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July 15, 2005

FEDERAL EXPRESS

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Re: Comments on Revenue Procedure 2005-24

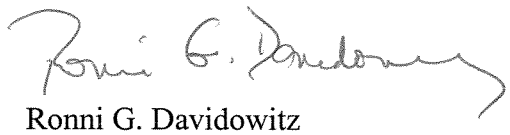
Gentlemen:

On behalf of the Association of the Bar of the City of New York, I am respectfully submitting comments on Revenue Procedure 2005-24 as approved by Bettina B. Plevan, President of the

Association of the Bar of the City of New York, and as reported by the Committee on Estate and Gift Taxation.

If you have any questions, please feel free to contact the undersigned or any member of my Committee.

Very truly yours,



Ronni G. Davidowitz

Enclosure

cc: Bettina B. Plevan, President, Association of the Bar of the City of New York
Alan Rothstein, Esq., General Counsel, Association of the Bar of the City of New York

ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK
AS REPORTED BY THE COMMITTEE ON ESTATE AND GIFT TAXATION

COMMENTS ON REVENUE PROCEDURE 2005-24

July 15, 2005

This report sets forth the comments of the Association of the Bar of the City of New York, as reported by the Committee on Estate and Gift Taxation, on Revenue Procedure 2005-24, which was effective March 30, 2005. Section I of this report introduces the issues and summarizes our recommendations. Section II discusses the provisions of Revenue Procedure 2005-24. Section III sets forth a detailed explanation of the recommendations summarized in Section I.

I. Introduction and Summary of Recommendations

On March 30, 2005, the U.S. Department of Treasury ("Treasury") and the Internal Revenue Service (the "Service") issued Revenue Procedure 2005-24 (the "Rev. Proc."), which provides a safe harbor rule pursuant to which a spousal right of election will be disregarded for purposes of determining whether a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT") meets the requirements of Internal Revenue Code §§ 664(d)(1)(B) or (d)(2)(B), respectively, from the trust's inception. The safe harbor rule provides, in substance, that if the donor's spouse irrevocably waives the right of election in the manner prescribed in the Rev. Proc., the trust will not be disqualified as a CRT. (For purposes of this report, the term CRT refers to both CRATs and CRUTs interchangeably.)

The Rev. Proc. aims to prevent any payments, other than annuity or unitrust payments, from being paid to any person other than a charitable organization by requiring a waiver of the right of election by a spouse, to avoid diversion of assets that should pass to charity instead of to a surviving spouse.

However, this goal, while worthy, can be accomplished in a more tailored way (described below) than that prescribed in this overly broad Rev. Proc., which endeavors to address a problem that is virtually non-existent as a practical matter with a sweeping, burdensome solution.

The practical effect of the Rev. Proc. will be to cause donors creating CRTs to incur the expense of constantly monitoring the right of election laws of their state, and to evaluate those laws in any state to which they subsequently may move during the term of the CRT. It is also likely to make CRTs less attractive as a planning vehicle and therefore likely to lead to a diminution in philanthropic giving.

Concomitant with the burdensome monitoring requirement imposed by the Rev. Proc. is the constant uncertainty for the donor during the life of the CRT. A donor of a CRT will never be sure that a CRT, valid when created, will not at some point be found

to be invalid retroactive to inception. Even should a spouse execute a proper waiver, there is no guarantee that the waiver will remain valid in the event of a subsequent move by the donor (or the spouse) to a new state. Also, should a donor divorce (or be widowed) and remarry, the Rev. Proc. requires a new waiver be executed by the new spouse in order for the safe harbor rule to apply. Further, depending upon applicable state law, unmarried donors who create a CRT and subsequently choose to marry would be forced to negotiate with their future spouses to obtain a waiver in order to preserve the CRT.

As a matter of sound public policy, taxpayers should be entitled to the protection afforded by the execution of well drafted estate planning documents. With the publication of Rev. Proc. 2005-24, this will no longer be possible for donors creating CRTs after June 28, 2005.

On May 19, 2005, the Service asked the public for comments on the Rev. Proc. In response, this report sets forth the comments of the Association of the Bar of the City of New York. We believe it is possible to amend the Rev. Proc. to make compliance less burdensome, while still effecting the intent that no amount other than the annuity or unitrust payment be paid to any person other than a charitable organization. We further believe that the adoption of the recommendations set forth in this report will protect the government from any loss of revenue or other undue prejudice.

