REPORT #819

TAX SECTION

New York State Bar Association

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TAX SECTION
New York State Bar Association

January 13, 1995

To: Tax Section Executive Committee

From: Michael Schler

Re: Proposed New York Estates, Powers and Trusts Law Amendment

In early 1994 the Tax Section commented on a proposal by the NYSBA Trusts and Estates Law Section to amend the New York EPTL in relation to a surviving spouse's election against the will, a key issue being the availability of a Federal charitable contribution deduction absent the proposed amendment. Our comments were distributed to all Executive Committee members as an attachment to the minutes, but were not treated as a numbered "report". It has been suggested to me that we redistribute the comments as a report, because many people only save reports and our comments might have value for future reference. As a result, the relevant material is attached.

TAX SECTION
New York State Bar Association

May 20, 1994

TO: John A. Williamson
Associate Executive Director

FROM: Michael Schler
Chair, Tax Section

RE: Trusts and Estates Law Section EPTL Proposal

On May 18, the Tax Section Executive Committee voted to oppose the Trusts and Estates Law Section proposal to amend the New York State Estates, Powers and Trusts Law. The vote was 27-0 against the proposal (with two abstentions).

The Tax Section Executive Committee believes that, as to outright charitable gifts made within one year preceding death, there is no material tax risk to the charitable contribution deduction and therefore no need for the proposed amendment. As to charitable gifts with a retained life estate, we believe there is some risk of loss of the tax deduction in the absence of spousal consent, although members differ as to the level of risk.

All voting members agree, however, that it would be inappropriate to address the Federal tax issue through the proposed EPTL amendment. We reach this conclusion because we believe that (1) the tax risk to a contributor under the existing EPTL is relatively small even in the absence of a spousal waiver, and (2) charitable gifts with retained life estates generally involve consultation with legal counsel, at

which time we would expect taxpayers to be advised that any potential tax exposure could be eliminated through a spousal waiver.

As a result, we believe that any attempt to address the Federal tax risk should not involve an approach that is potentially detrimental to surviving spouses, and thus inconsistent with the policy behind the existing EPTL. Moreover, given the number of states with legislation similar to the existing EPTL, we believe it would be better to work at the Federal level to achieve an equitable national solution to the common problem arising in all such states.

As a result, we believe that any efforts to eliminate the tax risk should instead focus upon solving the tax problem directly, first by attempting, in a more formal manner than previously, to obtain a favorable ruling from the IRS allowing the tax deduction under the circumstances in question. If the IRS refuses to issue such a ruling, an attempt might be made to obtain favorable legislation in Congress. One possibility, for example, is legislation that would permit the expected charitable deduction but trigger corresponding "recapture" income to the estate if the donated assets were subsequently in fact transferred to the surviving spouse pursuant to the right of election after the death of the contributing spouse. Given the number of states with legislation similar to the existing EPTL, there should be significant support in Congress for such an amendment. We would be happy to work with the Trusts and Estates Law Section if they wish to pursue an effort to solve the tax problem.

Finally, we understand the Trusts and Estates Law Section has proposed a "compromise" under which their proposed amendment would only apply to charitable gifts with a retained life interest if the contributing spouse provided for a survivor annuity for the surviving spouse following the death of the contributing spouse (with the result that the surviving spouse could not elect against the will with respect to those contributed assets). We also oppose that

compromise. First, it would restore the former law, rejected in the current EPTL, permitting a decedent to defeat a surviving spouse's right to an outright share of estate assets by providing the spouse with a life estate. Second, the principal justification given for the original proposal is that it would protect the tax benefits of persons making charitable contributions who are unaware of the existing EPTL spousal consent requirement. We think it is unlikely, however, that any person unaware of the need for spousal consent would be aware of the need to create such a survivor annuity. As a result, the compromise would not solve the perceived problem.

Please feel free to call me if you have any questions.

cc: Sanford Schlesinger
Claire Gutekunst

TAX SECTION
New York State Bar Association

April 5, 1994

TO: John A. Williamson, Jr.
Associate Executive Director

FROM: Michael L. Schler
Chair, Tax Section

Attached is a Memorandum by the Tax Section commenting on the proposal by the Trusts and Estates Law Section to amend the New York State Estates, Powers and Trusts Law.

