DEFINITION OF CHARITABLE REMAINDER UNITRUSTS

Under Code Section 664(d) (2) and (3), three variations of the charitable remainder unitrust are defined: "straight" unitrust, "net income" unitrust and "net-income-plus-makeup unitrust." (See also IRS Regulations, Sections 1.664-1, 1.664-3, 1.664-4.)

1. "Straight" Unitrust. A separately invested trust created by a gift of cash and/or securities or other property from which the trustee is required to pay the Donor and/or other named beneficiaries (who must be living at the time the trust is created) a fixed percentage of the market value of the trust assets, as revalued each year on the annual valuation date, for the life or lives of the beneficiary(ies) or for a term of years (not to exceed twenty years). Upon the death of the last surviving beneficiary, or upon the expiration of the term of years, the trust is to terminate, and the trust assets must be transferred to, or for the use of, a charitable organization, as described in Code Section 170(c), or be retained for such use.

The stated percentage of payout must be at least 5% and can be higher if stated in the trust agreement. To the extent that the investment income of the assets is insufficient to make the required annual payout, the balance must be paid from principal. Conversely, any earned income in excess of the required payout is added back to principal. The trustee can be the charitable organization for whom the remainder interest is designated, or may be an individual (other than the Donor himself or a non-charitable beneficiary of the trust) or a corporate trustee, such as a bank or trust company. A charitable organization can be an income beneficiary so long as there is at least one non-charitable beneficiary. Except for the required payout from the trust to the income beneficiaries, the trust may not be invaded, altered, amended or revoked for the beneficial use of a person other than an organization described in Code Section 170(c).

Under Code Section 664 (b) payments to the beneficiary of a straight unitrust retain the same character in the hands of the beneficiary as they had in the trust. The total of the payments for each year is taxable under, and must be reported in the order of, the following tier structure:

(A) First, as ordinary income to the extent of such income earned by the trust assets for the year and any undistributed ordinary income of the trust for prior years.

(B) Second, as long-term capital gain to the extent that the trust has realized long-term capital gains for the year and any undistributed realized long-term capital gains for prior years.

(C) Third, as non-taxable income to the extent that the trust has non-taxable income for the year and any undistributed non-taxable income for prior years.

(D) Fourth, as tax-free distribution of trust corpus.

2. "Net Income" Unitrust. Same as a "straight" unitrust except that payments to the income beneficiary(ies) in any taxable year of the trust are limited to the ordinary investment income (dividends, interest, rent) earned by the trust assets and cannot exceed the fixed payout percentage of the market value of the trust assets stated in the trust agreement. Thus, this type of unitrust can pay out only ordinary income and cannot make capital gain distributions or any payments from the trust corpus.

3. "Net-Income-Plus-Makeup" Unitrust. This is the same as the "net income" unitrust except that the trustee can pay out to the beneficiary income earned by the trust in excess of the stated percentage of the market value of the trust assets to the extent of accumulated payout deficiencies of prior years (years in which the trust earned less than the stated percentage).