Our recommendations are summarized immediately below and are explained in more detail in Section III. Item A below contains our recommendation regarding withdrawal of the Rev. Proc. Items B through D set forth our recommendations for crafting a more workable Rev. Proc. to prevent the possibility of an amount other than annuity or unitrust payments being made to any person other than a charitable organization.

A. Withdrawal of Revenue Procedure 2005-24

We join the view expressed by the American Council on Gift Annuities (the "ACGC") in its May 5, 2005 comments that Rev. Proc. 2005-24 should be withdrawn.[1] If Treasury and the Service believe that this Rev. Proc. should not be withdrawn, we believe, at a minimum, that it should be made a proposed regulation and that the public be given the opportunity to comment at a hearing or in writing.

B. Provide Protective Rules for the Estate to Follow in the Event a Right of Election is Exercised

If the recommendation set forth in Item A is not adopted, then we recommend that the Rev. Proc. be revised to eliminate the waiver requirement and to provide clear rules for a decedent's estate to follow in the event a surviving spouse's right of election in fact is exercised that are designed to return to the public fisc (with appropriate interest) all tax

[1] American Council on Gift Annuities (ACGC) May 5, 2005 Comments.

benefits derived by the decedent during his or her lifetime as a result of the establishment of the CRT.

C. Clarify the Requirement that a Copy of a Signed Waiver Must Be Provided to the Trustee of the CRT

If the recommendation set forth in Item B is not adopted, guidance is needed to clarify the time frame in which the waiver must be provided to the trustee. The Rev. Proc. does not address the issue of whether a waiver will be void if it be executed within the required time frame, but not delivered to the trustee.

D. Provide Guidance on post-June 28, 2005 Additions to a CRUT Created before June 28, 2005

Guidance is needed to clarify whether a post-June 28, 2005 addition to a CRUT created before June 28, 2005 is protected by the safe harbor rule even though a waiver was not obtained at the time of the subsequent addition.

II. Description of the Rev. Proc.'s Safe Harbor to Avoid Disqualification of a CRT Because of the Spousal Right of Election

A. In General

The core purpose of the new Rev. Proc. is to prevent any amount - other than an annuity or unitrust payment - in a CRT from being paid to any person other than a charitable organization. The scope of the new rule extends only to inter vivos CRTs. The new Rev. Proc. provides a safe harbor rule pursuant to which a right of election will be disregarded for purposes of determining whether a CRAT or CRUT meets the requirements of §§ 664(d)(1)(B) or (d)(2)(B), respectively, from its inception. The safe harbor provides that if the donor's spouse irrevocably waives the spousal right of election permitted under state law, the availability of the election against the donor's estate will be disregarded for purposes of determining whether a valid CRT had been created.

To fall within the safe harbor rule, the waiver must comply with the requirements set forth in the Rev. Proc.

A waiver is required when state law grants a surviving spouse a right of election and such election extends to assets held in a CRT.[2] A waiver is *not* required if applicable state law does *not* grant a spousal right of election, or if the right of election cannot be exercised with respect to assets held in a CRT.

[2] Uniform Probate Code ("UPC") § 2-207, for example, contains an elective share provision that permits a surviving spouse to take a percentage of the deceased spouse's "augmented" estate. The augmented estate includes the probate estate, specified nonprobate assets and other specified property. To date, fourteen states have adopted the UPC and four states have adopted UPC-"like" provisions.

We believe that the waiver requirement is overly burdensome, because although a valid waiver may initially be executed within the time frame set forth in the Rev. Proc., there is no assurance that the waiver will remain valid, under the Rev. Proc., for the duration of the CRT.[3] This is particularly so because of the requirement that the waiver be "valid under state law." Different states have different laws with respect to both the availability of the right of election and the type of assets against which the right may be exercised (and those laws can all change), and a waiver that is valid in one state may not be valid should the donor of the CRT move to a new jurisdiction.

