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CHARITABLE REMAINDER TRUSTS: REFORMING AND DRAFTING SPLIT-INTEREST TRUSTS UNDER THE NEW LAW

Charitable remainder trusts have long been an effective estate planning device which enables a settlor to insure the welfare of his heirs while making a charitable bequest as well. The charitable remainder trust not only provides the spouse or children with an income for life or a term of years, but it also provides a tax benefit to the estate in the case of a testamentary transfer[1] or to the donor in the case of an inter vivos transfer.[2] Before the 1969 Tax Reform Act such split interest trusts were commonly drafted in the form "income to *A* for life, remainder to *B* charity," and a mere multiplication of the actuarial remainder factor by the amount of the corpus transferred determined the amount of the charitable deduction allowed the estate or donor.[3] The previously simple task of drafting such instruments has been dramatically changed by the 1969 Tax Reform Act which provides that no charitable deduction for either income, estate, or gift tax purposes will be allowed for a split interest transfer in trust made after July 31, 1969,[4] unless the transfer is in the form of an annuity trust, unitrust or pooled income trust.[5] The Regulations provided some relief from this harsh rule if the trust was created after July 31, 1969, but prior to December 31, 1972.[6] If the transfer were made between those two dates then even if the trust were not a charitable remainder trust as defined in section 664 at the date of its creation, it could nevertheless be treated as one and the charitable deduction would be allowed if:

(1) The original governing instrument transferred an irrevocable remainder interest to charity,

(2) the governing instrument was amended, or legal proceedings were started to amend the instrument before December 31, 1972, to provide for the creation of an annuity trust or unitrust, and

(3) the payments made to the recipients before the conforming amendment of the trust are adjusted retroactively to the amounts payable as an annuity trust or unitrust.[7]

1. INT. REV. CODE OF 1954, § 2055.
2. INT. REV. CODE OF 1954, § 2522(a).
3. Under the old law, the charitable deduction was determined by use of Tables I & II in Treas. Reg. 20.2031-7 (1970).
4. Treas. Reg. § 1.664-1(f) (1972).
5. INT. REV. CODE OF 1954, § 170(f)(2).
6. Treas. Reg. 1-664-1(f)(3) (1972).
7. 1 FED. EST. & GIFT TAX REP. ¶ 3670 1.0725 (1973).

Furthermore, the Regulations provided another exception for instruments that were an attempt to comply with the new law but failed to do so because of the time lapse between the Tax Reform Act and the promulgation of the final Regulations by the Internal Revenue Service. In those cases, if the governing instrument contains the "bare bones"[8] provisions of a charitable remainder trust as specified in section 664, then in six specific cases, an estate will be entitled to a charitable deduction without reformation of the instrument notwithstanding the fact that not *all* the provisions of the section are contained in the governing instrument. Those six cases are as follows:

In the case of a will executed on or before December 31, 1972, if:

(i) The testator dies before December 31, 1975, without having republished the will after December 31, 1972 by codicil or otherwise,

(ii) The testator at no time after December 31, 1972, had the right to change the provisions of the will which pertain to the trust, or

(iii) The will is not republished by codicil or otherwise before December 31, 1975, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise.

In the case of a trust executed on or before December 31, 1972, if:

(i) The grantor dies before December 31, 1975, without having amended the trust after December 31, 1972,

(ii) The trust is irrevocable on December 31, 1972, or

(iii) The trust is not amended before December 31, 1975, and the grantor is on such date and at all times thereafter under a mental disability to change the terms of the trust.[9]

In an effort to provide even more extensive relief, recent congressional legislation[10] has extended the deadline for reformation of wills or trusts executed before the arbitrarily selected date of September 21, 1974. For such instruments, if the governing instrument is amended or conformed on or before December 31, 1975, or if later, on or before the 30th day after the date on which judicial proceedings begun on or before December 31, 1975 become final, a charitable deduction will be allowed. Reformation, however, is

8. A so-called "bare bones" instrument must contain all the provisions required by the Regulations issued pursuant to § 664 *except* the following: (1) that interest accrue on overpayments and underpayments, (2) that the unitrust amount cease with the death of the last recipient, (3) that the unitrust amount be adjusted for short taxable years, (4) that the unitrust amount be adjusted for additional contributions made to the trust, (5) that adjustments be made for incorrect valuation of assets, (6) that the governing instrument provide for an alternative remainderman in the event that the designated charity does not qualify as a § 170(c) charity at the time the remainder interest is irrevocably transferred to charity.

