

Valuing the Interests of a NIMCRUT for Gift and Transfer Tax Purposes

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High net worth individuals seeking a tax-advantaged trust structure to assist in charitable gift and estate tax planning may use a net income with makeup charitable remainder unitrust (NIMCRUT). The NIMCRUT structure may appeal especially to (1) individuals who have assets with significant embedded capital gains, (2) individuals who intend to donate a substantial sum of money to charity upon their death or at another time in the future, and (3) individuals who desire an income stream for themselves or their loved ones for life or for a specifically defined future period. When performing the valuation of an interest in a NIMCRUT, an analyst should follow specific procedures determined by the Internal Revenue Service. However, a better understanding of NIMCRUT-specific factors and how they affect valuation will assist the analyst in performing these procedures efficiently and accurately. This discussion provides analysts with (1) a basic understanding of what a NIMCRUT is (to assist them in their NIMCRUT-related valuation analysis) and (2) a step-by-step process for the accurate valuation of interests in a NIMCRUT in accordance with the Treasury regulations.

INTRODUCTION

A net income with makeup charitable remainder unitrust (NIMCRUT) is a unique structure typically used in charitable gifting and estate planning.

An analyst may be engaged to value different interests in a NIMCRUT for a variety of purposes that may be (1) required by the Internal Revenue Service (“the Service”) or (2) requested by the client for planning and compliance purposes.

Although various programs exist to calculate the value of interests in a NIMCRUT, it is beneficial for an analyst to understand the process behind the calculation when performing NIMCRUT-related valuation services.

The focus of this discussion is to provide a background understanding of a NIMCRUT which includes, among other things, the following:

- The basic requirements of the NIMCRUT structure
- Key advantages and disadvantages faced by holders of interests in a NIMCRUT

- Key transactions that require the valuation of interests in a NIMCRUT
- Specific procedures for correctly estimating the value of these interests

The background understanding outlined in this discussion may assist valuation analysts engaged to estimate the value of interests in a NIMCRUT. This background provides analysts with the tools to:

1. develop a well-organized valuation analysis,
2. effectively inquire of clients and their legal counsel regarding the key factors impacting the value of each interest in a NIMCRUT, and
3. perform procedures to ensure an accurate and efficient valuation of each interest.

Ultimately, analysts may use the information in this discussion to help them correctly calculate the value estimate of each interest in a NIMCRUT, logically present their calculation in straight-forward

valuation exhibits, and effectively explain their procedures and reasoning in the valuation report.

This discussion is also intended to assist attorneys in understanding the procedures a valuation analyst may undertake in estimating the fair market value of an interest in a NIMCRUT.

The well-reasoned valuation of an interest in a NIMCRUT results in a value estimate that allows the owner of the interest to benefit from all of the tax advantages provided by the NIMCRUT and ensures compliance with the applicable Internal Revenue Code sections and Treasury regulations.

KEY ASPECTS OF A NIMCRUT

A NIMCRUT is an irrevocable trust to which an individual (i.e., donor) contributes property or other assets and designates at least one noncharitable unitrust income beneficiary (which may be the donor or another person) and a charitable remainder beneficiary (which is required to be a qualifying charity as defined in Section 170[c]).¹

The unitrust income beneficiaries receive an income stream from the NIMCRUT for life or a period of up to 20 years, as defined in the trust agreement or other applicable governing documents of each NIMCRUT.

At the conclusion of the unitrust income beneficiary period (whether by the death of the last surviving noncharitable beneficiary or the conclusion of the specified term), the assets of the NIMCRUT are transferred to the designated charity or charities.

Overall, a properly organized and managed NIMCRUT may appeal to donors based on, but not limited to, the following key benefits:²

1. A NIMCRUT may provide the donor (or another income beneficiary of their choice) with a substantial income stream for life or a selected period of time immediately subsequent to making a donation.
2. The contribution of property or other assets into a NIMCRUT allows the donor to take a charitable deduction in the year the assets are contributed to the NIMCRUT.
3. A trustee (either the donor or an appointee of the donor) controls the assets within the NIMCRUT for the entity's duration and may defer income from the NIMCRUT based on their selection of investments.
4. Placing property or other assets into a NIMCRUT removes the assets from the donor's taxable estate.