Encl.

cc: Arlene Harris

TAX SECTION
New York State Bar Association

April 5, 1994

MEMORANDUM

Trusts and Estates Law Section Proposal
Tax Section Comments

This Memorandum provides comments by the Tax Section on the proposed amendment (the "Proposed Amendment") to the New York State Estates, Powers and Trusts Law ("EPTL"), and the Memorandum in Support of such amendment (the "Memorandum in Support"), approved by the Trusts and Estates Law Section. We discuss below several considerations that we believe should be taken into account by the members of the NYSBA Executive Committee in voting on the Proposed Amendment. We do not, however, take a formal position in favor of or against the Proposed Amendment.

There are two reasons for our not taking a position on the Proposed Amendment. First, as discussed below, we believe the question ultimately requires a balancing of two partially inconsistent goals: (a) encouraging charitable contributions without the need for spousal consent, and (b) protecting surviving spouses from disinheritance. We do not believe that we, as tax lawyers, have any particular expertise as to such balancing'. Second, because of the very short period of time the Tax Section has been given to provide these comments (exactly three weeks), we have not been able to have this matter considered by our entire Tax Section Executive Committee (which meets monthly). The officers of the Section are

reluctant to take a position on such a policy-oriented matter in the absence of such consideration.[1]/

Nevertheless, we do offer the following comments:

1. As we understand existing EPTL 5-1.1-A, a surviving spouse (the “Surviving Spouse”) can elect to receive an aggregate of one third (with a minimum of $50,000) of the net value of a decedent's estate, regardless of the provisions of the decedent's will. Moreover, a number of items not otherwise included in the decedent's estate are added to the estate for purposes of this calculation, including property- transferred by the decedent (the “Contributing Spouse”) during his/her lifetime without adequate consideration (i) within one year preceding death, to the extent it exceeds the Federal gift tax exclusion allowing a gift of up to $10,000 to any person in any year, and (ii) at any time preceding death, where the Contributing Spouse retained an income interest in the property until death. We further understand that the Surviving Spouse making the election can recover the property from the transferee in order to satisfy the Spouse's rights under the election. The spousal election must be made within six months of the issuance of letters testamentary, but in any event within two years of the decedent's death. Finally, a spouse can waive all future rights in a transfer of property by a Contributing Spouse by means of a written waiver executed at any time during the life of the Contributing Spouse. The Proposed Amendment would generally exempt tax-deductible contributions to public charities from the assets to be added back to the estate, even in the absence of a spousal consent to the contribution.

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[1]/ As a result, this Memorandum has been approved only by the officers (Administrative Committee) of the Tax Section. We would urge that in the future we be given more time to review matters on which our views are requested.

2. We observe that the provisions of the existing EPTL described above are not novel. [2]/ Rather, they are essentially the same as the corresponding provisions of the Uniform Probate Code (the "Probate Code"), although the Probate Code goes further and provides for an addback of gifts made within two years rather than one year preceding death. The Probate Code does not have any exception for charitable contributions. Although the Memorandum in Support provides no guidance on this question and we have not researched it ourselves, we understand that for some period of time a number of states have had spousal elective share provisions in their laws similar to those in the Probate Code and the EPTL (without exceptions for charitable contributions). We do know that one such state is Virginia.[3]/

3. The Proposed Amendment is based upon the concern that the IRS might successfully take the position that because of the existing spousal election provision in the EPTL, a charitable contribution deduction is not allowed for income tax purposes (and gift taxes might also arise) on certain charitable contributions by a Contributing Spouse. The concern, if valid, would apply because of the mere possibility at the time of the contribution that the Surviving Spouse might later recover the contributed assets from the charity, even though the Surviving Spouse never in fact recovers any of the contributed assets. Under this theory, the vulnerable charitable contributions would be those made in the absence of a contemporaneous

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[2]/ While it is not relevant to the discussion in the text, we are informed by Professor Harvey Dale at NYU that the Napoleonic Code contains a similar provision, with an addback to the estate for all lifetime transfers, and that this rule remains in French law today; the mechanics of a lifetime addback are unclear to us.

