Basis-Boosting: Tips and Tricks for Maximizing Basis Using Powers of Appointment, Trusts and Partnerships

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Introduction

With the advent of the $10 million plus inflation and estate tax exclusion and the increase to $15 million 2026, estate tax avoidance is not as significant of an issue for most taxpayers as it has been in the past. Additionally, the increased exemption amount provides considerable opportunities for taxpayers to intentionally cause inclusion in a taxpayer's estate for federal estate tax purposes to trigger a step-up in basis upon death. A "step-up in income tax basis" refers to the basis adjustment that occurs under Internal Revenue Code (IRC) Section 1014 with respect to certain property acquired from or passing from a decedent, which receives an income tax basis equal to the fair market value on the decedent's death, generally. This step-up in basis is widely known and is considered one of the greatest tax benefits widely applicable to taxpayers, including less wealthy taxpayers.

As a simple example, if a decedent acquires stock for $10 per share in 1970, dies in 2025 when such stock is worth $350 per share, then the income tax basis in such stock generally would increase to $350 per share following the decedent's death. This creates a significant tax benefit for the heirs of the decedent in that they can sell the stock for $350 per share after the decedent's death and not be subject to capital gains taxes.

Creative planners have developed techniques to help take advantage of this benefit whereby taxpayers can transfer assets in a manner that is intentionally included in estates of others for federal estate tax purposes for the purpose of getting a step-up in income tax basis on the death of such other individual. This concept is limited by IRC Sec. 1014(e), which states that gifts of assets to a an individual who (i) dies within one year of the gift, and (ii) leaves such property back to the original donor, will not receive a step up in income tax basis. For example, if an individual gives an elderly grandparent appreciated assets on January 1, 2025, and the grandparent dies on August 28, 2025, and leaves such property back to the individual upon the grandparent's death, then the property will not receive a step up in income tax basis.

Nevertheless, there are a number of techniques that can be beneficial to many taxpayers and that do not run afoul of the limitations imposed by IRC Sec. 1014(e). Many of these techniques involve utilizing testamentary powers of appointment to intentionally cause estate tax inclusion in the hands of the powerholder. A general power of appointment (GPOA) is a power to direct property to any one or more of the following four recipients: (1) powerholder, (2) powerholder's estate, (3) powerholder's creditors, and (4) creditors of powerholder's estate. Under IRC Sec. 2041, the possession of a GPOA causes the assets subject to the power to be included in the powerholder's estate for federal estate tax purposes. The purpose of this Code section initially was to cause estate tax inclusion where a powerholder held such broad powers to direct the distribution of property, and was not as beneficial to taxpayers when the estate tax exclusion amount was significantly lower (or when estate tax avoidance is a chief objective). However, in the day and age of a $10 million plus inflation-adjusted estate tax exclusion, bestowing a GPOA to individuals over appreciated property can cause a step up in income tax basis due to the inclusion that applies with respect to GPOA. In essence, estate planners have "turned on its head" this once seemingly anti-taxpayer provision to make it a widely available pro-taxpayer technique. In this paper, we will explore usage of GPOA concepts to help increase income tax basis, and also discuss techniques that might be beneficial in certain situations.

Power of Appointments Generally

A Power of Appointment ("POA") refers to the legal authority granted to an individual to designate who will receive ownership interests in certain property. Powers of Appointment are generally categorized as either general or limited, and either inter vivos or testamentary, and can be designed in a variety of ways, making them a flexible and effective estate-planning tool for estate tax minimization and asset protection.

When working with Powers of Appointment, the following terms may appear often:

Glossary

Term	Definition
Appointees	Individuals who actually receive the property when the POA is exercised. Permissible appointees are those eligible to receive the property under the POA.
Appointive Property (or "property subject to the POA")	The property or property interest that is subject to the POA.
Donee of the Power (or "Powerholder")	The person who holds the POA and has the authority to exercise it.
Donor	The individual who creates or grants the POA.
General Power of Appointment (GPOA)	A POA that includes the power to exercise it in favor of one or more of (1) the powerholder, (2) the powerholder's creditors, (3) the powerholder's estate, or (4) the creditors of the powerholder's estate.
Governing Document (or "Governing Instrument")	The legal instrument (e.g., a will or trust) that establishes the POA.
Limited Power of Appointment (LPOA)	A POA that is not a general power of appointment.
Non-Fiduciary Capacity	A status in which the powerholder can exercise the POA under his/her personal discretion, rather than pursuant to a fiduciary duty.
Permissible Appointees	Individuals or entities in whose favor the POA may be exercised. They may or may not ultimately receive the property but simply are the class of potential recipients of the Appointive Property of the POA is exercised.
Relation Back Doctrine	A legal principle under which the exercise of a POA is treated as if the donor had made the transfer directly. This has the effect of potentially causing the Powerholder not to be considered the transferor of the applicable property for federal gift and estate tax purposes.