9. Treas. Reg. 1-664-1(g) (1972).

10. 1 FED. EST. & GIFT TAX REP. ¶ 1954 (1974).

contingent upon the authorization of local law. In Illinois, House Bill 420[11] which provides for reformation of existing instruments to the extent necessary to bring the trust into conformity with the requirements of a charitable remainder annuity trust or a charitable remainder unitrust described in section 664, or a pooled income fund described in section 642(c)(5) has passed the House and is currently pending in the Senate. If enacted,[12] the legislation will provide an unconditional authorization for reformation of existing instruments consonant with the requirements of an annuity trust, unitrust, or pooled income trust fund.

In reforming an old instrument or drafting a new one, the practitioner must be cognizant of the basic differences between the three different forms of split-interest trusts permitted under the 1969 Tax Reform Act. An annuity trust is a trust from which a "sum certain" of not less than 5% of the initial net fair market value of the corpus assets is to be paid at least annually to one or more persons, one of whom must be a non-charitable beneficiary, with the remainder passing to a charitable organization.[13] A unitrust is a trust from which a fixed percentage of not less than 5% of the net fair market value of the corpus assets valued annually is to be paid at least annually to one or more persons, at least one of whom is not a charity.[14] As in the annuity trust, the remainder must be distributed to or for the use of charity.[15] In a pooled income trust fund, each donor transfers property to a fund controlled by a public charity, retaining for himself or creating for another beneficiary living at the time of the transfer, a life income interest in the transferred property.[16] Because of the requirement that the intermediary interest must be vested in the donor or some living beneficiary, a pooled income trust fund would generally not be used in testamentary estate planning. Rather the annuity trust or unitrust would be the preferred plans but in selecting one of these two alternatives it is important to be aware of the difference between the two. In the annuity trust, assets are valued only at the beginning of the trust while in the unitrust the assets are valued annually. Since the primary concern of most grantors is with the welfare of the recipient,[17] the unitrust is a more attractive

11. House Bill 420 will amend ILL. REV. STAT. ch. 148 § 51 (1971).

12. If House Bill 420 were not enacted by the Illinois Senate, Illinois case law would provide precedent for reformation of an existing instrument. *See generally* Curtiss v. Bron, 29 Ill. 201 (1862).

13. Treas. Reg. 1.664-1(a)(1)(i) (1972).

14. *Id.*

15. INT. REV. CODE OF 1954, § 170(c) provides in pertinent part that: the term "charitable contribution" means a contribution or gift to or for the use of a state; organization operated exclusively for religious, charitable, scientific, literary or educational purposes; a veterans organization; fraternal organization if such contribution is used exclusively for religious, scientific, literary, or educational purposes; or to a cemetery society.

16. Treas Reg. 1.642(c)-5(b)(2) (1971).

17. Treas. Reg. 1.664-1(a)(1)(iii)(d) (1972) defines a recipient as the beneficiary who receives the possession or beneficial enjoyment of the annuity amount or unitrust amount.

alternative as it adjusts to inflationary trends in the market while the annuity trust does not. Furthermore, no additional assets[18] may be added to the annuity trust thereby preventing its use in the popular "pour over" wills[19] of family members. Because the unitrust is a more flexible estate planning tool this article will focus on it.

THE BASIC UNITRUST

An instrument purporting to create a unitrust must specify (1) the basic unitrust amount, (2) the frequency of distribution of that amount, (3) the identity of the non-charitable recipient, (4) the duration of the trust, and (5) the charity to which the remainder must be irrevocably transferred.[20]

Basic Unitrust Amount: Initial and Additional Contributions

The basic unitrust amount must be expressed in terms of a specified fixed percentage of the net fair market value of the trust assets determined annually.[21] The fixed percentage with respect to all beneficiaries collectively must not be less than 5% of the net fair market value of the trust assets and may be expressed as a fraction.[22] A percentage is fixed if the percentage is the same either as to each recipient or as to the total percentage payable each year of the trust.[23] Thus a provision for a fixed percentage which is the same every year to *A* until his demise, and concurrently a fixed percentage (which may in fact be different from the other fixed percentage but may not be less than 5%) which is the same every year to *B* until his demise, satisfies the requirement.[24] Similarly, a provision for a fixed percentage of 5% or more to *A* and to *B* for their joint lives and then to the survivor of them satisfies the rule[25] while a bequest of 3% to *A* for life and 2% to *B* for life clearly violates the rule.

