THORNY PLANNING ISSUES IN LIGHT OF TAX REFORM

By:

Kathleen R. Sherby
Partner
Bryan Cave Leighton Paisner LLP

211 N. Broadway, Suite 3600
St. Louis, Missouri 63102
314-259-2000

THORNY PLANNING ISSUES IN LIGHT OF TAX REFORM

By: Kathleen R. Sherby

A. 2017 Tax Reform: Potential Pitfalls

1. Existing trusts may no longer accomplish client's goals and in fact may be counter to what the client actually wants.

   a. Does the client want to provide principally for spouse?

   b. Does the current trust document provide for descendants?

   c. Formula bequests may unintentionally disinherit a spouse by "overfunding" a credit shelter trust benefiting a grantor's children.

   d. A client's current trust may not allow for flexibility in planning.

   e. Estate and gift taxes are now, at least temporarily, irrelevant for most clients.

2. 2025 Sunset

   a. Unless Congress acts, the higher estate and gift tax exclusion levels will sunset at the end of 2025 and return to the 2017 levels indexed for inflation.

      i. We would anticipate that the estate and gift tax exclusion would then be around $6,000,000.

      ii. The GST exemption would also return to the same level.

   b. Estate and gift tax exclusion has become an increasingly politicized issue, and while we can't reliably predict how or even when the exclusion level will change, we can count on the fact that it will change itself.

      i. The GST exemption should also follow whatever change is made to the applicable exclusion.

   c. In planning, we must consider how to address these changes - if Congress extends or makes permanent the higher exclusion, allows the exclusion to sunset, or even moves to a lower exclusion level.

   d. Flexible planning will be the key for the post death provisions of the revocable trust

B. 2017 Tax Reform – Lifetime Planning Opportunities

1. Planning to Use the Increased Exclusion and Exemption

   a. Can the client afford to make a large gift now to make use of the higher applicable exclusion?

   b. If the client can afford making a large gift, the client should consider additional gifting transactions (outright or in trust) during life.

      i. Weigh potential estate tax savings through the use of the current applicable exclusion against any unexpected income tax liabilities that arise from a potential lost step-up in basis.

      ii. Consider having the client reacquire gifts of low basis assets that are expected to be sold shortly after death to keep such assets in the decedent's estate and achieve a step-up in basis – can prior gifts be reacquired?

   c. Consider allocating a portion of the increased GST exemption to a non-wholly GST-exempt irrevocable trust previously funded by the client to protect assets from GST tax.

   d. Consider funding a dynasty trust with the increased applicable exclusion and GST exemption amounts to reduce future GST tax burdens.

      i. Irrevocable dynasty trusts allow substantial amounts of wealth to grow and compound free of federal estate, gift and GST taxes, even if the value of the assets grows beyond the then applicable exclusion and GST exemption amounts.

2. Clawback Concerns.

   a. If the client makes a gift to use the increased exclusion and the current exclusion sunsets, what will be the effect of the gift on the client's applicable exclusion?

      i. The gift now does not trigger a gift tax payment, but if current applicable exclusion sunsets or a lower applicable exclusion is enacted, will the gift now cause the client to have a taxable estate at the time of death?

      ii. Clawback retroactively imposes estate taxes based on the use of applicable exclusion for gifts previously made.

   b. Congress didn't address whether clawback exists under the new tax scheme. New Code Section 2001(g)(2) directs the Secretary of the Treasury to prescribe regulations to address any difference in the basic exclusion amount at the time of a lifetime gift and the time of death.

c. Internal Revenue Code Section 2001(g)(2) states, "The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between—(A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and (B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent."

d. Many commentators assume that the IRS will take regulatory action to prevent the application of clawback, but this is not a certainty.

e. The Service may include this in their priority guidance plan now due to the adverse impact on gift planning now.

3. Even if the client is can't afford to get rid of the economic benefits of gifted funds entirely, the client could consider a gift to a dynasty trust for the benefit of spouse (and descendants) to use the increased exemption. This type of trust is commonly referred to as a Spousal Lifetime Access Trust ("SLAT").