5. Earnings from capital gains, dividends, interest, and other investment returns are tax exempt within a NIMCRUT.³
6. Appreciated assets contributed to a NIMCRUT may be sold without being subject to capital gains taxes.
7. After the creation of the NIMCRUT, no future contributions are required but unlimited contributions are permitted.

In order to obtain the benefits above, the NIMCRUT is required by the Service to abide by specific restrictions which are discussed in the requirements for a NIMCRUT classification section below.

A donor's decision for whether to utilize a NIMCRUT as part of his or her gift, estate, or tax planning is outside of the scope of this discussion; however, understanding key advantages and requirements of a NIMCRUT may assist analysts in their valuation.

REQUIREMENTS FOR NIMCRUT CLASSIFICATION

For an analyst to undertake proper valuation procedures with regards to a NIMCRUT, it may be beneficial to understand the Service's requirements for a trust to be classified as a NIMCRUT.

To obtain and maintain the NIMCRUT designation and related tax status, contributions to a unitrust are irrevocable, the present value of the remainder interest is required to equal at least 10 percent of the total value of the NIMCRUT,⁴ and the unitrust is obliged to fulfill all the requirements of a charitable remainder unitrust (CRUT) as defined in Section 664(d)(2) and discussed below.

Over a time-period specified in the NIMCRUT trust agreement or other governing documents, the NIMCRUT is required to pay each income beneficiary a unitrust income payment on an annual or more frequent basis.

The amount paid to each income beneficiary is equal to the lesser of a specified fixed percentage (between 5 and 50 percent) of the net fair market value of the annually valued assets of the NIMCRUT, and the income of the NIMCRUT.⁵

The specified fixed percentage payment contrasts with annuity trusts, which pay out a specified dollar amount to income beneficiaries.

The specified time period of the unitrust income payments made by a NIMCRUT may either be:

1. for the life or lives of the donor(s) or another living individual of the donor's choice or
2. for a specific term that does not exceed 20 years.⁶

In contrast to a traditional CRUT, a NIMCRUT allows for each income beneficiary to “makeup” for years when the net income of the NIMCRUT is less than the amount calculated using the specified fixed percentage by collecting the difference in future years when net income is greater than the amount calculated using the specified fixed percentage.⁷

This makeup provision provides NIMCRUT trustees more control over the timing of payments to beneficiaries based on the ability of the NIMCRUT assets to produce income in the current year.

The makeup provision does not affect the analyst's valuation of the NIMCRUT for income, gift, and estate tax purposes. This is because the analyst is required by the Service to rely on the specified fixed payment percentage when estimating the fair market value of interests in a CRUT or NIMCRUT—regardless of whether the makeup provision exists.⁸

After the completion of the required income payments, the remainder interest in a NIMCRUT is to be transferred to, or for the use of, or held by the unitrust for the use of, a qualifying charity as defined in Section 170(c).

One notable exception to this requirement exists if the remainder interest is composed of qualified employer securities as defined in IRC Section 664(g)(4). In this case, all or a portion of these securities are to be transferred to an employee stock ownership plan in a qualified gratuitous transfer.⁹

This charitable requirement separates NIMCRUTs from noncharitable trusts and provides a basis for the allowance of charitable gift deductions by the Service for the contribution of assets to the NIMCRUT.

To retain its classification, a NIMCRUT may not make any payments other than the required payment to income beneficiaries and qualified gratuitous transfers, as discussed above, to or for the use of any person other than a qualifying charity as defined in Section 170(c).¹⁰

Failure to fulfill each of the requirements above may result in a trust failing to qualify as a charitable remainder trust (CRT), which includes NIMCRUTs and CRUTs under Section 664.

This may result in the donor being disallowed from taking a charitable, gift, or estate tax deduction on assets contributed to the trust. It may also result

in the loss of the trust's tax-exempt status for its own tax purposes.¹¹

The NIMCRUT valuation procedures below assume that the subject trust is a qualified NIMCRUT as of the date of the analyst's valuation.