Provision must also be made in the governing instrument for determining the unitrust amount in a short taxable year which may occur either because the trustee initially elects[26] it or because of the death of the unitant or the expiration of the term of years.[27] In the first case, the governing instrument

18. Treas. Reg. 1.664-2(b) (1972).

19. A "pour-over" will is a simple will whose dispositive provisions, other than the specific bequests, are to a previously executed inter vivos trust. The terms of that trust constitute the testamentary scheme of a testator who employs such a device.

20. *See generally* Clark, *Changing World of Charitable Trusts*, 31 ANNUAL NEW YORK UNIVERSITY INSTITUTE ON TAXATION 1127 (1973) [hereinafter cited as Clark].

21. Treas. Reg. 1.664-3(a)(1)(i)(a) (1972).

22. Treas. Reg. 1.664-3(a)(2) (1972).

23. Treas. Reg. 1.664-3(a)(1)(ii) (1972).

24. Treas. Reg. 1.664-3(a)(1)(ii) (1972).

25. *Id.*

26. The trustee may elect a short taxable year initially so that later trust years will be based on the calendar year. For example, if the testator dies June 1, 1975, and the trust is activated October 1, 1975, the trustee will elect a short taxable year in 1975, viz., October 1 through December 31, 1975.

27. Treas. Reg. 1.664-3(a)(1)(v) (1972).

must require that the unitrust amount for the short period will be the regular unitrust amount multiplied by a fraction, the numerator of which equals the number of days in the short taxable year of the trust and the denominator of which is 365 days (or 366 if February 29 is a day included in the numberator).[28] In the second case, the regular unitrust amount must be multiplied by a fraction the numerator of which equals the number of days from the beginning of the taxable year to the death of the unitant or the expiration of the term of years and the denominator of which is 365 days (or 366 if February 29 is a day included in the numerator).[29]

The trust instrument must either prohibit additional contributions to the trust or provide for proration of the additional contribution.[30] Where no valuation date occurs in the taxable year of the trust after the time of the additional contribution (which would in fact be the case where the trust elects the first business day of the trust for valuation) proration requires valuation of the additional property at the time of contribution [31] The value of the additional assets multiplied by a fraction the numerator of which equals the number of days in the period which begins with the date of contribution and ends with the last day of the taxable year of the trust and the denominator of which equals the number of days in the taxable year, plus the net fair market value of the trust assets (excluding the value of the additional property), multiplied by the fixed percentage equals the unitrust amount for that period.[32] The following example illustrates how the unitrust amount would be calculated where additional assets were added to the corpus. Assume a testator dies January 1, 1975. A unitrust created by his will provides for a 5% annual distribution to *A*. Further, assume the unitrust is activated on January 1, 1976. If the value of the corpus as determined on January 1, 1976 is $100,000 and on August 1, 1976 additional assets of $100,00 are added to the trust, the unitrust will pay a unitrust amount on December 31, 1976 (assuming that is the date of distribution) of $7095.89 calculated as follows:

[($100,000 X 153/365) + $100,000] X .05 = $7095.89

Thus a draftsman must be certain not only that the terms of the instrument are such that the trust is distributing at least 5% of the net fair market value of the assets valued annually but also that the instrument either prohibits additional contributions or provides for proration of those additions.

Frequency of Distribution of the Unitrust Amount

The unitrust amount must be paid not less often than annually.[33] The Treasury Regulations provide that if the payment is made after the close of

28. Treas. Reg. 1.664-3(a)(1)(v)(a) (1972).
29. Treas. Reg. 1.664-3(a)(1)(v)(b) (1972).
30. Treas. Reg. 1.664-3(b) (1972).
31. Treas. Reg. 1.664-3(b)(1) (1972).
32. Treas. Reg. 1.664-3(b)(2) (1972).
33. Treas. Reg. 1.664-3(a)(1)(i) (1972).

the year, the trust will not be deemed to have failed to function exclusively as a charitable remainder unitrust as long as the payment is made within a reasonable time after the close of such taxable year. A reasonable time will not ordinarily extend beyond the date the trustee is required to file the 1041-B tax return,[34] including extensions.[35]