[3]/ See Virginia Code § 64.1-16.1, as amended effective January 1, 1991, adding back to the estate all outright lifetime gifts or gifts with a retained life interest made after the effective date, even if made many years before death (see note 2 above); the provision was amended in 1992 to limit the addback for outright gifts to gifts made within five years before death.

would be those made in the absence of a contemporaneous spousal waiver for (i) almost any transfer to a charitable trust with a retained income interest, or (ii) one third of an outright gift in excess of $10,000 to a particular charity, if made by an individual who was over age 76 or otherwise had a more than 5% probability of dying within one year. In the latter case, the concern would arise whether or not the individual in fact died within one year.

We have a number of comments on the possibility of an IRS challenge along these lines.

(a) There is some legal support for a charitable contribution deduction under the circumstances in question notwithstanding the possibility of a subsequent spousal election. See Longue Vue Foundation v Comm'r, 90 T.C. 150 (1988), acg. in result, 1989-1 Cum. Bull. 1 (estate tax charitable deduction allowed despite Louisiana forced heir statute allowing heirs to claim the assets within five years following probate,, where heirs waived the claim three years after death). This Tax Court decision was formally acquiesced in by the IRS, meaning that the IRS agreed to follow the holding on similar facts. The IRS also issued an unofficial Action on Decision (1989-006), copy attached, in which it explained its reasoning: the right to set aside the bequest arose as a matter of state law rather than by action of the decedent, the bequest was voidable rather than void, and the charity in fact received and kept the bequest.

This reasoning would also apply to support a charitable contribution deduction, despite the existing EPTL spousal election provisions, where the charity in fact retained the funds. See also Humphrey v. Millard, 79 F.2d 107 (2d Cir. 1935), relied on in Longue Vue, in which the Second Circuit allowed an estate tax charitable contribution deduction despite the New York statute allowing the spouse to elect to take half the estate.

It should be noted that these cases arise under the estate tax charitable contribution deduction, where it is easier to

apply a “practical lookback rule” and allow the deduction on the estate tax return if it is determined that the charity in fact retained the contributed assets. It is more difficult to apply that rule, and we are aware of no specific authority to do so, where (i) the deduction is being claimed on an income or gift tax return of the Contributing Spouse, and (ii) the event (the death of the Contributing Spouse) that triggers the Surviving Spouse's right to recover the funds, and therefore retroactively calls the deduction into question, may occur after the statute of limitations has run on such tax return.

However, it would not be a major extension of the favorable cases or the practical lookback rule to apply them to an outright charitable contribution, notwithstanding the existing EPTL provision, because in such a case the spousal election right would only arise if the Contributing Spouse died within one year of the contribution. It would, to be sure, be much more difficult to apply those favorable principles to a transfer with a retained life interest, because the spousal election right might arise only many years after the transfer and long after the tax returns of the Contributing Spouse could be audited.

(b) The Memorandum in Support places considerable weight on a meeting with the IRS at which the IRS indicated that the spousal election would create the above-described problems for charitable contributions. It is not clear from the Memorandum whether the IRS was presented with the arguments described above based on the favorable estate tax cases and the Action on Decision. In any event, it is our experience that informal oral statements by IRS officials (whether supporting or opposing taxpayer positions) are often an unreliable guide for future conduct.

(c) In addition, as indicated above, it appears that spousal elective share provisions relating to lifetime transfers have been in the laws of other states for some period of time. We are not aware of any challenges by

the IRS to charitable contribution deductions in other states on the basis of such provisions. It is quite possible, therefore, that the IRS had (at least until the issue was put to them directly) informally acquiesced in the conclusion that such provisions relating to lifetime transfers were consistent with the charitable contribution deduction.

Moreover, an IRS challenge to charitable contribution deductions on account of such provisions (under the new existing EPTL statute or in another state) would cause disruption of settled expectations by contributors in all states with similar provisions. As a result, we believe it is most likely that any new rule that was adopted by the IRS would apply on a prospective basis (to future gifts) only, thereby providing an opportunity for Contributing Spouses to be on notice that a spousal waiver was needed or, alternatively, for state statutes to be amended to eliminate the spousal elective share in such cases.

To be sure, there can be no absolute guarantee of prospectivity of any new IRS position, and in any event the issue could be raised on an audit by a Revenue Agent in the field who is not always under the direct control of the IRS policy makers. Nevertheless, this kind of retroactive action by the IRS would might well result in considerable bad publicity for the IRS and (if not quickly corrected by the IRS itself) might well prompt Congressional action protecting past charitable contributions.

