



Upon termination of the charitable remainder pet trust, the trust remainder must be paid to charitable organization(s) as defined in IRC '170(c).

The present value of the remainder interest of a charitable remainder pet trust is calculated under IRC '7520 and it must be at least 10% of the fair market value of the trust property at the time of funding of the trust. This is the same rule which applies to CRATS and CRUTS which are created for human beneficiaries.

## TERM OF TRUST

Under the Bill, the charitable remainder pet trust would pay a sum certain for a term of years (not in excess of 20 years) *or* for the life or lives of such pet or pets. (Emphasis supplied). The 20 year limitation ensures that there is no violation of the rule against perpetuities and a 20 year or 21 year limitation is standard for pet trusts under the statutes of various states.<sup>1</sup> However, under the Bill, the rule against perpetuities could be violated if the trust cares for animals, such as horses or parrots, which have life spans of more than 20 years. We recommend that the Bill be modified to read that the charitable remainder pet trust would pay a sum certain for the lesser of (i) the life or lives of the pet or pets, or (ii) for a specified term of years, in either case not to exceed 20 years.

## DEFINITION OF PET

The Bill defines pets as *Aany domesticated companion animal* (including a

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<sup>1</sup> As of the time of the drafting of this comment, the following states had statutes permitting the creation of trusts for pets: Alaska, Arizona, California, Colorado, Iowa, Michigan, Missouri, Montana, New Mexico, New Jersey, New York, North Carolina, Utah.

domesticated companion cat, dog, rabbit, guinea pig, hamster, gerbil, ferret, mouse, rat, bird, fish, reptile or horse) which is living, and owned or cared for by the taxpayer establishing the trust, at the time of the creation of the trust. (Emphasis supplied).

This language is more restrictive than the language of state statutes permitting the creation of pet trusts. For example, a pet trust created under New York law can be created for the care of designated domestic or pet animals. New York Estates Powers and Trusts Law '7-6.1. The following states have similar statutes permitting the creation of trusts for the care of designated domestic or pet animals: Alaska, Arizona, California, Colorado, Michigan, Montana, New Mexico, New York, North Carolina and Utah. A pet trust under New Jersey law can be created for the care of any domesticated animal. N.J.S.A. '3B:11-38. A pet trust under Missouri law can be created for the care of pet animals. Missouri Revised Statutes '456.055. A pet trust under Iowa law can be created for the care of an animal. Iowa Code '633.2105.

Under the Bill, a trust validly created under the laws of these states for pets with the trust remainder passing to charitable organization(s) could be an invalid charitable remainder pet trust under federal law because for example, the grantor created the trust for the care of all of his domestic animals on his farm, including livestock, and such animals while certainly domesticated, may not be considered companion or pet animals. Therefore we recommend that the definition of pet in the proposed statute be changed from *domesticated companion animal*, to domestic or companion animals. This change would bring the Bill, a proposed federal statute, in line with the majority of the states that have pet trust statutes.

The Bill defines pets as Any domesticated companion animal (including a domesticated companion cat, dog, rabbit, guinea pig, hamster, gerbil, ferret, mouse, rat, bird, fish, reptile or horse) *which is living*, and owned or cared for by the taxpayer establishing the trust, *at the time of the creation of the trust.*@ (Emphasis supplied).

The words *Alive at the time of the creation of the trust*@ works for a testamentary trust (trust created under a will to take effect upon death), but creates a problem for persons creating an inter vivos trust ( trust created during life to take effect during life). A person could create an inter vivos trust to last for 20 years for the care of all of his or her animals that he or she presently has or acquires during that 20 years. Most people who have pets have a succession of pets and the trust should be flexible enough to cover all of the grantors= pets during the term of the trust.

The Bill defines pets as Any domesticated companion animal (including a domesticated companion cat, dog, rabbit, guinea pig, hamster, gerbil, ferret, mouse, rat, bird, fish, reptile or horse) *which is living*, and *owned or cared for by the taxpayer establishing the trust*, at the time of the creation of the trust.@ (Emphasis added). The words *Aowned or cared for by the taxpayer establishing the trust*@ also creates a problem. Under various state laws, such as the New York statute allowing the creation of pet trusts, there is no requirement that the trust beneficiaries be owned or cared for by the person creating the trust. Thus for example, under New York law, a person can create a trust for the care of his mother=s cats, with remainder to charity, while under the proposed federal law, there would be no charitable deduction available for this trust as the grantor is not the owner of the animals. Therefore, we recommend that the

definition of pet in the Bill be changed to any Adesignated domestic or companion animals@, without further limitation.

We note that the designation of the animal would not have to be by specific animal, but instead the trust instrument could state for example that the trust is created Afor all the domestic or companion animals owned or possessed by my mother.@

Therefore, we approve H.R. 1796 with the following modification:

AIRC '664

Section 2 Charitable Remainder Pet Trusts

(a)(6) PET - for purposes of a charitable remainder pet trust, a pet is any *Adesignated domestic or companion animal*.@

#### VALUATION OF REMAINDER INTEREST

We also wish to bring the following matter to your attention:

The Bill provides that Aa sum certain is to be paid not less often than annually, for the exclusive benefit of one or more pets. . . for a term of years (not in excess of 20 years) or for the life or lives of such pet or pets.@

The Bill also provides that:

AThe value (determined under Section 7520) of such remainder interest is at least 10 percent of the initial fair market value of all property placed in the trust@

This language presents concerns. We not that under IRC '7520, there are tables showing the percent value of an annuity of the remainder interest passing to charity after the life of a human beneficiary. The tables are based on the life expectancy of a human beneficiary at any given age. There is a separate table for charitable remainder

annuity trust for a term certain. It would appear to be impractical for the IRS to develop new tables for the lives of animals B there are too many species with too many different life expectancies. Therefore, we presume that the only table to be used is Treasury Valuation Table B, showing the present worth of an annuity and of a remainder interest for a term certain. That term would be for 20 years, so all calculations of the value of the gift to charity would be after a term of 20 years, no matter that the trust could terminate earlier due to the death of the animal. The person creating the trust could specify a term of years shorter than 20 years, but a shorter trust might not cover the life spans of the pets. We recommend that the required use of Treasury Valuation Table B be specified in the Bill.

