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Rev. Proc. 2005-24 and the UPC Elective Share

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Abstract

This article discusses Revenue Procedure 2005-24, which came as a bombshell to the estate-planning bar. The Rev. Proc. requires a spousal waiver of elective-share rights in order for a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT) created on or after June 28, 2005, to qualify for a charitable deduction. The elective share is a statutory provision common to most probate codes in non-community-property states that protect a decedent's surviving spouse against disinheritance.

The Rev. Proc. is primarily though apparently not exclusively addressed to the elective share of the Uniform Probate Code (UPC). Unfortunately, the Rev. Proc. applies "applicable state law" that is sometimes consistent with and sometimes significantly departs from the UPC elective share, without identifying which is which. Consequently, the Rev. Proc. may give the wrong impression that the UPC served as the model for the applicable state law throughout the discussion and examples.

The source of the problem appears to be that the IRS misinterpreted the UPC elective share. The IRS's description of the UPC elective share overlooks an important feature of that law: Under UPC elective-share law, the settlor-decedent's surviving spouse has no claim on a "premarital CRAT or CRUT"—a CRAT or CRUT created when the settlor-decedent was unmarried or was married to a previous spouse. Consequently, no spousal waiver should be required of a later spouse if the UPC is the "applicable state law." Yet, the Rev. Proc. repeatedly states that a waiver is required of a later spouse.

The article concludes by pointing out that there is a larger question posed by

the Rev. Proc., which is that if the IRS remains determined to insist on a spousal waiver for CRATs and CRUTs that might but probably won't turn out to be liable for a pro rata share of an electing surviving spouse, the result may be to weaken the elective-share protection for surviving spouses. The article urges the IRS to drop the requirement of a spousal waiver and work out some mechanism for retroactively denying the charitable deduction only in cases in which the surviving spouse actually claims his or her elective-share rights and the CRAT or CRUT becomes liable for satisfying a portion of those rights. This is in fact the IRS's position regarding CRATs and CRUTs created before June 28, 2005, and would seem to be all that is necessary to protect tax revenues.

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ABSTRACT

This article discusses Revenue Procedure 2005-24, which came as a bombshell to the estate-planning bar. The Rev. Proc. requires a spousal waiver of elective-share rights in order for a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT) created on or after June 28, 2005, to qualify for a charitable deduction. The elective share is a statutory provision common to most probate codes in non-community-property states that protect a decedent's surviving spouse against disinheritance.

The Rev. Proc. is primarily though apparently not exclusively addressed to the elective share of the Uniform Probate Code (UPC). Unfortunately, the Rev. Proc. applies "applicable state law" that is sometimes consistent with and sometimes significantly departs from the UPC elective share, without identifying which is which. Consequently, the Rev. Proc. may give the wrong impression that the UPC served as the model for the applicable state law throughout the discussion and examples.

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The article concludes by pointing out that there is a larger question posed by the Rev. Proc., which is that if the IRS remains determined to insist on a spousal waiver for CRATs and CRUTs that *might but probably won't* turn out to be liable for a pro rata share of an electing surviving spouse, the result may be to weaken the elective-share protection for surviving spouses. The article urges the IRS to drop the requirement of a spousal waiver and work out some mechanism for retroactively denying the charitable deduction only in cases in which the surviving spouse actually claims his or her elective-share rights and the CRAT or CRUT becomes liable for satisfying a portion of those rights. This is in fact the IRS's position regarding CRATs and CRUTs created before June 28, 2005, and would seem to be all that is necessary to protect tax revenues.

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REV. PROC. 2005-24 AND THE UPC ELECTIVE SHARE[*]

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Rev. Proc. 2005-24[1] came as a bombshell to the estate-planning bar. The Rev. Proc. requires a spousal waiver of his or her elective-share rights in order for a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT) created on or after June 28, 2005, to qualify for a charitable deduction.