Due to the extended list of NIMCRUT requirements, it is recommended that the analyst confirm with the clients and/or their legal counsel that the subject trust is a NIMCRUT before performing the following valuation procedures.

NIMCRUT VALUATION PROCEDURES

As discussed previously, a NIMCRUT is composed of one or more remainder interests and unitrust income interests.

An analyst will primarily be engaged to estimate the value of a remainder interest in a NIMCRUT at any time when assets are contributed to the NIMCRUT. Unless otherwise specified in the NIMCRUT trust agreement or other governing documents, contributions may be made at the creation of the NIMCRUT and/or at any other time in the future of the NIMCRUT.

Each contribution requires the valuation of the related remainder interest as of the contribution date in order to deduct the estimated value of the remainder interest as a charitable deduction on the donor's personal income tax return.

This value estimate may be deducted on the donor's income tax return in the year of contribution and may be carried forward by the donor for up to five years.¹²

Although the donor may amend the charitable beneficiary of the remainder interest at a subsequent date (unless otherwise specified in the governing documents), this amendment does not allow the donor to take a subsequent deduction for the remainder interest, and thus does not require a value estimate of the remainder interest for the donor's income tax purposes.

An analyst may estimate the value of a unitrust income interest in a NIMCRUT for a variety of

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charitable, gift, or estate tax purposes, both at the date of contribution (such as the immediate designation by the donor of a family member or friend as the beneficiary of the interest), and at subsequent dates (such as the subsequent gifting of the interest or the passing of the interest to another individual upon the death of a beneficiary).

To estimate the value of both the total unitrust income interest and the total remainder interest of a NIMCRUT, an analyst may follow the required procedures outlined in Regulation 1.664-4, which apply to the valuation of NIMCRUTs and CRUTs and which detail the procedures to calculate the total present value of the remainder interest.

The present value of the total unitrust income interest may then be estimated based on the present value of the remainder interest.

To estimate the value of the remainder or unitrust income interest the analyst may perform the following procedures:

1. Estimate the net fair market value of the assets held by or contributed to the NIMCRUT.
2. Obtain the relevant present value factor for the remainder interest based on the specific facts of the case.
3. Calculate the present value of the remainder interest.
4. Calculate the present value of the unitrust income interest (if necessary).

To facilitate the discussion and provide better clarity of each step in the valuation procedures, examples are provided below for each step based on the following hypothetical NIMCRUT valuation engagement.

Illustrative Example

Let's assume that Steve engaged Willamette Management Associates to estimate the total fair market value of the remainder interest in NIMCRUT 1 that Steve and his wife, Katie, may record as a charitable deduction on their joint 2014 tax return.

The following list represents the relevant facts of the case.

- On June 30, 2014, Steve signed the NIMCRUT 1 trust agreement, which officially created NIMCRUT 1 and required the transfer of \$1 million in marketable securities from Steve to NIMCRUT 1 on the same date.
- Steve designated Charity X as the remainder beneficiary of 100 percent of the assets of NIMCRUT 1.

- Steve designated himself and his wife, Katie, as the sole income beneficiaries of a last-to-die interest in NIMCRUT 1.

This interest will pay Steve the lesser of 5 percent of the net fair market value of the assets of NIMCRUT 1 or the net income of NIMCRUT 1 on a quarterly basis until he dies, and will then pay Katie under the same terms until she dies, if she outlives him.

- At the time of the contribution, Steve is 79 years old and Katie is 75 years old.
- The assets of NIMCRUT 1 are valued annually as of December 31 each year.
- Required quarterly unitrust income payments are distributed to income beneficiaries on the last day of January, April, July, and October, each year.

The example procedures are specific to the facts presented. Analysts should use professional judgment when referring to this example in their own subsequent NIMCRUT valuations.