C. SLAT

1. A married settlor can create a trust for the settlor's spouse (and perhaps descendants) during their lifetimes

2. The spouse could be given an income interest in the trust or the trust could be discretionary for the benefit of the spouse. In either case, it is important to avoid reciprocal trusts if both will create a trust for his/her spouse.

3. No QTIP election would be made to claim a marital deduction for the assets transferred to the trust; instead, the settlor would use his/her gift tax applicable exclusion amount.

4. The SLAT would be funded with property in the settlor's own name to avoid any perception that the beneficiary spouse made a gift to the SLAT of his or her interest in joint property.

5. SLAT assets, plus growth, are not includable in either spouse's estate (except if the beneficiary spouse is deemed to have made a gift to the SLAT or the reciprocal trust doctrine applies).

6. Useful to quickly utilize the increased exemption and make completed gifts before exemption decreases.

7. Since the settlor's spouse is a beneficiary, the spouse will continue to have the economic benefit of the gifted assets.

8. The most obvious downside to a SLAT is the risk of divorce. This should be discussed with the clients in weighing the potential benefits of a SLAT.

   a. Will the spouse's interest in the SLAT continue in the event of a divorce?

      i. Many states by statute provide that the interest of a spouse in a trust created by a settlor terminates on divorce.

         - Missouri's UTC contains such a provision in R.S. Mo. § 456.1-112.
         - Iowa has a provision similar to Missouri's statute, but Iowa's provision (I.C.A. § 633A.2107) is under the Subchapter that relates only to revocable trusts.
         - Oklahoma's statutory provision (84 Okl.St.Ann. § 114) applies only to wills, but has been found in case law to apply to the provisions of a revocable trust after the settlor's death, where the will poured the probate residuary over to the revocable trust.
         - Arkansas's statute (A.C.A. § 28-25-109(b)) and Kansas's statute (K.S.A. 59-610) apply only to wills and there is no case law in either state that would apply this concept to trusts, whether revocable or irrevocable.

      ii. If the applicable state law does not contain this provision, it is possible to deal with this issue by defining the term "spouse" to include only a current spouse (and not a former or estranged spouse).

         - However, the attorney would have a waivable conflict in including such a provision in the SLAT.
         - Such a provision would need to be discussed completely with the couple and the conflict waived.
         - If such a provision were to be included in the trust, divorce would terminate the spouse's interest, and a future spouse could be provided for as a current beneficiary.

   b. In the event of a divorce, how will the trust be treated in the property settlement? Will the spouse's interest in the SLAT continue and be treated as marital property that would be used to satisfy the spouse's interest in the division of marital property?

9. If both spouses want to create SLATs to benefit the other, it is important to take care to avoid “reciprocal trusts” when implementing such a plan.

   a. The reciprocal trust doctrine provides that if settlors create trusts for one another with substantially identical terms and are “interrelated”, then each of the spouses will be treated as the grantor of the trust for his or her own benefit for estate tax purposes.

   b. To avoid the reciprocal trust doctrine, build in real distinctions.

      i. Create the trusts at different times (at least a few months apart).

      ii. Fund the trusts with different assets that add up to different values.

      iii. Provide different distribution standards (e.g. all income directed to be distributed for one trust and discretionary for the other) and withdrawal powers.

      iv. Include different termination dates and events.

      v. Appoint different trustees (consider not having spouses serve as trustees of the other’s trust), etc.

   c. The structure of the trusts is only part of the equation as the most important determining factor may be how the trusts are administered after they are created. IRS can argue the existence of a pre-arranged plan if the administration of the trusts looks suspect.

10. Another obvious downside of a SLAT is the early death of the beneficiary spouse. If the settlor may have need of the economic benefit from the assets used to fund the SLAT, consideration can be given to providing the beneficiary spouse with a power of appointment over the trust asset.

   a. The beneficiary spouse should not exercise this power of appointment close in time to the creation of the trust or the settlor may be treated as the grantor of any trust established through the exercise of this power of appointment.