4. The Memorandum in Support argues in favor of the Proposed Amendment by stating that a determined spouse can even today disinherit a Surviving Spouse through s variety of techniques more flexible than charitable contributions. Under that argument, the current law's failure to exclude charitable contributions from the elective share rule does not provide much protection to Surviving Spouses, and so the EPTL might as well be amended to protect the charitable contribution deduction of Contributing Spouses (most of whom

are not trying to disinherit their Surviving Spouses).

We would urge caution in accepting this argument. Taken to its logical conclusion, it would seem to justify repeal of the entire elective share rule. Moreover, many of the techniques described in the Memorandum of Support appear to be rather complex, to depend on the law of other states, and to invite challenge by the Surviving Spouse. In our experience as tax lawyers, the development of a simple and certain technique to achieve a favorable tax result will greatly increase the number of taxpayers applying the technique to reach the result (even if a more complex technique towards the same end existed all along). We have no reason to believe that the same principle would not apply to techniques to disinherit a spouse, although we have no idea of the magnitude of any increase in disinheritances.

5. Based on the foregoing, we would analyze the issues raised by the Proposed Amendment as follows.

(a) Adoption of the Proposed Amendment will have the benefits of encouraging charitable contributions, and allowing freedom of contract, by assuring tax deductions without the need for spousal consent to:

(i) Contributing Spouses over age 76 or in poor health (or otherwise concerned that the IRS might say they have a 5% or greater chance of dying within one year) making outright charitable contributions in excess of $10,000 per charity per year, and

(ii) all Contributing Spouses making gifts to charity with retained life interests.

Stated differently, the Proposed Amendment avoids the need for all persons described in the preceding sentence to obtain a spousal waiver in order to be sure of obtaining

a tax deduction on a charitable contribution. This is a desirable goal if and to the extent that (i) the tax risk is considered real, and either (ii) the requirement of a spousal waiver is unknown to many contributors and thus a trap for the less knowledgeable and less well advised, or (iii) the waiver requirement is considered burdensome, intrusive or unfair to the vast majority of those making charitable contributions who have no intention of disinheriting their spouses.

(b) On the other hand, adoption of the Proposed Amendment will have the detriment of hurting Surviving Spouses by permitting Contributing Spouses of any age or health status to make charitable contributions in any amount without tax risk, without spousal consent, and without a spousal right of election at the contributor's death. The Proposed Amendment will therefore make it easier to disinherit a Surviving Spouse (and presumably make it more likely chat such disinheritances will occur). It should be emphasized that the Proposed Amendment applies to a Contributing Spouse regardless of his/her age or health status, and it therefore makes such a disinheritance easier even for Contributing Spouses with no tax risk at all under the existing EPTL and for whom there is no tax need for the Proposed Amendment (i.e., a healthy Contributing Spouse below age 76 making an outright gift to charity).

(c) The balancing of benefits and detriments of the Proposed Amendment might be different in the case of outright transfers to charity as compared to transfers with a retained life estate, because of differing application of the three factors of (i) the existing tax risk, (ii) the burden of obtaining a spousal waiver under the existing EPTL, and (iii) the likelihood of a spousal disinheritance by a Contributing Spouse using each method of transfer.

As to outright transfers, the justification for the Proposed Amendment on the basis of the existing tax risk of a charitable contribution may be relatively weak (because of the practical lookback rule described above

possibly available to those at risk, and the fact that many contributors have no tax risk at all). On the other hand, to the extent there is tax risk even in outright transfers, justification for the Proposed Amendment may be relatively strong on the ground that the burden of the necessary spousal waiver under the existing EPTL may be relatively high (because outright contributions are much more frequent and made much more casually than transfers with a retained life interest). Finally, there would only be "downside" to adoption of the Proposed Amendment in this situation to the extent it was considered likely that a Contributing Spouse would disinherit a Surviving Spouse even if it required an outright lifetime transfer of property with no retained economic interest in the property.