Step 1: Estimate the Net Fair Market Value of the Assets Held by or Contributed to the NIMCRUT

To estimate the net fair market value of the assets contributed to the NIMCRUT, the analyst may apply one or more of the three generally accepted business valuation approaches (the market approach, the income approach, and the asset-based/cost approach) to estimate fair market value, which would be determined based on the types of assets contributed to the NIMCRUT.

An asset-based approach will most often be the most relevant business valuation approach to apply in this situation.

This is because the assets contributed to the NIMCRUT will commonly consist of marketable securities, real estate property, and other investments for which the fair market value of the assets may be obtained and for which the sum of the fair market values of the assets is the best indication of the net fair market value of the total assets.

However, the analyst should use his or her judgment in determining which of the generally accepted business valuation approaches to use in estimating the net fair market value of assets based on each specific case.

The procedures for completing each of these valuation approaches is outside of the scope of this discussion.

Example Step 1 Procedures

Because Steve's contribution is composed solely of marketable securities for which there is a readily available fair market value indication provided by an organized exchange (and such holdings are readily marketable and clearable at such price), we rely upon an asset-based approach adjusted net asset value method to estimate the net fair market value of the assets contributed to NIMCRUT 1.

This valuation method results in a net fair market value of NIMCRUT 1 equal to \$1 million as of the June 30, 2014, valuation date.

Had the assets been more appropriately estimated by market approach, income approach, or other asset-based/cost approach methods (or a synthesis of all of the above), such a synthesis would be applied at this step of the analysis.

Step 2: Obtain the Relevant Present Value Factor

Step 2a: Calculate the Adjusted Payout Rate

The first step to obtain the relevant present value factor for the remainder interest is to calculate the adjusted payout rate for the NIMCRUT based on the specific facts of the case.

The adjusted payout rate is calculated by multiplying the specified fixed percentage unitrust income payout of the NIMCRUT by the relevant adjustment factor listed in Table F of Internal Revenue Service Publication 1458 (reproduced in this discussion). The adjustment factor is obtained based on:

1. the Section 7520 interest rate during the month of transfer,
2. the frequency of the unitrust income payments made by the NIMCRUT (monthly, quarterly, semiannually, or annually), and
3. the number of months that the valuation date for the first full taxable year of the NIMCRUT precedes the first payout date of the NIMCRUT for the same taxable year.¹³

It is important to note that the valuation date for the first full taxable year of the NIMCRUT is the

**Internal Revenue Service Publication 1458
Table F(2.2)
Factors for Computing Adjusted Payout Rates for Unitrusts
Interest at 2.2 Percent**

# of Months from Annual Valuation to First Payout		Adjustment Factors for Payments at End of Period			
At Least	But Less Than	Annual	Semiannual	Quarterly	Monthly
--	1	1.000000	.994589	.991891	.990095
1	2	.998188	.992787	.990094	.988301
2	3	.996380	.990988	.988300	
3	4	.994574	.989193	.986509	
4	5	.992772	.987401		
5	6	.990974	.985612		
6	7	.989178	.983826		
7	8	.987386			
8	9	.985597			
9	10	.983811			
10	11	.982029			
11	12	.980250			
12	--	.978474			

date on which the assets of the NIMCRUT are valued each year, as presented in the NIMCRUT governing documents. This valuation date is not related to the date an analyst performs a valuation of any interest in the NIMCRUT.

Step 2a Example

To determine the adjusted payout rate for NIMCRUT 1, we first obtain the June 2014 Section 7520 interest rate of 2.2 percent from the www.irs.gov website.

The Section 7520 interest rate applies to the valuation of certain charitable interests in trusts and is calculated by the Service each month based on 120 percent of the annually compounded applicable federal midterm rate for that month.¹⁴

We then identify the relevant adjustment factor from Publication 1458 Table F based on (1) a 2.2 percent Section 7520 interest rate, (2) quarterly payments made by NIMCRUT 1, and (3) a first payout date (January 31), which is one month after the annual valuation date of NIMCRUT 1 (December 31).

As identified in the relevant portion of Internal Revenue Service Publication 1458 Table F, these procedures result in an adjusted payout rate adjustment of 0.990094.

