

Planned Giving News

FIRST QUARTER 2006

SPOUSAL “RIGHT OF ELECTION” AGAINST CRT ASSETS

Spousal Waiver No Longer Needed

By Ken Dike

In the 2005 second quarter edition of our Planned Giving Newsletter, we discussed Revenue Procedure 2005-24 issued by the IRS on March 30, 2005 (see article *Much Ado About Nothing*). This revenue procedure required a spousal waiver of their “right of election” against assets held in a *Charitable Remainder Annuity Trust* or *Charitable Remainder Unitrust* to protect the tax exempt status of these *Charitable Remainder Trusts* (CRTs) created on or after June 28, 2005. In response to criticism from various sources, the IRS has recently released Notice 2006-15, 2006-8 IRB 1 that extends the June 28, 2005 cutoff date indefinitely. This means that no waiver is required to protect the tax exempt status of CRTs unless the right of election is actually exercised against CRT assets.

BACKGROUND OF REVENUE PROCEDURE 2005-24

In many states, a surviving spouse could demand a percentage of the deceased spouse’s estate in lieu of the amount bequeathed to the surviving spouse by the decedent’s will. Since this *elective share* could include assets held in a CRT, the IRS reasoned that the *mere existence* of the right, and the related *possibility* that the CRT could be invaded by the surviving spouse, resulted in the trust’s

forfeiture of its tax exempt status *continuously from the inception of the trust*.

Revenue Procedure 2005-24 resulted in a disqualification of a CRT’s tax exempt status unless (1) the CRT was created prior to June 28, 2005 and the surviving spouse did not exercise their right to an elective share that could be satisfied from CRT assets, or (2) the surviving spouse irrevocably waived their right to an elective share in a timely manner to the extent that there was no possibility that any CRT asset could be used to satisfy the elective share.

Regarding item (2), a spousal waiver was required by Rev. Proc. 2005-24 for CRTs created on or after June 28, 2005 if applicable state law provided for a spousal right to an elective share that *could* be satisfied from the assets of a CRT. The applicable state was the state in which the CRT donor is domiciled in, or is resident of, *at the time of donor’s death*. Rev. Proc. 2005-24 contained the following situations that required a spousal waiver of elective share assuming the CRT was created on or after June 28, 2005:

- Donor creates a CRT in a community property state such as California that has no elective share provision (no waiver required) then moves to a common law state that

continued on insert back

**IN RESPONSE TO CRITICISM FROM VARIOUS SOURCES, THE IRS HAS RECENTLY RELEASED
NOTICE 2006-15, 2006-8 IRB 1 THAT EXTENDS THE JUNE 28, 2005 CUTOFF DATE INDEFINITELY.**

continued from insert front

provides for an elective share that could be satisfied with CRT assets (waiver required).

- Donor creates a CRT in a common law state where the elective share cannot be satisfied with CRT assets (no waiver required) then moves to another common law state where the elective share could be satisfied with CRT assets (waiver required).
- State law is amended to provide for an elective share that could be satisfied from CRT assets.

A disqualification of the CRT's tax exempt status under Rev. Proc. 2005-24 would have resulted in (1) the loss of any income or gift tax charitable deduction taken by the donor, (2) the CRT would have been taxed on any income or capital gains not paid to the income beneficiaries, (3) any gift or estate tax marital deduction related to assets transferred to the CRT would have been lost if the surviving spouse held an income interest (right to receive beneficiary distributions) in the CRT, and (4) any estate tax charitable deduction could have been disallowed.

THE RESPONSE TO REVENUE PROCEDURE 2005-24

Since issuing Revenue Procedure 2005-24, the IRS has been flooded with complaints from various sources pointing out the logistical problems

associated with compliance and the unreasonable burden placed on donors and the charities they support. In addition, the unlikely possibility that the problem envisioned by the IRS in this revenue procedure would actually occur (surviving spouses hardly ever exercise a statutory elective share against assets in a CRT) was addressed by the critics.

In response, the IRS issued IRS Notice 2006-15, 2006-8 IRB 1 which extended the June 28, 2005 cutoff in Revenue Procedure 2005-24 "until further guidance is issued by the Internal Revenue Service." The IRS is now reconsidering their approach to the spousal "right of election" and

investigating alternative safe harbor provisions aside from the spousal waiver previously required by Rev. Proc. 2005-24.

NO WAIVER REQUIRED

For the time being, no spousal waiver is required and a CRT will not be disqualified unless a surviving spouse actually elects against the estate and takes assets from the CRT. As stated in IRS Notice 2006-15, 2006-8 IRB 1 "the Service will disregard the existence of ... [a spousal] right of election, even without a waiver as described in Rev. Proc. 2005-24, but only if the surviving spouse does not exercise the right of election." §

PRUDENT INVESTOR RULE

Submitted by Jim Fox

From time to time as managers of non-profit assets, we review the key nuances of the Prudent Investor Rule, which was widely updated and adopted by nearly all states a few years ago. We think it is important for our clients to do the same. The following summary is a good refresher:

"A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

A trustee's investment and management decisions respecting individual assets and courses of actions must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust." §

Pasadena 200 S. Los Robles Avenue, Suite 320, Pasadena, California 91101 P 626-792-2228 F 626-792-2670

Huntington Beach 16902 Bolsa Chica Street, Suite 204, Huntington Beach, California 92649 P 714-846-2851 F 714-840-5212

Evergreen P.O. Box 2945, Evergreen, Colorado 80437 P 720-746-1244 F 720-294-9896

www.clifford1915.com