B. Application of the Safe Harbor Provision

The Rev. Proc. provides that a right to an elective share of a deceased spouse's estate will be disregarded for purposes of determining whether a CRT is valid from the date of its inception if the three requirements set forth in the Rev. Proc. are met (described below). CRTs created before June 28, 2005 are "grandfathered" and no waiver is required. However, for grandfathered CRTs, if the spouse later exercises the right of election, the CRT will be disqualified from its date of inception. The Rev. Proc. does not address the issue of whether a waiver is needed if there is a post-June 28, 2005 addition made to a CRUT created before such date.[4]

First Requirement

For a CRT executed on or after June 28, 2005, a spouse must execute a written, irrevocable waiver of the right of election against the assets held by the trustee of the CRT in order for a CRT to be valid continuously from its creation. The waiver must be valid under applicable state law, waive the right of election against CRT assets, and be signed and dated by the spouse.

Second Requirement

The waiver must be executed on or before the "due date", which is defined as six months after the due date (excluding extensions of time to file actually granted) of the trust's tax return (Form 5227) for the year in which the later of the following occurs:

1. the creation of the trust;

2. the date of the donor's marriage;

3. the date the trust donor becomes domiciled or resident in a jurisdiction whose law provides a right of election that could be satisfied from assets of the CRT; or

[3] The time frame in which the waiver must be executed is further discussed in subsection B of this section II.

[4] This point is discussed further in subsection D of section III.

4. the effective date of applicable state law creating a right of election.

Third Requirement

The donor must provide the trustee of the CRT with a copy of the signed waiver. The trustee must retain a copy of the waiver with the official records of the trust.

The Rev. Proc. has an effective date of March 30, 2005, and applies to all CRTs created on or after June 28, 2005.

III. Explanation of Recommendations

A. Withdrawal of Revenue Procedure 2005-24

We join the view expressed by the ACGC in its May 5, 2005 Comments that the Rev. Proc. should be withdrawn. The Rev. Proc. aims to prevent a problem that in reality seldom occurs, and that can be adequately addressed by other means that are simpler and equally effective.

The Rev. Proc. states that "[t]he Service believes that, in the interest of sound tax administration and to *reduce the burden* on taxpayers, it is appropriate to provide a safe harbor procedure..."[5] However, rather than "reduce the burden" on taxpayers, this Rev. Proc. creates a needless burden.

The requirement that the donor's spouse execute a valid waiver creates a burden on the taxpayer by imposing on the donor the need to monitor the right of election laws of the state in which the donor lives, as well as the laws of any state to which the donor subsequently may move. For instance, suppose a donor lives in a state that, at the time of the CRT's creation, does not have a right of election law or has a right of election law that does not extend to the assets of a CRT. A few years later, the state enacts a right of election law pursuant to which CRT assets could be reached by the surviving spouse, or the state modifies its existing right of election law to extend to CRT assets. For the CRT to remain valid in either instance, the donor must have the spouse execute a waiver. This is an onerous rule, as the chances of a typical taxpayer's knowing that a right of election law has been enacted or modified in his or her state is remote. As a practical matter, the donor would have to incur fees to a professional paid to monitor developments, if any, in the state's right of election laws. This may be lucrative for practitioners, but disproportionately expensive for donors.

The donor will incur further legal expenses when paying an attorney to draft a waiver for the spouse. It would depend on the practice in the particular state whether the spouse signing the waiver needs separate legal counsel as well (akin to the common practice for pre-nuptial and post-nuptial agreements). If that is the case, then still greater legal expenses will be incurred.

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[5] Revenue Procedure 2005-24 section 2.04 (emphasis added).

The requirement that the waiver be valid under state law causes further potential problems for donors. For example, assume that a married individual decides to create a CRT. The donor's spouse executes a waiver valid under the present state's law. Years later the now-elderly couple moves to a different state for health-related or other reasons and the new state has a different right of election law. Assume further that the "waiving" spouse has become incapacitated for purposes of executing legal documents. At the time of the move, the spouse no longer has the requisite capacity to execute a valid waiver under state law. The CRT will *automatically* become invalid under the safe harbor rule simply because the spouse is not able to execute another waiver.

Another problem arises in the situation where the donor of the CRT and the spouse reside in different jurisdictions. The Rev. Proc. states that the waiver must be "valid under applicable state law."[6] But it is not clear whether this refers to the law of the donor's state of residence or the spouse's state of residence. In addition, it is unclear how this would apply where a donor has real property located in a state (other than the state of his or her domicile) that has its own right of election.