We then multiply the adjusted payout rate adjustment of 0.990094 by the 5.00 percent fixed rate of NIMCRUT 1 to obtain an adjusted payout rate of approximately 4.95 percent.

IRS Publication 1458
Table U(2)

Ages		Adjusted Payout Rate					
O	Y	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%
79	60	.41115	.39515	.37985	.36524	.35127	.33792
79	61	.42232	.40633	.39103	.37640	.36239	.34898
79	62	.43352	.41756	.40227	.38762	.37359	.36014
79	63	.44474	.42882	.41355	.39890	.38485	.37137
79	64	.45595	.44008	.42485	.41022	.39616	.38266
79	65	.46715	.45135	.43616	.42156	.40751	.39400
79	66	.47838	.46266	.44754	.43297	.41895	.40544
79	67	.48959	.47397	.45892	.44441	.43042	.41694
79	68	.50073	.48522	.47026	.45582	.44188	.42843
79	69	.51177	.49638	.48152	.46716	.45328	.43987
79	70	.52266	.50740	.49265	.47838	.46458	.45123
79	71	.53338	.51826	.50363	.48946	.47575	.46247
79	72	.54390	.52893	.51443	.50037	.48675	.47355
79	73	.55417	.53936	.52499	.51106	.49754	.48443
79	74	.56414	.54949	.53528	.52147	.50807	.49505
79	75	.57378	.55930	.54523	.53157	.51828	.50537
79	76	.58306	.56876	.55484	.54131	.52816	.51536
79	77	.59197	.57784	.56409	.55070	.53767	.52499
79	78	.60050	.58654	.57295	.55971	.54681	.53425
79	79	.60863	.59484	.58141	.56832	.55556	.54312

Step 2b: Obtain the Relevant Present Value Factor

After calculating the adjusted payout rate, the analyst may then use the adjusted payout rate to obtain the present value factor relevant to calculating the value of the remainder interest from one of the actuarial tables within Publication 1458.

The analyst first selects the relevant actuarial table based on the type of interest held by the unitrust income beneficiary.

Table U(1) is relevant when there is one unitrust income beneficiary who holds a life interest in the income from the NIMCRUT.

Table U(2) is relevant when there are two unitrust income beneficiaries who together hold a last-to-die interest in the NIMCRUT.

Table D is relevant when there is one or more unitrust income beneficiaries who hold specific-term interests that do not exceed 20 years.

The relevant present value is then obtained from the appropriate Publication 1458 table based on:

1. the adjusted payout rate calculated above,
2. the age of the beneficiary or beneficiaries who hold life or last-to-die unitrust income interests in the NIMCRUT, or

3. the number of years remaining until the completion of specified-term unitrust income interests.

Within the Publication 1458 tables discussed above, the Service provides present value factors for adjusted payout rates separated by every 0.2 percent from 0.2 percent to 20.0 percent. Oftentimes, the adjusted payout rate will not fall exactly on a listed payout rate.

In this case, the analyst interpolates between the present value factors listed for the payout rates that are closest to the adjusted payout rate based on the proportionate difference between the adjusted payout rate and the closest listed payout rates.

Step 2b Example

Because Steve and Katie together hold a last-to-die unitrust income interest in NIMCRUT 1, we apply Table U(2) to obtain the closest relevant present value factors for a 79- and 75-year-old who hold a last-to-die unitrust income interest in a NIMCRUT with a 4.95 percent adjusted payout rate.

As shown in the relevant portion of Table U(2), the interpretation of the chart results in present value factors of 0.53157 for a 4.8 percent adjusted payout rate and 0.51828 for a 5.0 percent adjusted payout rate.

These are the closest relevant present value factors to the 4.95 percent adjusted payout rate of the NIMCRUT 1 remainder interest.

Because the adjusted payout rate of 4.95 percent falls in between the present value factors listed in Table U(2), we interpolate between the two numbers.

In this instance, we use the following calculation:

$$PV_{4.95} = PV_{4.80} - (PV_{4.80} - PV_{5.00}) \times \left(\frac{4.95 - 4.80}{5.00 - 4.80} \right)$$

where:

PV = Present value factor related to each rate

Based on this calculation, we obtain a present value factor of approximately 0.5216 for the NIMCRUT 1 remainder interest.