D. Client Goals and Considerations in Estate Planning for Transfers at Death.

1. With the much higher applicable exclusion amount, the client for the first time can focus on non-tax estate planning rather than be concerned with tax planning

2. The estate plan will appropriately consider the age of client. Planning will differ depending on the client's adult life phase: early years (ages 20-40), middle years (ages 41-70), and golden years (ages 71 and up).

    a. Couples in their early years are likely to be more interested in establishing accounts for young children and their own retirement.

    b. Couples near to or in their golden years are likely to focus more on how and to whom their assets are to be distributed, business succession, gifting programs (charitable or otherwise) and taking advantage of basis adjustments.

    c. Younger couples likely need more discretion in the distribution schemes, while couples in their middle and golden years need to secure stability in retirement.

3. The estate plan will appropriately consider the relative wealth of the client. Couples with low risk of ever incurring estate taxes will employ different estate planning strategies than couples who may, but not necessarily with certainty, incur any estate tax liability, and couples who may incur estate tax liability will employ very different estate planning strategies than those couples who will almost certainly be paying estate tax.

4. Consideration needs to be given to second/third marriages, children and stepchildren, and special needs planning for children and other beneficiaries.

5. Unless the couple will certainly be paying estate tax, any formula bequest will need to be recrafted as the old formula clauses no longer work under the current tax law. Any new formula clause will need to address the client's current and anticipated goals under a number of potential scenarios.

6. Clients who are making multiple specific gifts under their current estate planning documents should be encouraged to consider accelerating these gifts and/or forgiving outstanding loans to children or other family members.

7. Asset protection planning for the client and family members has taken on enhanced importance. The estate plan should balance protecting assets, minimizing tax exposure, and allowing clients to access funds in a way that meets each client's specific goals.

8. Flexibility should be emphasized in all aspects of the estate plan.

    a. Include nontaxable powers of appointment in trust instruments.

    b. Provide broad distribution standards by independent trustees.

c. When creating an irrevocable gift trust, make it a grantor trust by using substitution or swap powers, and include appropriate powers to eliminate these grantor trust provisions.

d. Provide for the use of a non-fiduciary trust protector with specifically delineated modification powers.

9. Where complex estate tax reduction tools are no longer necessary, consider simplification of estate plans to reduce the hassle and cost of administration after death. The optimum plan for most clients will involve flexibility and post mortem planning. The optimum structure may now be the single lung trust plan in the settlor's revocable trust (discussed below).

E. Flexibility Planning and the Marital Deduction.

1. Planning Where There Is No Need for Estate Tax Planning – Outright Gift.

a. Leaving assets to a beneficiary in trust protects the assets from creditors and future ex-spouses, provides for management of assets, allows for limitations on the use of assets, provides planning for special needs, and allows the client to lock in the beneficiaries of the trust.

b. An outright distribution of assets is simple, allows for flexibility in how the beneficiary will use the assets, causes inclusion in gross estate at death so that the assets receive a basis adjustment for income tax purposes, but leaves the assets at risk to creditors and former spouses, as well as potentially the subject of financial elder abuse.

2. Planning Where There Is No Current Need for Estate Tax Planning But May Have Such Need In the Future – Flexibility Around the Use of the Applicable Exclusion and the Marital Deduction is the Key.

a. Ensure that transfers that may need to qualify for the marital deduction actually do so and that those transfers intended to use the applicable exclusion so as not to be includible in the gross estate of the surviving spouse do not inadvertently become includible. A mistake here could subject an estate to estate tax that would otherwise be avoided with the proper drafting.

b. Make sure to preserve the use of the decedent's exclusion amount by planning for portability. A portability election allows for the possibility of using the marital deduction on the death of the first spouse to die and yet using both spouses' exclusion amounts.

i. By causing inclusion in the estate of the surviving spouse through the use of the marital deduction, the assets will get a basis adjustment at both deaths, potentially saving income tax on any capital gains.