The Rev. Proc. is primarily though apparently not exclusively addressed to the elective share of the Uniform Probate Code (UPC).[2] As stated by the IRS, the Rev. Proc. "applies to any charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) that is created by the grantor, G, if, under applicable state law, G's surviving spouse, S, has a right of election exercisable on G's death to receive an elective, statutory share of G' s estate, and such share could be satisfied in whole or in part from assets of the CRAT or CRUT in violation of § 664(d)(1)(B) or (d)(2)(B) of the Internal Revenue Code."[3]

The Rev. Proc. applies "applicable state law" that is sometimes consistent with and sometimes significantly departs from the UPC elective share. Because the Rev. Proc. does not identify which is which, the Rev. Proc. may give the wrong impression that the UPC served as the model for the applicable state law throughout the discussion and examples.

Rev. Proc. 2005-24's description of the UPC elective share. Rev. Proc. 2005-24 focuses on the UPC elective share and describes it as follows:

> Section 2. Background ....
>
> .02 In some states, the elective share is based solely on the probate estate but, in others, G's estate is defined more broadly for purposes of computing the elective share and may include assets of the CRAT or CRUT. In states that have adopted the elective share provisions of the UPC, S has the right of election to take a percentage (generally determined by the duration of the marriage, but subject to a minimum dollar amount in some cases) of the "augmented estate" provided that certain requirements are met. UPC § 2-202. The augmented estate includes G's net probate estate, as well as certain nonprobate assets of G, certain property transferred by G to others (including to S) during life, and certain other property. UPC §§ 2-202 and 2-207. The assets of the CRAT or CRUT may

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[**] The author was the Reporter for the UPC elective share. This article represents the views of the author. The article has not been submitted to the Joint Editorial Board for approval or for adoption as its official position.

[1] 2005-1 C.B. 909

[2] UPC §§ 2-201 to -214. The UPC elective share is described in some detail in Restatement (Third) of Property: Wills and Other Donative Transfers § 9.2 (2001).

[3] Rev. Proc. 2005-24 § 1.01.

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be included in the augmented estate and, therefore, may be used to determine and satisfy the elective share amount. UPC § 2-209. In some states, the CRAT or CRUT assets may be used to satisfy the elective share only after other property in the augmented estate first has been exhausted.

Section 2.02 omits an important feature of the UPC augmented estate. The UPC augmented estate does not include a CRAT or CRUT that was created by the settlor-decedent before the decedent's marriage to his or her surviving spouse. Rev. Proc. 2005-24 never mentions that limitation. That limitation is highly significant, however. Under UPC elective-share law, the settlor-decedent's surviving spouse has no claim on a "premarital CRAT or CRUT"—a CRAT or CRUT created when the settlor-decedent was unmarried or was married to a previous spouse. There is no "future-spouse problem" under the UPC.

The UPC augmented estate. Although the UPC augmented estate is made up of the sum of the values of four components, a CRAT or CRUT comes under the category called the "decedent's nonprobate transfers to others."[4] That category, as defined in UPC § 2-205, is divided into three components:

First component (§ 2-205(1))—CRAT or CRUT never included. The first component is broadly defined as property that the decedent owned in substance immediately before death and that passes outside of probate at the decedent's death to someone other than the surviving spouse. A CRAT or CRUT does not fit within this component because the settlor-decedent does not have substantive ownership of the property in the trust. To have substantive ownership, the settlor-decedent must have a power of revocation or withdrawal, or an equivalent power. Because a CRAT or CRUT is always irrevocable, and never includes a power of withdrawal or an equivalent power, a CRAT or CRUT is not included in the UPC augmented estate under § 2-205(1).[5]

Second component (§ 2-205(2))—CRAT or CRUT included if created during marriage and if retained annuity or unitrust interest expires at decedent's death or later.[6] The second component is broadly defined as property transferred by the decedent during the decedent's marriage to his or her surviving spouse, with a retained right to or power over the income[7] that terminates at the decedent's death or later. A CRAT or CRUT comes within this category if the retained annuity or unitrust interest was for life or for a period of time that turns out to extend beyond the settlor-decedent's death.