Step 3: Calculate the Present Value of the Remainder Interest

The calculation of the present value of the remainder interest simply requires multiplying the net fair market value of the NIMCRUT assets obtained in step one by the present value factor obtained in step two.

Step 3 Example

Based on our \$1 million estimate of the net fair market value of the assets contributed to and held by NIMCRUT 1 and our calculated present value factor for the NIMCRUT 1 remainder interest of 0.5216, we estimate the value of the remainder interest in NIMCRUT 1 to be approximately \$521,600 as of June 30, 2014.

Based on our procedures, Steve and Katie may deduct \$521,600 as a charitable deduction on their joint 2014 tax return.

Step 4: Calculate the Present Value of the Unitrust Income Interest (if necessary)

As the total value of the net assets of the NIMCRUT is composed of the total remainder interest and the total unitrust income interests, the analyst may apply the present value of the total remainder interest to calculate the present value of the total unitrust income interests by subtracting the present value of the total remainder interest from the total net fair market value of the assets held by or contributed to the NIMCRUT as of the analyst's valuation date.

Step 4 Example

In this instance, the value of the unitrust income interest is not required for gift or estate tax purposes because Steve and Katie are maintaining control of this interest as of the analyst's valuation date.

If Steve and Katie instead decided to gift all or a portion of the interest to another individual or organization, the value may be estimated for gift or income tax purposes.

To calculate the present value of the total unitrust income interest in this case, the \$521,600 remainder interest is subtracted from the \$1 million total present value of NIMCRUT 1. This calculation results in a total unitrust income interest for both Steve and Katie of \$478,400.

The \$478,400 total unitrust income interest value is then multiplied by the percentage of the interest being gifted by Steve and Katie to estimate the present value of the gift.

SUMMARY AND CONCLUSION

An analyst may be asked to value remainder interests and unitrust income interests in a NIMCRUT for a variety of gift, estate, and other transfer tax related purposes.

In each instance, the unique factors and valuation analysis applied to NIMCRUTs may pose

difficulty to analysts who are unfamiliar with the NIMCRUT structure and NIMCRUT valuation procedures.

The discussion summarized the key items that make NIMCRUTs unique in order to familiarize analysts with specific factors they may consider in their valuation analysis of interests in a NIMCRUT.

The discussion also provided step-by-step procedures an analyst may take in performing his or her valuation analysis, and it presented a theoretical example to explain each step.

Analysts may use this discussion to assist them in future valuation engagements regarding the valuation of interests within a NIMCRUT. However, the analysts should use their own professional judgment to perform valuation procedures based on the specific facts of their case.

Notes:

1. Nathan R. Brown, "A Primer on Charitable Remainder Trusts," *Tax Management Estates, Gifts, and Trusts Journal* (November 13, 2014).
2. *Ibid.*
3. David Wheeler Newman, "Advanced NIMCRUT Design" (May 18, 2011), from www.pgdc.com/pgdc/advanced-nimcrut-design.
4. §664(d)(2)(D). More information on this topic can be found in the decision of *Estate of Arthur E. Schaefer v. Commissioner*.
5. §664(d)(2)(A).
6. *Ibid.*
7. "Charitable Remainder Trust—Net Income with Makeup Charitable Remainder Unitrusts (NIMCRUTs)," Royal Bank of Canada, 2016.
8. §664(e).
9. §664(d)(2)(C).
10. §664(d)(2)(B).
11. Richard L. Fox, "Tax Court Issues Opinion on Valuing Remainder Interest in NIMCRUT for Purposes of 10% Remainder Interest Requirement" (September 9, 2015), from www.pgdc.com/pgdc/tax-court-issues-opinion-valuing-remainder-interest-nimcrut-purposes-10-remainder-interest-regu.
12. §170(b)(1)(B).
13. Regulation 1.664-4(e)(3).
14. "Section 7520 Interest Rates," www.irs.gov.

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