

**COMMENTS IN RESPONSE TO NOTICE 2000-37 ASKING
FOR COMMENTS CONCERNING REVISION OF THE INTERNAL
REVENUE SERVICE'S SAMPLE FORMS
FOR CHARITABLE REMAINDER TRUSTS**

The following comments and recommendations express the individuals views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments and recommendations were prepared by members of the Committee on Estate & Gift Taxes, the Committee on Exempt Organizations and the Committee on Fiduciary Income Tax. Primary responsibility was taken by Martin A. Hall, with assistance from Carolyn M. Osteen and Lawrence P. Katzenstein. These comments were reviewed by Richard S. Gallagher of the Section's Committee on Government Submissions and by Douglas M. Mancino, Council Director for those Committees.

Although many of the members of the Section of Taxation who participated in preparing these comments and recommendations have clients who would be affected by the federal tax principles addressed, or have advised clients on the application of such principles, no such member (or the firm or organization to the which such member belongs) has been engaged by a client to make a governmental submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these comments.

**RESPONSE TO NOTICE 2000-37 CONCERNING
REVISION OF CHARITABLE REMAINDER TRUST**

SAMPLE FORMS

I. Executive Summary.

As members of the Committee on Exempt Organizations, the Committee on Fiduciary Income Tax and the Committee on Estate & Gift Taxes of the American Bar Association, Section of Taxation, we welcome the opportunity to respond to the request of the Internal Revenue Service ("IRS") in Notice 2000-37 for comments concerning the revision of the IRS's sample forms for charitable remainder trusts ("CRTs").

II. Specific Comments.

A. General Approach.

In general, we favor an approach to the new sample forms for CRTs whereby the IRS would publish substantially annotated forms with optional provisions, rather than stand-alone trust instruments deemed to be safe harbors. These new forms would include, throughout the document where appropriate, both alternate provisions (from which one option must be chosen) and supplemental paragraphs (which may or may not be added to an otherwise sound instrument). All such alternate and supplemental provisions should be substantially annotated, either within the text or via footnotes. Moreover, additional annotations would apply to the instrument as a whole (*e.g.*, an annotation that the instrument must be valid under applicable state law) or to the valid establishment of a CRT independently of the instrument (*e.g.*, an annotation concerning the timing of the transfer of assets to the CRT relative to the charitable deduction for such transfer).

Publishing substantially annotated forms with optional provisions, rather than stand-alone documents deemed to be safe harbors, acknowledges the wide range of circumstances encountered by practitioners and donors, with many such circumstances not easily lending themselves to one or another of a small set of stand-alone instruments. Moreover, by being able to choose from among the optional provisions set forth in the annotated forms, practitioners, charities, and donors could be more certain of the validity of particular CRTs without resort to private letter rulings. In turn, by better accommodating a wide range of donor circumstances and intentions and by decreasing both uncertainty and the need for private letter rulings, annotated forms with optional provisions would increase charitable giving by facilitating the use of CRTs. These comments are not intended, in general, to address areas in which substantive change in the law or current interpretation by the Internal Revenue Service is desired, but rather to suggest changes in the form of the sample documents to be provided by the Service

B. Tax-Related Provisions of Current Forms

The new forms should explicitly or implicitly address the following tax-related provisions and omissions in the current forms:

- Public Charity Restrictions. The current forms only require that the charitable remainder interest pass to charitable organizations described in sections 170(c), 2055(a), and 2522(a) of the Internal Revenue Code (the 'Code'). However, in light of Rev. Rul. 79-368, 1979-2 C.B. 109, the possibility that the charitable remainder may pass to a private foundation not described in section 170(b)(1)(A) may limit the donor's charitable income tax deduction to the levels applicable to gifts to private foundations. The new forms should include a reference to section 170(b)(1)(A) and instruct that the reference be deleted only if the donor intends for the remainder interest to be distributable to private foundations.
- Revocation Rights. The current forms pertaining to a two-life CRT with the donor as the first non-charitable beneficiary do not provide for the donor to retain the right to revoke the second non-charitable beneficiary's interest by will at the donor's death. We acknowledge that a revocation right is not necessary for tax purposes if the second beneficiary is the donor's U.S. citizen spouse. But, in almost all other situations, it is advisable for the donor to retain this right, thereby avoiding a completed taxable gift to the second non-charitable beneficiary at the time the CRT is funded. Furthermore, in the case of spouses, the existence of the right and its exercise could avoid a taxable transfer at death in the event of divorce after the CRT is established. The new forms should include an optional right to revoke by will any successor interest and should explain the gift and estate tax consequences of including or deleting such a right.
- Payment of Estate Taxes. Rev. Rul. 82-128, 1982-2 C.B. 71, provides that, in the case of a two-life CRT, no assets of the CRT may be used to pay estate or like taxes due upon the donor's death (even if such taxes are attributable to the CRT). However, the current forms comply with this rule by providing that any such estate or like taxes must be paid by the surviving non-charitable beneficiary. This is too restrictive an interpretation of the Revenue Ruling. The new forms should permit estate taxes to be recovered first from other assets owned by the donor (including the donor's residuary probate estate) and then impose the liability on the successor beneficiary (or cause him or her to forfeit his interest for non-payment) only if the obligation is not satisfied from those other assets. The new forms should also emphasize that the estate tax provision is necessary even if the successor beneficiary is the donor's spouse. The marital deduction would not be available in the event of divorce and some states still impose inheritance and succession taxes that do not provide an unlimited marital deduction or a zero rate band for all forms of spousal transfers.
- Additions to Charitable Remainder Unitrusts. The current forms for inter vivos charitable remainder unitrusts ("CRUTs") do not deal with additional contributions to the trust by testamentary transfers and retroactive payments in respect thereof; however, it is permissible and not uncommon for a donor to make a testamentary addition to an inter vivos CRUT. Conversely, the current forms for testamentary CRUTs actually prohibit additional contributions; however, it is again permissible (albeit less common) for

additional contributions to be made to a testamentary CRUT (*e.g.*, by third parties or by distributions from other trusts established by the donor). Thus, the new forms for both inter vivos and testamentary CRUTs should include the provisions regarding testamentary transfers and retroactive payments, while also permitting and accommodating additional contributions.

- Payments Following Death of Beneficiaries. The current forms for two-life CRTs do not specify whether the payment for the period in which the first non-charitable beneficiary's death occurs is to be prorated and paid to the estate of that beneficiary or instead paid in full to the second non-charitable beneficiary. Likewise, the current forms for all CRTs provide that the payment for the period in which the death of the last non-charitable beneficiary occurs is to be prorated and paid to that beneficiary's estate, notwithstanding Treas. Reg. § 1.664-3(a)(5)(i) that permits payments to terminate with the regularly scheduled payment for the period immediately preceding the death of the last non-charitable beneficiary. The new forms should include and explain the options available for proration at the death of non-charitable beneficiaries and should adopt as a standard approach a cut-off as of the immediately preceding periodic payment.
- Distribution of Annuity or Unitrust Amount. The current forms provide sample trusts that pay the annuity or unitrust distribution to individual beneficiaries over a period of one or two lives. The two life trusts provide for consecutive and concurrent interests. This does not cover comprehensively the options available for the payout. We would recommend that the new forms address at least the following payout options, through a combination of sample clauses and annotations: payments to classes of beneficiaries, including spray provisions; payments to trusts for the benefit of incapacitated individuals; payments to other trusts, partnerships, and corporations for a term of years; peel-off trusts that provide for the payment to multiple individual beneficiaries and provide for a portion of the trust assets to be distributed to charity at the death of each individual beneficiary; and options for the payout period, including payments to multiple or single beneficiaries for the lesser of their lives and a fixed term of less than twenty years. We would also recommend that the new forms indicate that some part (but not all) of the annuity or unitrust distribution may be paid to charitable organizations.
- Disposition of Charitable Remainder. The current forms only provide for the distribution of the charitable remainder to one charitable organization. However, it is both permissible and common for the charitable remainder to pass to two or more charitable organizations named in the trust instrument and/or to one or more charitable organizations not named in the trust instrument itself but designated by a separate writing in accordance with the provisions of the trust instrument. Thus, the new forms should include and explain these alternate dispositions of the charitable remainder.
- Prohibited Transactions. The current forms prohibit self-dealing, taxable expenditures, jeopardy investments, and excess business holdings in all cases. However, the prohibitions against jeopardy investments and excess business holdings are not applicable to a CRT except in the unusual circumstance that it has ceased to be treated as a split interest trust because all non-charitable interests have terminated. A charitable remainder trust is permitted a reasonable period of time after the death of the last surviving income