Takers in Default	Individuals or entities who will receive the property if the powerholder does not exercise the POA.
Testamentary POA	A POA that may only be exercised upon the death of the powerholder, typically through a will.
Trust	A legal entity or arrangement that typically holds the appointive property and grants the POA to the powerholder.

Elements of POA and Flexibility

A POA generally requires three key elements: (1) the intent of the donor to create the power, (2) identifiable property subject to the power, and (3) identifiable individuals/entities or classes of permissible appointees. POAs are highly valued in estate planning due to their inherent flexibility, particularly in how they can be structured and executed.

The governing instrument typically outlines how the POA must be exercised (such as whether it must be done by will) and whether a specific reference to the instrument creating the POA is necessary for a valid exercise. A POA may be drafted as exclusive, allowing the powerholder to exclude certain permissible appointees from receiving any portion of the property, or non-exclusive. Additionally, a POA can be imperative, obligating the powerholder to exercise it and choose among permissible appointees and make a distribution, or non-imperative, which allows the powerholder to decline exercising the power. If a non-imperative power is not exercised, the property typically passes to default takers, or, in their absence, to the residue of the trust.

The POA may also include provisions regarding the timing and conditions of its use. It might be exercisable immediately, at a future date, or upon the occurrence of a specific event (such as the death of the powerholder, and it may also be subject to conditions precedent to ensure valid execution.

A strategic use of a POA is its ability to effectively “rewrite” an irrevocable trust. A powerholder may exercise the POA to transfer trust assets into a new trust with more favorable terms, such as relocating the trust to a state with preferable tax laws. A POA can also allow for revised distributions to beneficiaries in response to changing circumstances like a beneficiary’s health, marital, or financial status, or a shift in family dynamics. For instance, if a beneficiary becomes estranged or poses a legal or financial risk, the powerholder can adjust distributions accordingly.

This kind of restructuring is often viewed more favorably than decanting by institutional trustees, as it may help reduce liability and avoid the need for unanimous beneficiary consent. A POA exercised by a single powerholder provides a more streamlined mechanism for modifying trust terms.

Finally, POAs can be instrumental in extending the life of a trust through the use of a POA in further trust. This approach essentially allows the trust to "restart," resetting the perpetuities period and maintaining compliance with the rule against perpetuities.

Types of POAs

One of the most important distinctions in the classification of POAs is whether the power is general or limited. The distinction between general powers of appointment (GPOAs) and limited powers of appointment (LPOAs) is significant for both tax and creditor protection purposes. A GPOA grants the powerholder broader authority to direct the distribution of property, including the ability to appoint it to one or more of themselves, their estate, their creditors, or the creditors of their estate. The inclusion of even one of these categories as a permissible appointee is sufficient to characterize the power as general. Because a GPOA is considered equivalent to ownership for estate tax purposes, the assets subject to the power are included in the powerholder's gross estate upon their death and also may be subject to claims by the powerholder's creditors.

In contrast, an LPOA expressly excludes the powerholder, their estate, their creditors, and the creditors of their estate as potential appointees. While an LPOA may be drafted broadly to permit distributions to virtually anyone else, it can also be narrowly tailored to a specific individual or class of individuals or entities. Assets subject to an LPOA are not included in the powerholder's estate for estate tax purposes, making LPOAs a valuable tool in both tax and asset protection planning.