With respect to the timing of the execution of the waiver, the donor must have a waiver executed if the donor marries for the first time after the creation of a CRT or remarries after the divorce (or death) of a previous spouse. This is onerous on the donor. If the donor created a CRT five years ago, lives in a state with a right of election statute that extends to CRT assets and is now getting married, the donor may not be aware – or may have forgotten – that a waiver must be executed by the spouse. The Rev. Proc. thus imposes on clients a requirement to monitor a relatively arcane provision of state law or, alternatively, pay a professional to monitor the client's marital status to ensure compliance.

The donor will also be put in a difficult position if the new spouse simply refuses to execute a waiver, in which case the CRT would be invalidated from its date of inception, with the only protective alternative to the donor being not to marry.

More often, the donor will choose not to raise the issue of waivers or pre-nuptial agreements at the time of the marriage. In real life, these issues raise practical and emotional difficulties in many situations, and we believe it is inappropriate to require such a waiver as a condition of an ongoing valid CRT.

Another practical issue regarding the need for a waiver is that not all lawyers who draft CRTs are specialists in estate planning. As the ACGC reminds us, many courts have reformed defectively drafted CRTs,[7] and the Service is certainly aware of the difficulties many practitioners have with the technical requirements – in fact, Sections 2055(e)(3) and 2522(c)(4) of the Code operate as permanent statutory "fixes" for split-interest trusts that do not otherwise meet those technical requirements. It is likely that a number of donors could have their CRTs invalidated from the date of inception simply because their lawyers were not aware of Rev. Proc. 2005-24.

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[6] Id. at 3.02.
[7] ACGC May 5, 2005 Comments.

Assume a donor has a CRT drafted by a lawyer unaware of the Rev. Proc. Even though the surviving spouse does not exercise the right of election on the donor's death, the CRT will be invalidated from its inception simply because the Rev. Proc. requirements were not satisfied. The donor is not at fault and the government has not been disadvantaged in any way. However, under this Rev. Proc., the CRT was *always* invalid because of the mere existence of the right of election statute. The CRT is invalid even if the right of election is not exercised and no payment other than the annuity or unitrust payment goes to persons other than charitable organizations. This is an excessively harsh result.

The purpose of allowing for a charitable deduction is to promote charitable giving. Creating burdensome rules will lead to a decrease in the use of these trusts. This new Rev. Proc. will have the effect of impeding charitable giving by imposing compliance costs on the donor while trying to prevent a problem that (a) is not an issue in the first place and (b) can be cured in a less draconian manner.

For all of the foregoing reasons, we believe that Rev. Proc. 2005-24 should be withdrawn. However, if the Service and Treasury believe the Rev. Proc. should not be withdrawn, we believe it should be made a proposed regulation and that the public be given the opportunity to comment at a hearing or in writing.

B. Provide Protective Rules in the Event a Right of Election is Exercised

Instead of requiring that a waiver be executed regardless of whether a right of election might be exercised, a better solution is to provide protective rules for when and if a right of election is exercised. In other words, do not provide any rules for CRTs except in the event a right of election extending to CRT assets is exercised.

We propose consideration of a rule that, in the event that a right of election were exercised, would restore to the public fisc (with appropriate interest) all excess tax benefits derived by the decedent during his or her lifetime as a result of the establishment of the CRT. There would be two components to this adjustment: an income tax component and a gift tax component.

The income tax component would include in gross income on the first federal fiduciary income tax return of the estate of the decedent who created the CRT an amount equal to the sum of the following:

(1) the amount of any income tax charitable deduction taken by the decedent in connection with the establishment of the CRT to the extent that said deduction was attributable to trust assets not passing to charity as a result of the exercise of the right of election (as adjusted for interest, computed at the appropriate applicable federal rate, from the month of transfer to the CRT to the date of death); and

(2) the amount of ordinary income and capital gains that would have been taxable to the decedent from year to year were it not for the CRT. This, in turn, would require a computation of the net amount of ordinary income and capital gains that would have been taxable to the decedent were it not for the CRT general exemption from income tax under Internal Revenue Code Section 664(c), after taking into account the amount of ordinary income and capital gains that was in fact taxed to the holder of the annuity interest or the unitrust interest under Code Section 664(b). (This too would presumably require an interest adjustment, computed at the appropriate applicable federal rate, through the decedent's date of death. However, given the number of tax years that could potentially be involved in this computation, certain conventions or assumptions could be employed.)