ii. In order to preserve portability, the estate planning documents should proactively address the need to file the estate tax return to elect portability, and provide the source of payment for the preparation of such a return.

iii. If the first spouse to die passes away when the estate tax applicable exclusion is high, and the portability election was properly made at that time, the predeceased spouse's higher unused exclusion amount should still be able to be used on the death of the surviving spouse in later years even if the exclusion amount has decreased by the time of the death of the surviving spouse.

c. It may be desirable to provide for disclaimer planning in the estate planning documents, so that if the surviving spouse refuses to accept all or a portion of a marital gift, the disclaimed assets will be distributable to a credit shelter trust for the benefit of the spouse or for the benefit of the spouse and descendants.

i. This "second look" allows for post mortem flexibility, but requires the spouse to disclaim the assets in a timely and effective fashion.

ii. The disclaimer must be completed within 9 months of the death of the first spouse to die in the fashion prescribed by applicable state law.

iii. The surviving spouse must not have accepted the gift, even inadvertently.

iv. Finally, it is often said that the greatest lie during estate planning is by the spouse who promises to disclaim. Often, after the death of the first spouse to die, the surviving spouse is so unsure about financial affairs that he/she declines the opportunity to disclaim until it's too late, even though disclaiming assets would result in a beneficial tax situation without causing economic hardship.

F. Flexibility Using a QTIPable Trust

1. Using a single lung QTIPable Trust may create greater flexibility, certainty and protections than portability planning or disclaimer planning while keeping the estate plan relatively simple.

a. The estate will have up to 15 months to make the QTIP election, during which time the surviving spouse can benefit from the gifted assets without losing the opportunity to decline to make the QTIP election.

b. Making or declining to make the QTIP election will not have an economic impact on the surviving spouse, and the decision can be put into the hands of an independent third party personal representative who can make the election without emotion or histrionics.

c. The trust can provide asset protection for the surviving spouse, and can guarantee the remaining assets will ultimately pass to or for the benefit of those intended by the settlor. Principal assets held in the QTIP Trust are protected from creditors (but mandatory income distributions could be at risk).

d. QTIP Trust assets are included in the surviving spouse's estate and receive a basis adjustment at the surviving spouse's death potentially saving income taxation on capital gains. However, the estate tax, if any, is only paid at the time of the survivor's death, at a time when the assets can be sold without incurring capital gains taxes.

e. The decedent's personal representative may also make a reverse QTIP election to take full advantage of a decedent's unused GST exemption. The reverse QTIP election allows the decedent to be treated as the "transferor" for GST tax purposes of a portion of the trust property. The surviving spouse is deemed the "transferor" for the non-reverse QTIP portion of the trust property.

2. The single lung trust would have to qualify for the QTIP marital deduction as of the decedent's death. The elements to satisfy the marital deduction are set out below.

   a. The net income must be paid to, or used for the benefit of, the surviving spouse at least annually, even if the surviving spouse becomes disabled or incompetent and even if the surviving spouse remarries.

   b. The trust may (but isn't required to) authorize principal distributions for the surviving spouse, and if authorized, can provide that this authorization ceases on divorce.

   c. No one other than the surviving spouse can benefit from the trust during the surviving spouse's lifetime.

d. The surviving spouse must have the power to require that the trust produce a reasonable income.

3. QTIP Trusts allow for flexibility in estate planning since the trust does not qualify for the marital deduction until the executor so elects some 15 months after the decedent's death, instead of well before the decedent's death in the initial planning process. The executor has the ability to make the election for all, none, or a part of the trust.

4. If the couple desires to provide principally for each other until both have died and have no separate families, the single lung QTIPable Trust provides the greatest flexibility and simplicity. Determining whether a marital deduction is desirable and the amount of any such deduction that may be desirable is determined post death without changing the economic benefits to the surviving spouse.