There are exceptions to the general rule of classification. The following are examples of circumstances where a POA will not be considered a GPOA:

- If the POA is limited by an ascertainable standard, most commonly health, education, maintenance, and support (HEMS), then it is not deemed a GPOA. [1]
- If the consent of the donor is needed for the power to be exercised, then it is not considered a GPOA.[2]
- If the consent of an adverse party is needed for the power to be exercised (such as someone whose economic interest would incentivize them to withhold consent, like a taker in default), then the power would not be considered a GPOA. [3]

As highlighted above, there are several ways to structure a POA to be considered as an LPOA for estate tax purposes. In some cases, however, a POA may unintentionally be treated as a GPOA if the drafting does not carefully account for applicable state laws**.** Given the risks associated with GPOAs, including creditor exposure and estate tax inclusion, it is essential that the power be clearly and intentionally drafted in accordance with both the donor's intent and relevant legal requirements.[4]

It could also be helpful to specify the type of POA by explicitly stating that it will be a "general power of appointment" or "limited power of appointment" to eliminate any ambiguity.

[1] IRC Sec. 2041(b)(1)(A)
[2] IRC Sec. 2041(b)(1)(C)(i)
[3] IRC Sec. 2041(b)(1)(C)(ii)

To eliminate ambiguity, it is also advisable to explicitly label the POA as either a **"**general power of appointment**"** or a **"**limited power of appointment**"** within the trust or governing instrument. This small step can help ensure the power is classified correctly for legal and tax purposes.

(Non-)Fiduciary Capacity

An important consideration is whether the powerholder should serve as a fiduciary while they hold a POA. When a power of appointment (POA) is held by a fiduciary, such as a trustee, that individual assumes duties of good faith, loyalty, care, confidentiality, and more. However, fiduciary roles carry inherent risks because it can be challenging to uphold these duties equally among all beneficiaries. In some situations, it may be necessary to treat one beneficiary differently from the others. When assets are not divided equally upon distribution, one or more beneficiaries will receive benefits that others do not, which can complicate the fiduciary's obligations. The governing document creating the power of appointment therefore should expressly state that the POA is exercisable in a non-fiduciary capacity to avoid any doubt as to the powerholder's status and role in evaluating the exercise of the POA.

How a GPOA Can Be Used To Achieve a Step-Up in Basis

A major benefit of using GPOAs is the ability to achieve a step-up in basis for appreciated assets. Even if the powerholder never actually exercises the GPOA, the mere fact that it exists and is exercisable by the powerholder can result in the assets being included in the powerholder's estate, which allows for a step-up in basis at death.

As stated above, upon a person's death, appreciated assets held by such person receive a basis equal to their fair market value at the time of death. This results in a step-up in basis where the cost basis of the asset is increased to match its value when the decedent died. This change is particularly valuable because it minimizes the capital gains tax when the asset is later sold by the beneficiary. Instead of being taxed on the full appreciation, the beneficiary is taxed only on the part of appreciation after the date of death.

If a person dies holding a GPOA over certain assets, those assets are included in their estate for tax purposes. As a result, any appreciation in value during the period the powerholder held the power is recognized through a step-up in basis at their death, assuming the assets appreciated in that time frame.

For example, John owns a house worth $1,000,000, which he transfers into a trust. His grandmother, Sarah, is granted a GPOA over the trust property. Over time, the house appreciates and is worth $5,000,000 by the time of Sarah's death. Two years later, the house is sold for $7,000,000. Because Sarah held a GPOA at the time of her death, the house is included in her estate, and the tax basis is stepped up to $5,000,000. When the house is eventually sold for $7,000,000, the beneficiary is taxed only on the $2,000,000 of appreciation after Sarah's death, rather than on the full $6,000,000 of appreciation from the original $1,000,000 basis. This is a significant capital gains tax savings.

A powerholder can be granted a GPOA directly, or, more commonly, can be bestowed a GPOA under a trust agreement. Utilizing a trust agreement which contains a GPOA can create significant flexibility and income tax planning benefits, as described below.

Upstream Planning with POAs

Upstream planning involves transferring assets directly to family members (or other close individuals), or granting a GPOA over appreciated assets to such family members with shorter life expectancies. When these individuals pass away, their ownership of the assets, and GPOA over appreciated assets, triggers a step-up in basis, therefore reducing potential capital gains taxes. This strategy effectively utilizes the senior family member's unused estate tax exemption to minimize future income tax liabilities.