Considering next the case of a contribution with retained life income, there may be more tax justification for adoption of the Proposed Amendment in this case than in the case of outright charitable gifts, because the technical tax risk to the contribution deduction in the absence of a spousal waiver may be considered somewhat (although to an uncertain extent) more serious. As a result, there might be more need to avoid the trap for the unwary created by the existing spousal waiver requirement. On the other hand, arguments for the application of the Proposed Amendment may be weaker in the case of a contribution with a retained life interest than in the case of an outright transfer, because (i) the burden of obtaining a spousal waiver under the existing EPTL is less serious in the case of a transfer with a retained life interest, given that such transfers are usually made at most only a few times during a lifetime and already involve considerable planning, legal advice, and documentation, and (ii) the consequences of eliminating the spousal waiver requirement in this situation may be more adverse to Surviving Spouses if a Contributing Spouse is considered more likely to disinherit a Surviving Spouse through a charitable contribution if he/she can do so while at the same time retaining significant economic benefits from the

"contributed", assets.[4]/

[4]/ A Contributing Spouse's ability to disinherit a Surviving Spouse in this manner may also increase the bargaining power of the spouse with the majority of assets in divorce negotiations.

Proposed Amendment

AN ACT to amend the estates, powers and trusts law in relation to protection of income and gift tax deductions for charitable gifts otherwise subject to the spousal right of election.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Subsection (b) of section 5-1.1-A of the estates, powers and trusts law is amended by adding thereto a new clause (I), as follows: *

(I) Notwithstanding anything to the contrary in the foregoing, a transfer made during lifetime that entitles the donor to a charitable contribution deduction for United States income or gift tax purposes is not a transfer described in clauses (B) or (F) if it is a transfer entirely to or for public charity, or is a transfer in which only public charity and either the donor, the donor's spouse, or both spouses, have interests. “Public charity” for the purposes of is clause shall mean an organization or organizations described in subsection (b) (l)-(A) of section one hundred seventy of the United States Internal Revenue Code.

§ 2. This act shall take effect immediately and shall apply to transfers made on or after the effective date.

REPORT NO._____ _____, 1994

S._____ By: Senator _____

A._____

Senate Committee:_____

Assembly Committee:_____

Effective date: immediately

ACT to amend the estates, powers and trusts law in relation to servation of income and gift tax deductions for lifetime charitable

LAW AND SECTION REFERRED TO: EPTL 5-1.1-A

REPORT PREPARED BY THE COMMITTEE ON ESTATE PLANNING OF THE TRUSTS AND ESTATES LAW SECTION

MEMORANDUM IN SUPPORT

EPTL 5-1.1-A, added by the Laws of 1992, Ch. 595, and amended by the Laws of 1993, Ch. 515, expanded the list of “testamentary substitutes” that will be subject to a surviving spouse's right of election. Included now are transfers made within one year before the decedent's death and transfers as to which the decedent had retained income for life.

At the time of proposing these changes to the Legislature, the EPTL-SCPA Advisory Committee was aware that the expanded transfers Id include charitable gifts, and that the contingent claim given to spouse on these might endanger their deductibility for income and gift tax purposes. However, the Committee preferred to address that only if and when it might get some sense from the Internal Revenue Service that the deduction problems are deemed real. Representatives met with the Service

and were told that it would, indeed, consider the right given the spouse to be an impermissible interest, disqualifying deductions for almost all types of inter-vivos charitable remainder trusts and similar split-interest gifts, and disqualifying one-year gifts made by persons of sufficiently short life expectancy. Needless to say, if the rules disallow the income tax deduction for an inter-vivos transfer, all the more frightening is the prospect that the same rules will disallow the much-needed gift tax deduction. The donor of a generous charitable gift encouraged to expect a valuable deduction may instead end up owing a substantial tax on the transfer.

The Advisory Committee has been asked by this Section to propose or support amendments that will give charitable deduction protection to the most common and important forms of lifetime charitable gifts." It has now declined to do so, purportedly feeling that a grant of exemption for selected charitable gifts would undercut the gains it has achieved for surviving spouses. Given the serious problem involved, however, we believe that it is possible to balance the State's policy favoring expansion of the surviving spouse's rights against its policies favoring charitable giving and tax certainty.

The number of cases where a spouse would choose a charitable transfer as the means of defeating the survivor's right of election would be minimal: there are alternative ways of disinheriting that do not require giving everything to charity. The present law presents a tax trap that will affect a very great number of our citizens. The tax harm to them and the economic harm to their charities will be substantial. The present mechanism for avoidance of the problem is unavailable to some citizens, difficult to accomplish for others, wholly unknown to

most, and will have a significant chilling effect on our charities' solicitation efforts.