5. While a QTIP Trust is a useful tool in second marriages as well, the single trust with the same provisions for the surviving spouse regardless of whether or not the QTIP election is actually made, may not be appropriate in a second marriage situation.

   a. The client may want to provide for other family members but would not be able to do so with a single lung QTIPable Trust.

   b. The client may want to be able to provide for termination of the income interest of the surviving spouse in the event of remarriage.

   c. The client may be concerning about providing for mandatory distribution of the trust income to the surviving spouse annually and would prefer to authorize discretionary distributions of income and principal instead.

   d. The Clayton QTIP trust may be the answer.

G. "Clayton" QTIP

1. A "Clayton QTIP" allows for greater flexibility in a trust since any part of the marital gift for which a QTIP election is not made to qualify the trust for the QTIP marital deduction will pass to another trust or to other beneficiaries without jeopardizing the entire marital deduction.

2. The decedent's personal representative may determine whether all or a portion of the decedent's assets should qualify for the marital deduction and remain a part of the QTIP trust. If the decedent's personal representative does not make the QTIP election for any portion of this QTIP trust, the assets not subject to the QTIP election will then pass to a credit shelter trust.

3. Technique originated with the case Estate of Clayton v. Comm., 976 F2d 1486 (CA-5 1992). This case confirmed that the provision that would divert assets from a QTIP trust to a trust with different provisions if the personal representative failed to make the QTIP election did not invalidate the marital deduction for QTIP trust. The pertinent provision was as follows: "In the event my executors fail or refuse to make the election under Section 2056(b)(7)(B)(II)(v) of the Internal Revenue Code of 1954, as amended [QTIP election], with respect to my Trust "B" property on the return of tax imposed by Section 2001 of the Internal Revenue Code of 1954, as amended, then the property with respect to which such election was not made shall pass to and become a part of the corpus of Trust "A" [Credit Shelter Trust] for the benefit of my Trust "A" beneficiaries."

4. While originally hostile to this concept, ultimately, Reg. § 20.2056(b)-7(d)(3) was reissued to provide that an income interest which is contingent on the election of the executor will not fail to be a qualifying income interest for purposes of the marital deduction.

5. Consider if the surviving spouse should be named to serve as the personal representative who would be charged with making the QTIP election, or if an independent personal representative should be appointed.

   a. There is concern that a surviving spouse-personal representative who fails to make the QTIP election can be said to have "gifted" the forgone mandatory income interest in the QTIP Trust that now passes to the credit shelter trust.

   b. Until authoritative guidance is released, the more cautious drafting approach would be to designate an independent personal representative, or, at the very least, if the surviving spouse is to serve as personal representative, designate to an independent personal representative the power to make the QTIP election.

   c. The concern about the potential for gift treatment stems from Treas. Reg. § 25.2514-1(b) "[w]hen a person has the right to income for life and the ability to transfer that right to anyone or to retain it as long as she lives, transfer of that property without consideration gives rise to a taxable gift."

6. The Clayton QTIP election also permits the personal representative to give consideration to the possible use of the IRC section 2013 tax on prior tTransfers credit ("TPT") if the surviving spouse dies within fifteen (15) months from the decedent's date or death, or has a short life expectancy. The purpose of the TPT credit is to prevent property from being diminished by estate taxes imposed on the property in successive estates within a relatively short period of time.

a. Overall estate tax savings can result if no or only a partial QTIP election is made and the estate pays some estate tax since a portion of the estate tax paid will be allowed as a credit against the estate tax otherwise payable on the death of the surviving spouse.

b. The full amount of the TPT credit is allowed if the surviving spouse dies within two (2) years of the decedent. Thereafter the amount of the credit diminishes by twenty (20%) percent every two (2) years. At the end of ten (10) years no credit is allowable.

7. If a Clayton QTIP is to be used, the trust instrument should provide sufficient guidance as to what the settlor intends to be taken into consideration in deciding whether and to what extent the QTIP election should be made.

a. Does the settlor prefer setting up the alternative trust into which the QTIPable trust would flow if there is no need for a marital deduction?

b. Does the settlor instead intend that the marital deduction be obtained in most events. In other words, what are the settlor's preferences in making this important decision.