However, it is critical to exercise caution when selecting a recipient of a GPOA and when drafting to create a GPOA. A GPOA allows the holder broad discretion to distribute the appointive property, which could open up the possibility of misuse of such property or to potential creditor claims. While this can provide significant tax benefits, it also entails a substantial loss of control and the risk that the powerholder may act contrary to the donor's wishes.

To mitigate these risks, planners can incorporate safeguards into the estate plan. These may include:

- Requiring the consent of an independent third party before the GPOA can be exercised. If the "consent party" is not a beneficiary or fiduciary under trust granting the POA, then the consent requirement should not cause the GPOA to be treated as an LPOA.
- Withholding knowledge of the GPOA from the powerholder. There is supporting case law for this approach, where a decedent was considered to have a POA even though they had no knowledge of the power [5], but it carries inherent risks and the IRS may not necessarily agree with a POA being "real" if the powerholder does not have actual or constructive knowledge of the power.
- A safer approach is to document providing the powerholder with notice of the existence of the power, thereby helping prevent the GPOA from being deemed "naked" or illusory.

Additional protective mechanisms like as formula clauses, disclaimers, or limited powers can also offer flexibility in response to future changes in estate tax laws or the senior powerholder's financial circumstances. A formula GPOA is one example. It can grant a trust beneficiary a testamentary GPOA over a "defined portion" of trust assets in favor of their estate. This defined portion is typically structured to be the largest amount that can be included in the beneficiary's estate without increasing the total inheritance, estate, death, or GST taxes payable compared to what would be owed absent the GPOA. This approach was recently accepted by the IRS in Private Letter Ruling 202206008. For instance, the formula may cap the GPOA to the lesser of the senior member's remaining federal estate tax exemption, GST exemption, or state estate tax exemption, thus avoiding triggering transfer taxes.

It is important to note that a GPOA may be exercised at any time, unless it is appropriately drafted to apply only at certain times (such as at the powerholder's death). Accordingly, estate planners should carefully consider the health, life expectancy, and personal circumstances of the powerholder. Additionally, it is crucial to evaluate whether the trust assets are expected to appreciate or depreciate over time, as each situation may call for a different planning strategy. It is important to ensure that the powerholder does not have known creditor issues, or a potential divorce, as these could expose the transferred assets to third parties the donor did not intend to benefit.

[5] Estate of Freeman v. Commissioner, 67 T.C. 202 (1976)

Finally, obtaining a favorable and well-documented appraisal at the powerholder's death is vital. This ensures that the stepped-up basis is clearly recorded, simplifying future asset sales by making the adjusted basis readily available.

Creditor Protection Concerns Involving the Powerholder

As mentioned previously, a GPOA can expose the trust property to the powerholder's creditors, including divorced spouses, judgment creditors, or other claimants. One approach to enhance protection against creditor claims is to ensure that the situs and governing law of the trust are in a state that does not permit creditor access to property subject to an unexercised GPOA. State laws vary significantly in this area. For example, in some jurisdictions, creditors can only reach the property if the GPOA is exercised, while in others, the assets may be protected altogether, even if a GPOA exists. Additionally, query whether including a consent requirement in order for a POA to be exercised would prevent the power holder's creditors from accessing the appointive property.

Estate Tax Considerations in Upstream Planning

A significant consideration to make regarding upstream planning is the potential estate tax burden of the powerholder. While upstream planning with GPOAs is highly effective for reducing capital gains taxes by getting a step-up basis, it can result in unintended consequences on the estate tax side of planning.

To illustrate this, we can go back to our earlier example with John and his grandmother, Sarah. In that scenario, assume that the value of Sarah's estate (i.e., her assets other than the property subject to the GPOA that she had at death) was only worth $750,000 ($1,750,000 with the house included from the GPOA). Sarah's estate for federal estate tax purposes is well below the $13,990,000 exclusion amount in 2025. The inclusion of John's house in Sarah's estate, therefore, did not create any federal estate tax liability. However, if Sarah's other assets were worth $13,500,000, then, the inclusion of John's $1,000,000 home would have pushed her estate above the exemption limit. As a result, the excess amount would be subject to federal estate tax at a 40% tax rate. In this case, the use of the GPOA would have generated an avoidable estate tax liability, potentially eroding the overall benefits of the upstream planning strategy. A well drafted formula GPOA clause can avoid an estate tax trap, but at the expense of not having a step-up in basis upon Sarah's death. Thus, Sarah does not seem to be an ideal candidate for this type of upstream planning.

