IBT Indiana Bank & Trust Company

The residuary clause

A recent IRS private letter ruling provides a timely reminder on the importance of understanding your will.

Decedent created a charitable trust on Date 1. On Date 2 he executed a new will, revoking all prior wills and affirming the existence of the charitable trust. The new will provided for a lifetime interest in certain real property for a son and the son's wife, as well as a trust funded with a specific sum of money for the son and his wife for their lives. At the death of the survivor of the son and his wife, any funds remaining in the trust, as well as the real property, pass to the charitable trust.

What the new will did not have was a *residuary clause*.

A residuary clause in a will takes care of any property that has not been specifically mentioned earlier in the will. Very often "all the rest of my estate" pours into a trust created outside the will, or it may be added to a trust established in the will. Sometimes the residue simply goes to charity.

After Decedent's death, the son asserted that *he* was entitled to the residue of his father's estate. Because there was no residuary clause, the residue of the estate, if any, would pass by the laws of intestacy, that is, the state-provided plan that takes effect in the absence of a will.

The charitable trust contested that claim, arguing that evidence from outside the will proved Decedent intended that the residuary pass to the charitable trust. Such evidence included Decedent's earlier wills, his large number of lifetime charitable transfers, and testimony of the lawyer who drafted the will. He admitted that the absence of a residuary clause in the will and in three subsequent codicils was his oversight.

The son and the charitable trust argued for several months until reaching a settlement. The son accepted a specific dollar payment outright, free and clear of all expenses and taxes, including the estate taxes due on the transfer to him. The balance of the estate then passed to the charitable trust. The settlement was approved by the local court without an evidentiary hearing.

Such a settlement is not binding upon the IRS. When the executor asked for a charitable deduction for the amount paid to the charity under the settlement, the IRS said no. IRS believed that the son was correct; the charity never had an enforceable claim for any portion of the residuary estate. Although the will may have been incomplete, it was not ambiguous. There was nothing in the will that was inconsistent with the idea of distributing the residuary estate under the laws of intestacy. Therefore, resort to outside evidence was not allowable, and the estate should have been administered within the four corners of the will. Given that IRS does not find an enforceable claim, the charitable deduction for amounts paid in settlement are not permitted.

The IRS ruling shouldn't change what the son and his wife receive. The increased taxes will necessarily reduce the amount going to the charity.

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