I. THE TECHNICAL PROBLEMS

(a) One-Year Gifts: EPTL 5-1.1-A(b)(1)(B) makes a testamentary substitute out of all gifts made within one year of the decedent's death, except for those entitled to federal gift tax exclusions. On its face, therefore, it applies to outright gifts exceeding $10,000 in a single year to a given charity, and to trust gifts of any size.

The contingent right of the surviving spouse is a power to reclaim up to a third of the gift if the transferor dies within a year. An income tax deduction, however, is given only where a charitable contribution is irrevocable, not subject to diversion to a private interest, and not subject to a substantial condition. Treas. Regs. § 1.170A-1(e) provides that a tax deduction will be allowable r - if any act or event that could defeat the charitable interest is remote as to be negligible. The same test applies for the “partial interest rule” of Regs. § 1.170A-7(a)(3). Remoteness constituting negligibility is defined as having less than a 5% probability. See, e.g., Rev. Rul. 70-452, 1970-2 C.B. 199; PLR 8213093.

Actual defeasance for these gifts will occur only if the donor fails to give the spouse a full elective share. However, the test of remoteness will be made theoretically and without regard to any facts that may lie within the donor's continuing control. Accordingly, whether a donor had the assets or inclination to give the surviving spouse a full share will be immaterial for the tax test.

According to the government's current mortality table, (Table 80CNSMT), a person of normal life expectancy crosses into a better than 5% probability of death within one year at about 76-1/4 years of age. The 5% probability of defeasance is raised to some eighthly higher age by factoring in the likelihood that the spouse all predecease the donor within the year. That is primarily a function of that spouse's own age, but could be affected further by other factors that might be addressed by expert actuaries.

Even if the tax danger were confined to donors aged 76 or so, that would still put a large population of particularly generous donors at risk. Unfortunately, the problem is wider. The negligibility age level can be lower than 76, without limit. The Regulation leaves it open to the IRS to prove probability by appraisal of the actual health condition of the donor, or with other germane facts. If the donor is in poor shape, the problem may attach at any age. Probability at the time of making the gift (or as assessed at the time of auditing the tax issue) is all that matters: the deduction is not saved by showing that death didn't occur or that no election arose or was exercised.

If the gift is a charitable remainder trust, pooled income fund, gift annuity, lead trust or the like, flunking the negligibility test disqualifies the entire charitable deduction. If it is an outright gift, a third of the deduction is disallowed. Gift tax is due on the value of the disallowed transfer amount.

(b) Split-Interest Charitable Gifts. EPTL 5-1.1-A(b)(1)(F) extends the right to elect against a decedent's transfer if he or she had retained the right to income from the

property for life or for a period not in fact ending before death.

The category includes charitable remainder trusts, pooled life income funds, charitable gift annuities, retained life use gifts of personal residences or farms, and qualified conservation easements, where the donor has retained the life interest. If the election right exists, the spouse can withdraw the ratable share from the charitable remainder after the donor's death.

The technical basis for disallowance of a deduction for any of these gifts is clear, again via Regs. § 1.170A-l(e). The trust has duly vested the charitable interest and is irrevocable except for being subject to a possible divesting by the spouse. That possibility must therefore be tested for 5% negligibility at the time of the gift. In just about every case one can imagine, the odds of the spouse failing to survive the donor will be more on the order of fifty-fifty than under 5% as required. The odds are sufficiently unfavorable, indeed, that one could even suggest that there should be an accuracy- related penalty assessed on the taxpayer and return preparer for disregarding the clear thrust of the probability regulation.

Where the retained interest makes an inter-vivos transfer a testamentary substitute, it will not matter that it is written to continue for the successive lifetime of the spouse if he or she inter-vives. EPTL 5-1.1-A(a) (4) sets the elective right at a third of testamentary provisions, reduced by the capital value of interests that pass or have passed absolutely to the surviving spouse. The interest passes “other than absolutely” if it consists of less than the decedent's entire interest in the property, or if it is an interest in a trust or trust equivalent

created by the decedent. Thus, the spousal elective share can no longer be satisfied by a life interest in a trust, pooled fund or similar arrangement. The spouse can therefore elect against the successive interest of a joint and survivor plan, and the income and gift tax charitable deductions must be wholly disallowed at the outset. Although this rule will apply only for decedents dying on or after 9/2/94, its tax-disqualifying effect has applied to inter-vivos trusts created anytime since August 31, 1992 (because such trusts become subject to the spouse's defeasance if the creator merely lives till September of 1994).