Of course payment of the unitrust amount is predicated on a determination of the net fair market value of the trust assets. The Regulations provide that the instrument may specify any date for valuation during the taxable year of the trust or alternatively, the average of valuations made on more than one date during the taxable year may be used as long as the same valuation date or dates are used each year.[36] The instrument need not specify the date but failure to do so vests discretion in the trustee to so elect. He then must indicate his selection on the initial fiduciary return filed by the trust. Clearly selection of the year end date favors the recipient as unrealized appreciation is included in the net fair market value of the trust assets thereby increasing the unitrust amount distributable to the recipient.[37] If, however, a valuation date other than the first day of the taxable year is selected, the governing instrument must also provide that where no valuation date occurs in a taxable year of the trust which is a short taxable year or is one in which the non-charitable interest terminates, the trust assets shall be valued as of the last day of such short taxable year or as of the day the non-charitable interest terminates.[38]

Non-charitable Recipients or "Unitants"[39]

The final Regulations provide that the unitrust amount must be payable "to or for the use of" a named person or persons, at least one of which is not a charitable organization.[40] If both the intermediary and remainder interests were transferred to charity then a private foundation rather than a charitable remainder trust would be created. This is an important distinction inasmuch

34. Federal law requires all trusts to file a 1041 fiduciary return each year.

35. Treas. Reg. 1.664-3(a)(1)(i) (1972).

36. Treas. Reg. 1.664-3(1)(iv) (1972).

37. Olsen & Ledwith, *Final Regulations Point Way to Effectively Use Charitable Remainder Trusts*, 37 J. TAXATION 370 (1972) [hereinafter cited as Final Regulations]. Assume the corpus of the unitrust is a portfolio of publicly traded securities whose net fair market value January 1, 1975 is $100,000. Because of appreciation in the value of the stock, the portfolio is worth $101,000 on December 31, 1975. The net fair market value of the corpus on the last business day of the trust is $101,000. Clearly, 5% of $101,000 is greater than 5% of the corpus on January 1. In fact, 5% of the corpus on January 1 is $5000; 5% of the corpus on December 31 is $5050. The increase in the unitrust amount is 1 1/2%.

38. Treas. Reg. 1.664-3(a)(1)(v)(a)(3) (1972).

39. The Code refers to one who receives the annual distributions as the "recipient". Since a unitrust is similar to a variable annuity and the recipient of an annuity is referred to as an "annuitant", it seems appropriate to denominate the recipient of a unitrust "unitant".

40. Treas. Reg. 1.664-3(a)(4) (1972) provides that current distributions may be made to charity in addition to the amount distributed to the unitant. However, no distributions other than the unitrust amount may be made to any non-charitable person other than the unitant: INT. REV. CODE OF 1954, § 664(d)(2)(B).

as private foundations are governed by the provisions of a different section of the Internal Revenue Code.[41]

The phrase "for the use of"[42] a named person was not a part of the Proposed Regulations. It is an important addition as it permits distribution to the guardian of a minor beneficiary or to the guardian of a beneficiary who has become incapacitated.[43]

One problem raised by the terminology of the Regulations is whether the terms "person or persons" could include a trust.[44] Arguably it does since the Code defines a person to include "an individual, a trust, estate, partnership, association, or corporation."[45] This question could be important in a situation in which a husband creates an insurance trust, the terms of which are "to my children for life," and his spouse executes a "pour over" will which creates a charitable remainder unitrust with the unitrust amount being distributed to the insurance trust. If the wife predeceases her husband, the entire class of beneficiaries will not have been ascertained and hence the "person or persons" for whose use the unitrust amount is to be paid are not determinable. Because of the specificity required of charitable remainder instruments, it would not be advisable to use this kind of planning which risks loss of the charitable deduction even though alternate planning would require the creation of two trusts and additional trustee's fees.

