) and Table U(1) (Unitrust Single Life Remainder Factors) based on data compiled from the 1990 census as set forth in Life Table 90CM, and make conforming amendments to various sections to reflect the revised tables. The current tables are moved to sections containing actuarial material for historical reference. Table B, Table D, Tables F(4.2) through F(14.0), Table J, and Table K, which are not based on mortality experience, are not changed. Internal Revenue Service Publications 1457 "Actuarial Values, Book Aleph" (forthcoming 1999), 1458 "Actuarial Values, Book Beth" (forthcoming 1999), and 1459 "Actuarial Values, Book Gimel" (forthcoming 1999) will contain a complete set of actuarial tables that include factors not contained in the regulations (for example, annuity and life interest factors). Although not available on May 1, 1999, IRS anticipates these publications will be available by July 1, 1999. These publications will be available for purchase

Charitable Financial Planner

from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402.

Text omitted here.

Effective Dates

These regulations are applicable in the case of annuities, interests for life or terms of years, and remainder or reversionary interests created after April 30, 1999.

Transitional Rules

The regulations provide certain transitional rules intended to alleviate any adverse consequences resulting from the proposed regulatory change. For gift tax purposes, if the valuation date of a transfer is after April 30, 1999, but before July 1, 1999, the donor may determine the value of the gift (and/or any applicable charitable deduction) under tables based on either Life Table 80CNSMT or Table 90CM (at the donor's option). Similarly, for estate tax purposes, if the decedent dies after April 30, 1999, but before July 1, 1999, the value of any interest (and/or any applicable charitable deduction) may be determined under tables based on either Table 80CNSMT or Table 90CM, at the option of the decedent's executor.

However, the section 7520 interest rate utilized is the appropriate rate for the month in which the valuation date occurs. In accordance with this transitional rule and those contained in sections 1.7520-2(a)(2), 20.7520-2(a)(2) and 25.7520-2(a)(2), in cases involving a charitable deduction, if the valuation date occurs after April 30, 1999, and before July 1, 1999, and the executor or donor elects under section 7520(a) to use the section 7520 interest rate for March 1999 or April 1999, then the mortality experience contained in 80CNSMT must be used. If the executor or donor uses the section 7520 interest rate for May 1999 or for June 1999, then the tables based on either Table 80CNSMT or Table 90CM may be used. However, if the valuation date occurs after June 30, 1999, the executor or donor must use the new mortality experience contained in Table 90CM even if a prior month interest rate election under section 7520(a) is made.

In addition, for estate tax purposes, the estate of a mentally incompetent decedent may elect to value the property interest included in the gross estate under the mortality table and interest rate in effect at the time the decedent became mentally incompetent or the mortality table and interest rate in effect on the decedent's date of death if the decedent was under a mental incapacity that existed on May 1, 1999, and continued uninterrupted until the decedent's death, or the decedent died within 90 days of regaining competency after April 30, 1999.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act

(5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is William L. Blodgett, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

Section 4: Licensee Information

Update Policy

Technical Support

Update Policy

When you initially license the program, you are automatically covered by maintenance for an initial six-month period. Before the end of the period, you will be sent an invoice to sign up for the optional maintenance for coverage of the next twelve months. You are eligible for any major and minor updates that are released during the duration of your maintenance agreement.

Major updates reflect tax law changes or addition of new features. When new features are added or changes are made due to a tax law change, customers with maintenance will **automatically** be sent the major update.

Minor updates reflect user-interface problems, typos, or minor changes to a calculation. Minor updates are available for downloading from our web site. Visit our web site at <http://www.brentmark.com/download.htm> to download the latest patch.

We are always interested in hearing from you about ways to improve the program. Whether it's a small change to the user-interface or a new area of coverage, we would like to hear from you.

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Technical assistance is available by telephone, FAX, postal mail, e-mail, or the Internet.

- For assistance by e-mail, contact us at support@brentmark.com.
- For assistance using the Internet, visit our web site at <http://www.brentmark.com>.
- For assistance by telephone call (407) 306-6160 between 9:00 AM and 6:00 PM eastern time, Monday through Friday.
- For assistance by FAX, send your FAX to (407) 306-6107.
- For assistance by mail, send a sample printout to:

Brentmark Software
3505 Lake Lynda Dr., Ste. 212
Orlando, FL 32817-8327

If your questions concern calculations, please have a list of your exact input values available when you contact us. We want the software to be as accurate as possible and we want you to be satisfied that it is accurate. We would like to hear from you if you think there is a problem.

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