The gift tax component would include in the decedent's adjusted taxable gifts on the Form 706, Federal Estate Tax Return, the amount of the gift tax charitable deduction taken by the decedent during his or her lifetime that is attributable to trust assets not passing to charity, as reduced by the amount of any gift tax marital deduction to which the decedent would have been entitled had the transfer instead been to his or her spouse (provided that the decedent was married at the time of the transfer to the CRT).

To prevent a statute of limitations (SOL) obstacle to the imposition of taxes, the applicable statute pertaining to trusts[8] could be amended to provide that the SOL does not begin to run with respect to CRTs (for right of election purposes only) until the time for the exercise of a right of election by the surviving spouse expires. Donors can enjoy the protection provided by the SOL law by having their spouses execute a valid waiver as provided by the Rev. Proc.; however, there would be no obligation on the donor's part to obtain the waiver.

C. Clarify the Requirement that a Copy of a Signed Waiver Must Be Provided to the Trustee of the CRT

The Rev. Proc. provides that a copy of a waiver must be provided to the trustee of the CRT and the trustee must keep the waiver with the trust's records. The Rev. Proc., however, does not provide a time frame during which this requirement must be met.

The Rev. Proc. provides that "[a] copy of the signed waiver *must* be provided to the trustee of the CRAT or CRUT [emphasis added]." Strictly construed, this indicates that if a signed waiver is executed, but not provided to the trustee, the CRT is invalid. We do not believe this was the intended result. If it is, it is a bad result. The goal of the Rev. Proc. is to prevent annuity and unitrust payments from being paid to any person other than a charitable organization. If a spouse executes a waiver, the goal of the Rev. Proc. has been met, regardless of whether the trustee has been given a copy of the waiver. The fact of whether the trustee received the waiver during the donor's life or upon the donor's death is irrelevant to achieving the goal of the Rev. Proc. The requirement that the trustee be provided a copy of the waiver is appropriate to make sure that CRT assets are not distributed to a noncharitable beneficiary, but it is not clear why the copy of the waiver must be provided to the trustee before the donor's death, and if it is not, why must

[8] I.R.C. § 6501(a).

the result be the invalidation of the CRT *ab initio*, which, again, seems excessive in light of the offense.

We believe the donor will be faced with a needlessly harsh result if the donor or the donor's lawyer does not comply with this provision due to a mere oversight. For example, suppose a donor's spouse executes a valid waiver under state law within the time frame provided by the Rev. Proc. However, due to an oversight, the waiver was never delivered to the trustee. Upon the donor's death, the waiver is found in the donor's safe deposit box. We believe it is not the intended result that the CRT be invalidated although no CRT assets are passing – or at that point could possibly pass - to any person other than a charitable organization. Guidance, therefore, should be provided to that effect.

D. Provide Guidance on post-June 28, 2005 Additions to a CRUT Created before June 28, 2005

The Rev. Proc. does not address the issue as to whether a post-June 28, 2005 addition to a CRUT is protected by a waiver executed at the time of the CRUT's creation. For example, if a donor creates a CRUT *prior* to June 28, 2005 and later, *after* June 28, 2005, the donor makes an addition to the CRUT, but does not have his or her spouse execute a waiver, does this later addition invalidate the CRUT? Assume further that at the time of the donor's death the surviving spouse does not exercise the right of election. Will the CRUT be invalidated since its inception because no waiver was executed at the time of the later addition, or would only the later additions be deemed to be gifts for which the income tax charitable deduction should be disallowed?

Requiring a waiver to be exercised at the time of the later addition reinforces the unwarranted burden that the Rev. Proc. places upon the donor to monitor the law of his or her particular state. We believe that if the CRUT is grandfathered under the Rev. Proc., a later addition to the trust should *not* require a waiver for the safe harbor to apply, and guidance should be provided to that effect.