The trust instrument may grant the trustee power to distribute the unitrust amount among the members of a class of unitants. Revenue Ruling 72-395[46] stipulates that such a spray or sprinkle trust is permissible in two situations: first, where the amount is allocated among members of a class for their lives provided the class is closed and all members are living or ascertainable at the creation of the trust. Second, if the unitrust amount is to be allocated among members of a class for a term of years not exceeding twenty years, the members of the class need not be living or ascertainable at the creation of the trust.[47] However, where such a spray trust is used, it is important for the drafter to be cognizant of the caveat of Regulation 1.664-3(a)(3)(ii) which specifies that such a power to allocate or spray among members of a class must not cause a person to be treated as an owner of any part of the trust under the Clifford Trust provisions of Internal Revenue Code sections 671-678.[48] From a planning point of view, this caveat would preclude

41. INT. REV. CODE OF 1954, §§ 4940 *et. seq.*
42. Treas. Reg. 1.664-3(a)(3) (1972).
43. Final Regulations, *supra* note 37, at 371.
44. Clark *supra* note 20, at 1137.
45. INT. REV. CODE OF 1954, § 7701(a)(1).
46. Rev. Rul. 72-395, 1972-2 CUM. BULL. 340.
47. Treas. Reg. 1.664-3(a)(3)(i) (1972).
48. In a Clifford Trust the grantor retains such extensive control over the corpus or income of a trust that he is deemed the owner of it and income is taxed to him. Clifford trusts are frequently referred to as "grantor trusts.".

a grantor or one to whom the grantor had a legal obligation of support from acting as a trustee.[49]

Duration of the Trust

The unitrust may not extend beyond either the life or lives of the names unitant or unitants or a term of years not to exceed twenty years.[50] Thus the Regulations preclude the creation of an estate pur autre vie as well as an interest of the form "to A for life and then to B for 10 years" since the latter interest could last longer than either the lives of the unitants in being at the creation of the trust or a term of years not to exceed twenty years. An interest of the form "to A for life and then to B for his life or a term of years (not to exceed 20), whichever is shorter, is permissible if both A and B are alive at the creation of the trust inasmuch as this trust could not last longer than the lives of the unitants in being at the creation of the trust.[51]

Remainder Interest to Charity

To qualify as a charitable remainder unitrust not only must the remainder interest be irrevocably transferred to or for the use of charity but the governing instrument must also provide that in the event the designated charity does not qualify as a section 170(c) organization at the time the remainder interest is irrevocably transferred, then the remainder interest will be transferred to an organization that does qualify under section 170(c).[52] In addition the Regulations specify four other requirements that are important to a drafter. First, a charitable remainder trust must be either a charitable remainder annuity trust or a charitable remainder unitrust. No hybrid is permitted. Thus a trust which provides for an annual distribution to a non-charitable beneficiary of the greater of a sum certain or a fixed percentage of the annual value of the trust assets is not a charitable remainder trust since the trust is neither an annuity trust nor a unitrust.[53]

Second, the instrument may not restrict the trustee from investing trust assets in a manner which could result in the annual realization of a reasonable amount of income from the sale or disposition of trust assets.[54] Arguably this provision could preclude a trust from qualifying as a charitable remainder unitrust where the instrument required the trustee to invest in tax-exempt securities since a reasonable amount of income may not be assured from

49. Clark, *supra* note 20, at 1136.
50. Treas. Reg. 1.664-3(a)(5)(i) (1972).
51. *Id.*
52. Treas. Reg. 1.664-3(a)(6)(iv) (1972).
53. Treas. Reg. 1.664-1(a)(2) (1972). Such a dispostion is not an annuity trust inasmuch as the annual payment may be a fixed percentage of the annual value of the trust assets which is not a sum certain. Similarly, it is not a unitrust inasmuch as payment may be a sum certain which is not a fixed percentage of the annual value of the trust assets.
54. Treas. Reg. 1.664-1(a)(3) (1972).

municipal bonds.[55] Clearly, this provision in the Regulations is without foundation in the Code,[56] but is included to insure that the charitable deduction received by the estate more closely approximates the amount ultimately transferred to charity. Without such a provision distribution of the unitrust amounts could require invading the corpus when income was less than the unitrust amount required to be distributed.

Third, the trust must qualify and function exclusively as a charitable remainder trust from its creation.[57] In the case of a testamentary transfer, the Regulations provide that notwithstanding the aforementioned requirement, the trust will be considered a charitable remainder trust at the date of the transferror's death if the obligation to pay the unitrust amount begins on the date of the decedent's death, even though the requirement to pay the unitrust amount is deferred.[58] This provision is necessary to allow for orderly administration of the estate.[59]

The Regulations[60] also require that within a reasonable time after funding, the trust in the case of underpayment must pay 6% interest on the difference between the unitrust amount actually paid and the unitrust amount payable. In the case of overpayment, the unitant must repay the trust at the same interest rate. Administrators should be cognizant of this requirement because if a reserve for federal estate taxes were established until a closing letter on the estate tax return is received from the Internal Revenue Service interest on the unitrust amount actually distributed may be due where the reserve is added back to the corpus thereby increasing the unitrust amount payable.[61] If the trust instrument prohibited additional contributions, then such a reserve could not be established as it may prevent the trust from qualifying if such additions were considered additional contributions.[62] It is unlikely that the Service would take that position inasmuch as Regulation 1.664-3(b) says that all property passing to the trust by reason of the grantor's death shall be considered one contribution. If however, the Service did consider it an additional contribution, then in the event additional tax was due and no reserve had been established, the trustee would be saddled with the unpleasant task of collecting overpayment plus 6% interest from the unitant.