beneficiary (or other terminating event) in which to wrap up its affairs and file final returns. It would only become a private foundation subject to the jeopardy investment and excess business holdings provisions after that reasonable period has expired. The new forms should make the prohibitions against jeopardy investments and excess business holdings optional and explain those limited circumstances in which they are operative. Rev. Rul. 75-38, 1975-1 C.B. 161 recognizes that the law of virtually every state imposes the private foundation restrictions on entities that are deemed to be private foundations, so that inclusion of restrictive language in a CRT is unnecessary, save as a reminder of the existence of the restrictions.

- Non Marketable Assets. The current forms are silent on the valuation of trust assets. If a CRT is funded with cash, cash equivalents, or marketable securities, the valuation issues are relatively straightforward. However, the 1998 Regulations provide that a CRT funded with assets for which there is not a ready public market may not qualify as a CRT unless those assets are valued by an independent trustee or a qualified appraisal. Similar concerns apply to the acquisition of such assets during the term of the trust. These issues should be addressed in the forms and explained in annotations and optional model clauses.
- Sample FLIP Unitrust Provisions. While the authors of these comments have long held the view that it should be possible for a unitrust to switch from a lesser of net income exception model to a straight percentage amount model – a so-called FLIP CRUT – the regulations finalized in 1998 approved formally such an approach. Sample FLIP CRUT language should be included in the new models, with thorough annotations explaining the restrictions inherent in the regulatory FLIP structure.

C. Non-Tax Provisions of Current Forms.

The current forms are limited almost exclusively to tax-related-safe-harbor provisions and include very few non-tax provisions. While it may have been presumed (1) that state law would provide default non-tax provisions, (2) that any non-tax provisions provided would be vulnerable to differences in state law, and (3) that practitioners would simply add non-tax provisions as necessary on a case law basis, the relative exclusion of non-tax provisions in the current forms creates two substantial difficulties. First, state law default provisions are often not preferable; but, second, practitioners might often be wary of adding their own non-tax provisions to the current forms, lest they inadvertently impinge on the safe-harbor provisions or otherwise jeopardize the trust's qualification as a CRT. Accordingly, and in light of our position that the safe-harbor approach should be abandoned, we believe that the new forms should address various non-tax provisions in one or both of two ways:

- In some instances, the new forms could include actual provisions (or two or more alternate provisions) addressing a particular non-tax matter. This would be most feasible and appropriate where the laws of the various states generally permit similar provisions which are relatively straightforward. Even in these instances, though, annotations should emphasize that the relevant provisions may need to be changed depending on state law and/or the donor's intentions.

- In other instances, the new forms could simply include annotations highlighting the need to add provisions addressing a particular non-tax matter. This would be especially preferable where the laws of the various states differ more widely or where the provisions are more complex and dependent on the peculiarities of state law and/or the donor's intentions.

The following is a list of non-tax matters which should be addressed via one of the approaches discussed above:

- Acknowledgment and/or witnessing requirements;
- Resignation and removal of trustees;
- Appointment and qualifications of successor and additional trustees;
- Trustee powers (both with respect to investments and otherwise);
- Delegation of trustee powers;
- Trustee surety and indemnification;
- Trustee fees and other administrative expenses;
- Allocation of payments and expenses to fiduciary income and principal;
- Choice (and permissibility of change) of governing state law;
- Accounting to beneficiaries;
- Permissible methods of payments to minors and incapacitated beneficiaries;
- Spendthrift provisions and restraints on voluntary alienation; and
- Custody of trust instrument and related documents.

III. Conclusion.

Charitable Remainder Trusts have become very widely used in estate planning. At the same time, the regulatory structure has increased in complexity. Sample safe-harbor forms are too restrictive and become obsolete quickly. Accordingly, we hope that the Service will adopt the annotated and active approach we have suggested and provide a comprehensive resource of guidance usable by all practitioners.