With the split-interest gifts, the tax damage is even worse n loss of income tax deduction and imposition of gift tax. When an evocable trust is determined to be disqualified, it loses, retroactively to its inception, the special income tax treatment of § 664(c), causing it to be taxed under normal trust rules. Thus, for example, the trust's capital gains become taxable even though destined wholly for charity. It appears that a Pooled Income Fund otherwise favorably taxed under § 642(c)(3) should be entirely disqualified by acceptance of a transfer with a non-negligible third party interest in principal, ruining the tax benefits for all of its participants.

II. THE WAIVER AS A SOLUTION

EPTL 5-1.1-A(e) allows a spouse to waive or release a right of election, including selectively against a particular testamentary substitute. To be effective, the waiver instrument must be duly acknowledged or otherwise proved in the manner required for recordation of a deed. Clearly, a donor who knows the rules, and whose spouse concurs with the making of a given gift, can protect the charitable deduction by taking a spousal waiver. The government can audit the contemporaneity, sufficiency

and validity of the waiver, but should be bound by it if it proves to be in order.

Nevertheless, that leaves us to worry about the unknowledgeable, the uncounselled, the unskilled, the unthorough, the hasty, the dilatory, and those who for reasons other than willingness cannot get a waiver from the spouse. Consider the case of the elderly couple, no children, everything goes to charities on the death of the second to die, and, indeed, large giving to church and universities is going on every year. The hitch: one of them now slips into incompetency. No waivers. The competent spouse must be told that a charitable gift cannot exceed $10,000, and that a trust or pooled fund gift cannot be done at all, or that if done the charitable deduction is not allowed and gift tax is due. Return preparers should refuse to prepare returns otherwise. Charities soliciting gifts and trustees for proposed charitable trusts should pry into a spouse's competence.

Over time, New York charities may get the word out to the giving community on the need for waivers, but that is expecting a lot. Further, it isn't so easy for most folks to accomplish the necessary legal steps. Most pledges and gifts are done on the donor's signature alone, and often by mail without consultation. Requiring a separate document and notarization in connection with that is a serious chill on the solicitation process. The rules require asking a waiver of a spouse who will usually have no legal counsel on the matter. For tax purposes, the waiver will not be effective if the notarization is not done before or contemporaneously with the time when the gifted property transfers to the charity. So, for example, if the donor sends off a year-end stock gift without the waiver in place, the charity's attempt to get compliance after the fact should not

resurrect the deduction and should not prevent the imposition of gift tax on the transfer.

III. POLICY CONSIDERATIONS

(a) One Year Gifts: The one-year rule is an arbitrary time limit adopted to avoid the need to prove scienter. Nevertheless, the policy behind it is to prevent the intentional disinheriting of the spouse by denuding the estate within sight of the donor's end. How much should the State worry about cases of disinheritance motivated solely by spite, as opposed to by the desire to see the donor's property pass to his or her own children or other preferred beneficiaries? Suppose we cure the one-year problem by granting an exclusion for wholly charitable gifts: will there be people in numbers worth considering who will then give their goods to charity when they think they have less than a year to live, just to keep them away from the spouse? Not if they are at all informed, it would seem. Even under the present statute, the spiteful spouse can give away an entire estate by passing out an appropriate number of $10,000 checks, or by paying the tuitions of every student at Harvard, or the medical ense of every patient in Bellevue, or can consume it by throwing the biggest party ever seen. Larger outright gifts will evade the statute if they are made to a charity domiciled in a state whose policy favoring its own residents would outweigh its interest in enforcing a New York spouse's elective right, and where the donee does not have sufficient solicitation or business contacts with New York to give the Surrogate enforcement jurisdiction. See, Matter of Roy. 147 Misc. 2d 292, 555 N.Y.S.2d 1013, aff'd 570 N.Y.S.2d 385 (3d Dept.1991).

Of course, where the motivation for gifts shortly before death is not to disinherit out of spite, but rather to shift

property to preferred beneficiaries, a solely charitable outright gift would not be usable at all.