55. Olsen & Ledwith, *Charitable Remainder Trusts: How to Comply with Final Regulations*, 38 J. TAXATION 3 (1973) [hereinafter cited as *Charitable Remainder Trusts*].

56. INT. REV. CODE OF 1954, § 664.

57. Treas. Reg. 1.664-1(a)(4) (1972).

58. Treas. Reg. 1.664-1(a)(5) (1972).

59. Without such a provision an estate could not pay the debts and expenses of the decedent without disqualifying the trust from § 664 treatment inasmuch as no other payments other than the unitrust amount or a payment to charity may be made by the unitrust.

60. Treas. Reg. 1.664-1(a)(5) (1972).

61. *Charitable Remainder Trusts*, *supra* note 55, at 2.

62. If a reserve for federal estate taxes were established on the books of the trust until a closing letter was received from the Service, the net fair market value of the corpus would be reduced by that amount that had been credited to the "reserve for estate taxes" account.

Where an incorrect valuation of the corpus assets by the fiduciary results in an overpayment or underpayment to the unitant, no interest need be paid. The governing instrument, however, must provide for payment to the unitant in the case of undervaluation and require that the unitant shall repay in the case of overvaluation the amount equal to the difference between the amount which the trust should have paid if the correct value had been used and the amount that was actually paid.[63]

INCOME OPTION UNITRUST

The basic unitrust is not the only option a testator or grantor may select in creating a unitrust. He may in fact elect to provide that the unitant receive the lesser of the basic unitrust amount or the income of the corpus. Section 664(d)(3) describes the exception:

> (3) Exception—Notwithstanding the provisions of paragraph (2)(A) and (B), the trust instrument *may* provide that the trustee shall pay the income beneficiary for any year
>
> (A) The amount of the trust income, if such amount is less than the amount required to be distributed under paragraph (2)(A), *and*
>
> (B) The amount of the trust income which is in excess of the amount required to be distributed under paragraph (2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.[64]

This section clearly says that in the event the income option unitrust is selected, and if the income in any one year exceeds the unitrust amount, the trust shall pay an additional amount equal to the difference between the aggregate amounts distributed in such prior years and the unitrust amounts for those years. Whether or not the distribution of that additional amount, called "make up" is mandatory or optional is unclear.[65] The Code says it is mandatory; the Regulations, however indicate that "make up" is optional:

> (b) Income Exception. Instead of the amount described in (a) of this subdivision (i), the governing instrument may provide that the trust shall pay for any year either the amount described in (1) or the total of the amounts described in (1) and (2) of this subdivision (b).
>
> (1) The amount of trust income . . . for a taxable year to the extent that such amount is not more than the amount required to be distributed under (a) of this subdivision (i).
>
> (2) An amount of trust income for a taxable year which is in excess of the amount required to be distributed under (a)

63. Treas. Reg. 1.664-3(a)(1)(iii) (1972).

64. INT. REV. CODE OF 1954, § 664(d)(3) (emphasis supplied).

65. Mr. W.T. Baetz of McDermott, Will, & Emery, Chicago, Illinois initially pointed-out to me the disparity between the Code and legislative history on the one hand, and the Regulations and the Revenue Ruling on the other.