Third component (§ 2-205(3))—CRAT or CRUT included if created during marriage and if retained annuity or unitrust interest expires during the two-year period preceding the decedent's death. The third component includes any transfer that would have been covered by the second component, except for

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[4] The other three components are the decedent's net probate estate (UPC § 2-204), the decedent's nonprobate transfers to the surviving spouse (UPC § 2-206), and the surviving spouse's property and nonprobate transfers to others (UPC § 2-207).

[5] The settlor of a CRAT or CRUT never retains a right to change the charitable remainder beneficiary to the settlor or the settlor's estate.

[6] UPC § 2-205(2) includes in the augmented estate "Property transferred in any of the following forms by the decedent during marriage: (i) Any irrevocable transfer in which the decedent retained the right to the ... income from the property if and to the extent the decedent's right terminated at or continued beyond the decedent's death."

[7] As defined in UPC § 2-201(9), the term "right to income" includes an annuity or a unitrust interest.

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the fact that the retained income interest actually terminates within the two-year period next preceding the decedent's death. A CRAT or CRUT comes within this category if the settlor-decedent's retained annuity or unitrust interest was for a period of time that turns out to expire within that two-year period. If the period expires more than two years before the settlor-decedent's death, the value of the CRAT or CRUT is not included in the UPC augmented estate, even if the trust was created during the settlor-decedent's marriage to his or her surviving spouse.

Summary. To summarize: A CRAT or CRUT is included in the UPC augmented estate if the trust was created during the settlor-decedent's marriage to his or her surviving spouse and if the settlor-decedent's retained annuity or unitrust interest was for the settlor-decedent's life or for a period of time that actually expires within the two-year period next preceding the settlor-decedent's death or later. Otherwise, a CRAT or CRUT is not included in the UPC augmented estate.

Liability of a CRAT or CRUT for payment of the UPC elective share. UPC § 2-209 covers liability for payment of the elective-share amount. The first source of payment is the sum of the decedent's voluntary transfers to his or her surviving spouse plus the surviving spouse's marital property (UPC § 2-209(a)). If, after applying the sum of these amounts, there is an unsatisfied balance, liability for payment of the unsatisfied balance is covered by UPC § 2-209(b). Section 2-209(b) provides that *only property that is included in the augmented estate under UPC § 2-205 is liable for payment of the elective share amount*. Any property included in the augmented estate under § 2-205 is proportionally liable for payment of the unsatisfied balance. If a CRAT or CRUT is included in the augmented estate under § 2-205, the CRAT or CRUT could be liable for a pro rata payment to an electing surviving spouse.

Spousal waiver under the UPC. Under UPC § 2-208, property is excluded from the augmented estate if the transfer was made with the joinder of or was consented to in writing by the surviving spouse. Section 2-213 also provides that a spouse can (before or after marriage) wholly or partially waive his or her right to an elective share, if certain requirements such as voluntary execution are satisfied.

The Rev. Proc. requires a spousal waiver (called a "safe harbor"), but gives confusing and questionable directions regarding the required timing and necessity of the waiver. Section 3 of Rev. Proc. 2005-24 requires a spousal waiver (called a "safe harbor") for any CRAT or CRUT created on or after June 28, 2005, "if the [surviving spouse's elective] share could include any assets of a CRAT or CRUT created or funded by G."[8] (For CRATs or CRUTs created before June 28, 2005, "the failure of S to waive the right of election, combined with S's exercise of that right of election, will result in the CRAT or CRUT failing to qualify under § 664(d) continuously since its creation.")

The Rev. Proc. gives directions regarding the timing and necessity of a spousal waiver that are confusing and, insofar as the UPC elective share is concerned, questionable. Section 3.03 provides:

> .03 *Timing of Waiver*. For CRATs or CRUTs created by G on or after June 28, 2005, section 3.02 of this revenue procedure must be satisfied on or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of Form 5227, Split-Interest Trust Information Return, for the year in which the later of the following occurs:
>
> (1) the creation of the trust;

[8] Rev. Proc. 2005-24 § 3.01.