It seems reasonable, then, to ask the Legislature whether the policy favoring charitable giving might not co-exist amicably with the policy against disinheriting by one-year outright gifts. A purely charitable gift would not be the weapon of choice for such disinheriting.

(b) Retained Interest Trust: The charitable remainder trust, pooled income fund, or other type of remainder gift, where the donor retains an income interest for life or for a term of years, is a very common and attractive type of charitable gift. If these arrangements were to be given an elective share exemption, the person wishing to disinherit the spouse out of spite would presumably prefer it to an outright charitable gift, since it would provide a retained income interest protecting the donor against miscalculation on the imminence of death. Again, however, under present law, a properly advised spiteful spouse can already disinherit while retaining a life interest: just transfer the assets to a Connecticut bank's custody and do a “Connecticut Will”, invoking that state's law to dispose of the assets found within its borders, free of regard for New York elective rights, Conn. Gen. Stats. § 45a-287; or put the assets in an inter-vivos' trust in Massachusetts or Illinois, which will apparently enforce the terms of the trust after the grantor's death, see National Shawmut Bank of Boston v. Cumming. 325 Mass. 457, 91 N.E.2d 337 (1950), Johnson v. LaGranae State Bank. 73 I11. 2d 282, 383 N.E.2d 185 (1978); or invest in income-producing realty or a Totten Trust bank account in a state like Florida, which will not recognize the New York survivor's claim on it, Fla. Stat. § 732.205. These are not at all inconvenient ways of keeping full control of property during lifetime while

also having full control of disposition after death. Indeed, never mind spiteful disinheriting: these methods set the testator free from the elective right statute -- free to give the estate to beneficiaries preferred over the spouse, and free to control a spouse's interest by use of trusts in the way that-New York has tried to prevent. As lawyers and charities come to understand all this, we should expect to see an outflow of trust business from New York to ford and Boston. If we don't cure the problem, the institutions people affected will. Given this, it seems poor policy to endanger all charitable giving for the sake of preventing transfers that will be done only by accident or by fools.

Thought has been given to protecting the retained interest trust's charitable deduction only if it is written in joint-and- survivor form, thus limiting the protection to arrangements where the spouse will share for life. The problem with that, however, is that the single-life retained interest charitable remainder trust is widely promoted by the nations' universities and churches and other major charities. Most of these are not New York institutions and will come very slowly if ever to understand our peculiar tax problem. That means that many well-intentioned donors will sign up for the single-life trusts presented by equally well-intentioned institutions, not realizing the trap they have fallen into.

Accordingly, given the wide prevalence and importance of ained life interest arrangements and the relatively small likelihood that they will be used to intentionally disinherit, these tax deductions should also be protected.

(c) Transfers Taking Effect at Death: As a matter of balancing policies, we have less concern for the adverse effect

of the elective right on death-time charitable gifts that do not seek an income or gift tax deduction. The elective right will attach to them, and the surviving spouse will just as surely be able to divert a third of the charities' interests. That will be a disappointment to the affected institutions, but that is not the issue. It is the policy of the State of New York that the spouse be given the right to his or her third. Charitable recipients have no preferred status in the face of an exercised right. No, the issue is simply one of tax deduction predictability and fairness. The donor must know whether he or she has a safe deduction. On transfers taking effect only at death, the relation-back rule will operate to save a two-thirds deduction for charitable gifts actually elected against, whether outright bequests or split - interest' remainders. The spouse also gets marital deduction treatment for the diverted third. The tax results accord with the final facts, and no-one is treated unfairly.

It is unfair, however, for the system to (.a) leave major income tax deductions at risk of disallowance, (b) subject the transfers to gift tax (with a good probability of collection with penalties and interest after the donor's death: there is no statute of limitations on these gifts), (c) leave major charitable gifts in limbo for a year before the charity can safely spend or contract in reliance, or (d) deprive New York's citizens, charities and banks of such important charitable giving and estate planning techniques as the inter-vivos charitable remainder trust and other split-interest vehicles.

(d) "Charity:" The charity that will qualify a gift for protection must be a public charity, including only such private foundations as are given public status by the Internal Revenue Code. If all private foundations were to be included here, there

would be room for abuse in cases where the donor's own foundation could be a natural object of bounty.

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