> of this subdivision (i) for such year, to the extent that . . . the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.[66]

The key words in the Regulation which suggest that "make up" is not mandatory are that the governing instrument may provide that the trust shall pay *either* the lesser of income and the unitrust amount *or* the total of the lesser of income and the unitrust amount plus "make up". Similarly, Revenue Ruling 72-395 is based on an interpretation of § 664(d)(3) that "make up" is not required:

> Make up of deficiencies not required. If it is desired to use the above provision, the second sentence, increasing the unitrust amount by the income in excess of the fixed percentage to the extent of deficiences between the income and the regular unitrust amount in prior years, is optional.[67]

Whether or not "make up" is mandatory is very important to a drafter since if it is mandatory and the provision is not included in the instrument, the trust would not qualify as a charitable remainder unitrust under Treasury Regulation 1.664 1(a)(2). It would seem, however, that the Service would not deny a charitable deduction to those who rely on the Regulation and Revenue Ruling noted above. Nevertheless an examination of the final Regulation, the Proposed Regulations and the legislative history of the Code section suggests the correct interpretation of the problem. Although the Proposed Regulations contained no provision for the income option unitrust, it was incorporated in §201(e) (1) of H.R. 13270 of the Tax Reform Bill of 1969, and a report of the Staff of the Joint Committee on Internal Revenue Taxation indicates that the Staff considered the provision mandatory:

> The Act . . . allows a charitable remainder unitrust to provide that when the trust income is less than the required payment to the non-charitable income beneficiary the trust need only distribute to the income beneficiary the amount of the trust income. The deficiencies in income distributions in this case (i.e. where the trust income was less than the stated amount payable to the income beneficiary) *must* be made up in later years when the trust income exceeds the amount otherwise payable to the income beneficiary for that year.[68]

One commentator writing on the income option exception has taken the position that "make up" is mandatory.[69] Moreover, since the Code seems to indicate that it is mandatory and the legislative history substantiates that interpretation, drafters would be well advised to include it in instruments where pertinent. If a charitable deduction is allowed by the Internal Revenue Service the amount of the deduction will not be altered, however, either by including or excluding the provision from the governing instrument.

66. Treas. Reg. 1.664-3(a)(1)(i)(b) (1972).
67. Rev. Rul. 72-395 § 7, 1972-2 CUM. BULL. 340.
68. JOINT COMM. ON INTERNAL REVENUE TAXATION, GENERAL EXPLANATION OF THE 1969 TAX REFORM ACT, H.R. Doc. No. 13270, 91st Cong., 1st Sess. 85 (1970) (emphasis supplied).
69. S. GOLDBERG, TAXATION OF CHARITABLE GIVING 69 (Practicing Law Institute 1973).

THE FUTURE OF CHARITABLE REMAINDER TRUSTS

A mere perusal of the Code and Regulations on charitable remainder trusts indicates how complex the drafter's job has become to accomplish what was previously a relatively simple task. Under the old law, a drafter only had to employ the simple form "income to A for life, remainder to charity" to insure a charitable deduction for his client. Now he must carefully select terminology that will insure that at least 5% of the net fair market value of the assets will be paid to some recipient each year of the trust. Furthermore, complex provisions must be included in the governing instrument for determining the amount to be distributed to the recipient in a short taxable year. He must also be certain that the duration of the trust does not extend beyond the life of the recipient or the arbitrarily-selected period of twenty years. In the event a client wishes to empower the trustee to spray the trust amounts among a class of recipients, the attorney must be careful to avoid the Clifford Trust provisions of the Code. These are only a few of the possible pitfalls an attorney may encounter in drafting a charitable remainder trust; an exhaustive list would be extensive.

Because of the complexity in the law, a general practitioner who previously was able to obtain a tax benefit for his client's estate by the use of a charitable remainder trust, will now be forced to refer such work to the estate planning specialist. Moreover, once such an instrument has been drafted by a specialist, the client no doubt will reject the instrument because of its obfuscating terminology. A testator is not likely to sign a document he does not understand and, therefore, charity will be deprived of the essential funds heretofore contributed by its benefactors through charitable remainder trusts.

It is clear that the congressional intent behind this legislation was to insure that the charitable deduction afforded an estate would more closely approximate the amount ultimately transferred to charity after the termination of the income beneficiary's interest. But one must question if such complex requirements were indeed necessary to accomplish that result. It would seem that the updating of the actuarial valuation tables by the use of more recent statistics on mortality and the prescribing of the more realist interest rate of 6% for the discounting of future interests[70] would have been sufficient to accomplish the result intended and would not have deterred testators from making charitable bequests. Nevertheless section 664 of the Internal Revenue Code appears to be here to stay and a practitioner who attempts to draft a charitable remainder trust must be apprised of the intricacies of the Section and incorporate them into the instruments he drafts so that the charitable deduction his client seeks will not fail.

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70. Clark, *supra* note 20, at 1130.