H. Estate Tax Planning v. Income Tax Planning - Basis Adjustment at Death.

1. Assets gifted during life soak up applicable exclusion and are not includible in gross estate at death so that any growth in the asset after the gift is out of the donor's estate. However these gifted assets take the donor's basis for purposes of determining capital gain (IRC § 1015(a)), with some adjustment for any gift tax paid as a result of the gift (IRC § 1015 (d)).

2. Property includible in the decedent's estate and acquired from the decedent will have a basis equal to the fair market value of the property as of the decedent's date of death. IRC § 1014(a) & (b).

3. Conversely, if property is not includible in a decedent's gross estate, such as property in a credit shelter trust, the basis of the property is not adjusted as a result of the decedent's death and remains either the cost of the property when acquired by the trust, or the fair market value of the property when the initial settlor died who created the trust.

4. As provided in IRC § 1014 (b)(9)&(10) respectively, property that is includible in a decedent's estate and acquired from the decedent through the exercise or nonexercise of a power of appointment, or under IRC § 2044 (QTIP Trust property) will receive a basis adjustment at the death of the decedent equal to its fair market value at the time of such death.

5. As a result of this basis adjustment regime, estate planning to use applicable exclusion to save estate tax will result in subjecting the subsequent growth in the value of the property to capital gains tax

    a. Assets in credit shelter trusts receive step-up in basis on the decedent's death, but not the surviving spouse's death.

    b. Assets includable in the surviving spouse's estate receive a full step-up in basis.

6. Consider when and how to use the estate and gift tax applicable exclusion to maximize basis step-up, by giving away high basis assets, and using grantor trusts that would enable the settlor to buy back the transferred assets prior to death without the recognition of any gains.

7. Identify the assets that will benefit the most from a step-up in basis and ensure those assets are organized in an efficient way in the overall estate plan, in the hands of the settlor prior to death.

8. What is the most surprising in the 2017 Tax Act is that the estate tax was eliminated for all but a minute portion of the population – about the most wealthy .02% of the population), but continued to permit basis step up at death when no estate tax is incurred or paid. Congress knows how to change this to carryover basis as that was the law in 2010 when there was no estate tax. With the ever increasing debt and deficit, even if the applicable exclusion remains the same, carryover basis may return.

9. In all of this planning, it is important to consider the estate tax rate (currently 40%) vs. the capital gains tax rate (currently a zero tax rate if the taxpayer is in the 10% or 15% income tax bracket, 15% if the taxpayer is in the middle brackets and 20% if the taxpayer is in the highest bracket).

    a. In no event does it make any sense to incur estate taxes in order to obtain a basis step up.

    b. It may make no sense to be concerned about a basis step up if the recipient of property from a decedent would be in one of the lower brackets.

    c. And the uncertainty about the estate tax and basis adjustment at death may ultimately make this planning much ado about nothing.

10. It is also important to remember that the market does not always go up. Since 1998, we have lived through 3 market downturns, with the most recent being the longest and deepest market drop. Basis adjustment at death does not always mean a basis step up. Recall that basis adjustment means that the property has a basis equal to its fair market value on the date of the decedent's death. If the asset is trading at a loss, the asset will receive a "basis step down" not a basis step up.

11. In planning for basis adjustment at death, make sure that estate tax "inclusion" does not result in any actual estate tax liability. Include flexible options to cause (or not cause) assets to be included in the gross estate of a trust beneficiary. One way to cause estate tax inclusion with flexibility is with a general power of appointment.

I. General Powers of Appointment (GPOA)

1. The trust instrument could give an independent party the power to grant a general power of appointment to the beneficiary of the trust.

    a. Trustees hold fiduciary duties to all beneficiaries, including the remainder beneficiaries, and may be reluctant to grant a general power of appointment to a particular beneficiary.

    b. The Trustee could be given the power to appoint a Trust Protector who would act in a non-fiduciary capacity and have the power to grant a general power of appointment to the trust beneficiary.

    c. A powerholder, such as a Trust Protector acting in a non-fiduciary capacity, could be appointed in the trust instrument and given the power to grant a general power of appointment to the trust beneficiary.