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(2) the date of G's marriage to S;

(3) the date G first becomes domiciled or resident in a jurisdiction whose law provides a right of election that could be satisfied from assets of the trust; or

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

Use of the term "later of" is confusing when applied to four events.[9] Four events call for either of two terms: "latest of" (most recent) or "last of" (last of the four).[10] Neither of these terms captures what the IRS obviously intended, however.[11] The intended meaning, it would appear, is that a spousal waiver must be executed on or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of Form 5227, for the year in which the first of the following occurs: (1) creation of a CRAT or CRUT if applicable state law then makes the trust potentially liable to satisfy the spouse's elective-share rights, (2) any change in applicable state law that makes a previously created CRAT or CRUT potentially liable for satisfying the spouse's elective-share rights, or (3) a change of domicile to a jurisdiction whose applicable state law makes a previously created CRAT or CRUT potentially liable for satisfying the spouse's elective-share rights.

Half of the IRS's examples apply elective-share law that is inconsistent with the UPC. Section 4 of the Rev. Proc. uses six examples to illustrate the necessity and timing of a spousal waiver. Without noting which is which, the "applicable state law" used by the IRS in three of the examples is consistent with the UPC elective share and the law used in the other three is inconsistent. Here is the full set of examples given in the Rev. Proc.:

Section 4. Examples

In each of the following examples, G created a CRAT that provides an annuity to G for G's life. Upon G's death, the remainder of the trust will pass to an organization that meets the requirements of § 170(c). In each example (except Example 3), at the time the CRAT is created, applicable state law provides S a right of election to receive an elective share of G's estate and the share would include (and could be satisfied from) assets of the trust.

.01 *Example 1*. G creates the trust in 2007 while married to S. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, S irrevocably waives S's right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to G's probate estate).

.02 *Example 2*. G creates the trust in 2006, and is unmarried on the date the trust is created. On May 1, 2007, G marries S. On or before the date that is 6 months after the due date (excluding

[9] The term "later of" is properly applied to two events (the comparative form), not more than two events (which call for the superlative form). See, e.g., The Oxford English Grammar ¶ 4.24 at 139 (Sidney Greenbaum 1996).

[10] See Merriam-Webster's Dictionary of English Usage 584 (1989).

[11] "Latest of" (most recent) would require a spousal waiver upon the second or perhaps even the first of any of the four cited events. "Last of" (last of the four) is problematic because one or more of the cited events might never occur.

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extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, S irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to G' s probate estate).

.03 *Example 3*. G creates the trust in 2008 while married to S. Under applicable state law in effect on the date that G creates the trust, the elective share does not include the assets in the trust. Effective on March 1, 2009, applicable state law is amended to give S the right of election to receive an elective share of the "augmented estate," which, by definition, includes the assets of the trust. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2009, S irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to G's probate estate).

In each of Examples 1 through 3, assuming that S's timely waiver of the right of election is valid under applicable state law and satisfies the other requirements of this revenue procedure, the existence of the right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation as a CRAT under § 664(d)(1)(B). Further, in each of Examples 1 through 3, the result would be the same if, instead of executing only a partial waiver, S had waived the full right of election with respect to all assets in G's augmented estate.

.04 *Example 4*. G creates the trust in 2007 while married to S. Under applicable state law in effect on the date that G creates the trust, the elective share includes the assets in the trust. Later in the same year, applicable state law is amended to provide that the augmented estate does not include the assets of a CRAT or CRUT and the amendment applies retroactively to include the trust created by G. Accordingly, no waiver of the right of election is required with respect to the assets of the trust in order for the trust to continue to qualify as a CRAT.

.05 *Example 5*. The facts are the same as in Example 2 except that the waiver is contained in, or is signed pursuant to the requirements of, a prenuptial agreement. Unless the agreement as a whole (or only the waiver) is subsequently found to be invalid or unenforceable, the waiver will satisfy the requirements of this revenue procedure.

.06 *Example 6*. The facts are the same as in Example 1, except that S dies in 2010. In 2012, G marries S2. S2 refuses to waive S2's right to receive an elective share with regard to the assets in the trust. The existence of S's right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation up until G's marriage to S2, as a CRAT under § 664(d)(1)(B). However, because S2 did not timely and irrevocably waive S2's right to receive an elective share with regard to the assets in the trust, the trust does not qualify as a CRAT under § 664(d)(1)(B).