Although any amount could be put into a pet trust, it is our experience that pet owners commonly put approximately \$50,000 into pet trusts, so that figure will be used as an example. If a trust is funded with \$50,000 in October, 2002, the most that can be paid out annually for the pet is approximately 6.4% of the principal. Payment of any more than that amount and the present value of the remainder interest for the charity would be less than 10 percent of the initial value of the trust, thus violating the statute. See attached calculation showing a remainder interest of 11.0%, with an annuity interest of 6.4%. This calculation is based on the applicable federal midterm rate of 4.2%.

Even if the applicable federal midterm rate increases, the amount payable for the animals may not be sufficient. As an example, if the applicable federal midterm rate increases to 5.6% as it was in March 2002, and a trust is funded with \$50,000, the most

that can be paid out annually for the pet is 7.1% of the principal. Payment of any more than that amount and the present value of the remainder interest for charity is less than 10 percent of the initial value of the trust, thus violating the statute. See attached (i) calculation showing a remainder interest of 11.1%, with an annuity interest of 7.1%, and (ii) a calculation showing a remainder interest of 9.9% (which violates the statute as it is less than 10% of initial value of trust), with an annuity interest of 7.2%.

If an annuity rate of 6.4% of a trust funded with \$50,000 is paid, only \$3,200 could be paid out for the pets annually no matter what the actual costs of care are. In the case of an annuity rate of 7.1%, the most that can be paid from the trust for the pets annually is \$3,550. While either of these amounts may be sufficient for one pet, if the trust is created say, for the decedent's five pets, it would not likely be sufficient. In that case it would be preferable to create a pet trust under the law of one of the states permitting pet trusts with flexible language allowing the trustee to use income and principal as needed for the care of the animals, even if nothing is left for the charitable remainderman, and not create the trust under the proposed federal statute.

The federal pet trust will work best for a grantor with strong charitable interests who wishes to put a substantial amount into the trust to assure that there is a sufficient annuity to cover the care of the pets, and who wants a large portion of the trust to pass to charity.

## TAX ON ANNUITY DISTRIBUTIONS FROM CHARITABLE REMAINDER PET TRUSTS

Under the Bill, any distribution for the benefit of a pet will be treated as taxable

income of the trust to the extent that the trust has income for that year and undistributed income for prior years. In effect, this permits the individual who receives the distributions from the trust on behalf of a pet to avoid including those amounts in his or her income. Instead, the tax on the distribution will be paid from the trust.

IRC '664(b) provides for a tiered structure of determining the character of distributions from CRATS and CRUTS for income tax purposes. We recommend a similar structure be adapted for taxation of distributions from charitable remainder pet trusts and suggest the following addition to the Bill (our addition is italicized).

A(b) Tax on annuity distributions from charitable remainder pet trusts - Section 664(c) is amended by inserting >and except, in the case of a charitable remainder pet trust, that any distribution during such year for the benefit of a pet (as defined in subsection (d)) shall be taxable income of the trust for such year, to the extent of the income of the trust for the year and undistributed income of the trust for prior years (*in each case, the character of the income shall be determined in the same manner as provided in Section 664(b)*), = after Aapplied to such trust.@

In addition, the payment of income tax from the trust on distributions made on behalf of a pet will diminish the amount which ultimately passes to charity. Clarification is needed whether, in meeting the statutory requirement that the value of the remainder interest must equal at least ten percent of the value of the trust assets, the value of the remainder interest is calculated taking into account the required payments of tax.

## CONFORMING AMENDMENTS

The Bill brings a charitable remainder pet trust within the ambit of IRC '2652(c)(1)(C), a generation-skipping transfer tax provision. As we see no way in which

a

charitable remainder pet trust could be subject to this tax, we recommend deleting this reference.

Finally, please note that there is a typographical error in the language of the Bill under A(c) Conforming Amendments. @

A(5) Section 2055(e)(2)(F) should be A(5) Section 2055(e)(3) (F). @

## CONCLUSION

We make the following recommendations to the Bill:

(1) that the Bill be modified to read that the charitable remainder pet trust would pay a sum certain for the lesser of (i) the life or lives of the pet or pets, or (ii) for a specified term of years, in either case not to exceed 20 years.

(2) that the definition of pet in the Bill be changed to any A designated domestic or companion animals, @ without further limitation.

(3) that the applicable Treasury Valuation Table B be specified in the Bill.

(4) that a structure be adapted for taxation of distributions from charitable remainder pet trusts similar to the tiered structure under IRC '664(b) for determining the character of distributions from CRATS and CRUTS for income tax purposes.

(5) that the Bill clarify whether, in meeting the statutory requirement that the value of the remainder interest must equal at least ten percent of the value of the trust assets, the value of the remainder interest is calculated taking into account the required payments of income tax.

(6) that reference to IRC '2652(c)(1)(C), a generation-skipping transfer tax provision, be deleted.

(7) that the typographical error in the Bill under A(c) Conforming Amendments@ be changed from A(5) Section 2055(e)(2)(F) to A(5) Section 2055(e)(3) (F).@