2. A formula general power of appointment provision could be included in the trust to achieve inclusion in the beneficiary's estate and obtain a basis step-up upon the beneficiary's death.

    a. The formula power of appointment can be given over a fractional share of the trust assets, or even specify which assets would be subject to the general power of appointment.

3. Consider nontax reasons that would make including a general power of appointment in a trust inadvisable (for example, if the donor is uncomfortable with the powerholder having the ability to appoint to people the donor may not like).

4. The general power of appointment should be narrowly drawn, and could be as narrow as providing for the power to appoint to the creditors of the beneficiary's estate. It could also be exercisable only with the consent of a non-adverse person.

J. GPOA Concerns

1. The traditional rule is that the mere granting of a power of appointment (either by a third party or by an estate planning instrument) does not by

itself allow creditors to access appointable assets. However, Federal and state laws continue to evolve; some states have adopted statutes that allow creditors to reach unappointed assets subject to a general power of appointment if the powerholder's estate cannot satisfy the creditor's claims. Creditors may also be able to access assets subject to a power of appointment to the extent such power is presently exercisable.

2. In some states, assets subject to a general power of appointment may be subject to the elective share rights of a beneficiary's surviving spouse.

3. If the general power of appointment is limited to only creditors of the estate, some commentators worry the general power of appointment may fail to cause estate tax inclusion if there are no such creditors of the beneficiary.

4. In the event a similar power is granted in other trusts for the same beneficiary, there is uncertainty as to how a formula provision may be implemented, and there is a risk that estate tax may inadvertently be triggered by causing too many assets to be includible in the beneficiary's estate.

K. GPOA Drafting Considerations

1. A decision needs to be made in drafting the estate planning documents whether to hardwire the general power of appointment or to appoint a powerholder with the authority to grant a general power of appointment in the future. There are some concerns with each approach.

2. Hardwiring the general power of appointment into the trust ensures its existence, but concerns arise over whether or not that general power of appointment will be appropriate down the road.

   a. A beneficiary's actions may not yet be predictable, federal and state tax laws may change regarding the amount of the applicable exclusions or regarding the availability of a basis adjustment at death, and the class of potential appointees may need to be narrowed or broadened based on future circumstances.

   b. To alleviate these concerns, if the general power of appointment is hardwired, a provision should be included giving a non-adverse party the power to amend a hardwired general power of appointment. The non-adverse party should also have the ability to remove a general power of appointment from the trust instrument.

3. Instead of hardwiring the general power of appointment, the trust could be drafted with a provision appointing a powerholder with the authority to grant a general power of appointment in the future. This would provide

greater assurance that any power of appointment granted to the beneficiary in the future will be specifically tailored for the then known circumstances.

a. However, there is some concern that the power will never actually be granted, because the powerholder will not be aware of the need to grant the power of appointment, or the powerholder may be concerned about potential liability in granting the power of appointment.

b. If a trustee is given the authority to grant the general power of appointment, consider adding a broad exculpatory clause to incentivize the fiduciary to grant the power when appropriate.

   i. There will likely be a limitation under state law as to the exculpation available to provide to a trustee.

   ii. The limitation on exculpation may warrant giving the authority to grant a general power of appointment to a third party powerholder who would act in a non-fiduciary capacity, as then full exculpation is available.

c. If a third party powerholder, a Trust Protector, acting in a non-fiduciary capacity, is appointed with the authority to grant a general power of appointment, there is concern that the third party powerholder won't know when such a power should be granted.

   i. The Trust Protector will not want to monitor the performance of the trust or follow whether and to what extent a general power of appointment should be granted to the beneficiary or having been granted should be eliminated.

   ii. This concern could be addressed by including triggering events to ensure that the power is granted in certain situations. For example, the Trust Protector would act to consider whether or not to grant the general power of appointment only upon first being requested to do so either from the Trustee or from the beneficiary or his/her legal representative.