If, in these examples, G had instead created a CRUT, the results would be the same for purposes of § 664(d)(2)(B).

Examples 2, 5, and 6 require a spousal waiver for a CRAT or CRUT entered into before marriage and are incorrect insofar as the UPC elective share would constitute the applicable state law in each of these three cases.

CONCLUSION

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Rev. Proc. 2005-24 should be revised to state clearly when a spousal waiver is required and hopefully also to clarify when the UPC is used as the model for applicable state law and when it is not. As it now stands, the Rev. Proc. is misleading because it implies that the UPC augmented estate includes a CRAT or CRUT created before marriage.

There is a larger question posed by the Rev. Proc., however. Even if the IRS revises the Rev. Proc. in the light of the above analysis, the fact remains that the IRS seems determined to insist on a spousal waiver for CRATs and CRUTs that *might but probably won't* turn out to be liable for a pro rata share of an electing surviving spouse.[12] It would be preferable if the IRS could work out a position that would protect tax revenues by retroactively denying a charitable deduction only when the corpus of a CRAT or CRUT is *actually* diverted to an electing surviving spouse,[13] as the IRS does for CRATs and CRUTs created before June 28, 2005.[14]

The UPC itself is not likely to be amended to exempt CRATs and CRUTs from the augmented estate,[15] but the requirement of a spousal waiver might tempt individual states to do so,[16] thus weakening the elective-share protection for surviving spouses. The rationale for exemption is likely to be the "once-in-a-blue-moon" argument,[17] the idea that charitable donors are very unlikely to be motivated to use CRATs or CRUTs to disinherit their surviving spouses. But if the augmented estate is airtight in preventing other disinheriting devices, leaving CRATs and CRUTs as the only loopholes, the client who has a strong desire to disinherit a spouse will be counseled that a CRAT or CRUT is about the only device left to achieve the purpose. To be sure, exempting CRATs and CRUTs from the augmented estate would only open up a narrow loophole, because such a trust can only be used to prefer qualified charities over the spouse, and not others such as the

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[12] Even if a CRAT or CRUT is included in the UPC augmented estate, an electing surviving spouse will have no claim on the CRAT or CRUT if the spouse's entitlement is satisfied by the sum of the decedent's voluntary transfers to the surviving spouse plus the surviving spouse's marital property. See UPC § 2-209(a).

[13] In Conrad Teitell, Inter Vivos *CRUTs and CRATs—IRS Opens Pandora's Box with Spousal "Right of Election,"* 31 ACTEC J. 68, 73 (2005), the author cites Example 6 of Treas. Reg. § 20.2055-2(e)(1)(i) as being inconsistent with and therefore trumping Rev. Proc. 2005-24.

[14] See Rev. Proc. 2005-24 §§ 1.02, 3.01. If the IRS persists in requiring a spousal waiver, it would be helpful if the IRS would issue new revenue procedures that append an optional spousal waiver form to the Services's model forms for CRATs and CRUTs. It is notable that the IRS did not do so in the new CRUT revenue procedures issued after the promulgation of Rev. Proc. 2005-24. See Rev. Procs. 2005-52, -53, -54, and -55. The routine inclusion of a spousal waiver form on CRATs and CRUTs created on or after June 28, 2005 would put such trusts on much the same footing as ERISA-covered pension beneficiary designation forms, which routinely append a spousal waiver form that the employee's spouse must sign if the employee designates someone other than the spouse as beneficiary.

[15] The Official Comments are likely to be revised to caution about the need for a spousal waiver for CRATs and CRUTs entered into while married.

[16] See Teitell, *supra* note 13, at 73: "State legislatures should be urged to change the right of election laws to deny a right to elect against CRUTs, CRATs, pooled income funds, charitable remainders in personal residences and farms, and charitable lead annuity trusts and lead unitrusts."

[17] See Teitell, *supra* note 13, at 71.

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decedent's children by a prior marriage. Nevertheless, a loophole is a loophole, and a certain percentage of disinheriting spouses will take advantage of any loophole no matter whom it benefits.

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