This example highlights the importance of evaluating not just the capital gains implications of upstream planning, but also the estate tax exposure of the person receiving the power of appointment. If that individual's estate is near or exceeds the applicable exclusion amount, adding additional assets (even temporarily) can trigger substantial tax consequences.

Therefore, before implementing an upstream plan, drafters must carefully assess the powerholder's total estate value, projected appreciation of assets, and potential changes to federal or state estate tax laws. This is an important part of selecting the powerholder. In some cases, it may be practical to limit the scope of the GPOA or incorporate formula clauses that cap the value of property subject to the power at a level that will not cause an estate tax liability.

Installment Sale to a Grantor Trust - But for Income Tax Purposes.

A common estate planning technique is for a taxpayer to transfer assets to an irrevocable grantor trust that is outside of the taxpayer's estate for federal estate tax purposes. A grantor trust (sometimes referred to as an "intentionally defective grantor trust" or "IDGT") is an irrevocable trust that is considered as owned by the taxpayer for income tax purposes. The dichotomy is that the trust assets are considered to be outside of the estate of the taxpayer for estate tax purposes, meaning that the assets under the trust should not generally be subject to estate tax on the taxpayer's death, while the taxpayer is considered as owning the assets of the trust for income tax purposes. The taxpayer therefore is responsible for paying all income tax associated with the activities of the trust and can enter into transactions with the grantor trust without causing any income tax consequences. Revenue Ruling 85-13 discusses this benefit in great detail and espoused the concept that a taxpayer can transfer appreciated assets to an irrevocable grantor trust, and no income tax consequences would result because it is considered as if the taxpayer transferred the assets to himself.

This can beneficial from an estate tax planning perspective because the taxpayer can transfer appreciating assets to the trust in exchange for a promissory note that is based upon a fixed level of interest. In theory, the assets transferred to the irrevocable trust may grow at a rate higher than the interest rate, therefore freezing the value of the transferred assets and allowing for the appreciation of such assets to the outside of the estate of the taxpayer. Exploring the nuances of such transactions is outside of the scope of this paper, but it remains a key cornerstone to the discussion of using POAs to create basis increases on death.

To achieve the contemplated estate tax planning purposes, the taxpayer cannot have certain powers over the trust and generally cannot be a beneficiary. However, a taxpayer can establish a trust to provide that an elderly family member or friend can be a beneficiary of the trust and the trust can provide that such elderly individual have a testamentary GPOA over the assets of the trust. A testamentary GPOA can be exercisable only with the consent of one or more independent parties which can prevent misuse of the power and further can prevent the assets from potentially being subject to the creditors of the powerholder upon death. What's more, the powerholder need not be aware of the power, although some commenters believe this lack of awareness causes the power to be considered as illusory by the IRS. The authors are not aware of any case or authority that has successfully argued this position but it remains a risk to be considered. The powerholder need not exercise the power in order to cause a step-up in basis upon the death of the powerholder, and it generally preferable for the GPOA not to be exercised in order to preserve the income tax status of the trust as a grantor trust.

Therefore, it would seem that including an elderly individual as a discretionary beneficiary of an irrevocable grantor trust, and giving such individual a testamentary power of appointment over the appreciated assets in the trust would be appropriate to not only achieve the estate tax benefits of an installment sale to an irrevocable grantor trust but also to obtain an increase in income tax basis of the assets being sold in the trust.

An installment sale to a grantor trust can be beneficial even when there is no estate tax avoidance objective. For example, the grantor trust can provide for the assets in the trust to pass back to the transferor or the transferor's family (whether in trust or otherwise) following the death of the elderly individual. The trust can provide that it is held exclusively for the transferor's spouse and children and the

elderly individual, and that the elderly individual will have a testamentary general power of appointment over the appreciated assets in the trust. The trust can provide that the trust assets would be distributed to the transferor or held in trust for the benefit of the transferor after the powerholder's death. If the powerholder does not exercise the POA (which is likely to occur), the trust is likely to be considered as a grantor trust not withstanding that the assets in the trust were included in the powerholder estate for federal estate tax purposes. [6] Conversely, if the powerholder exercising the power of appointment, the such individual will be considered as the transferor to the trust therefore eliminating grantor trust status as to the trust and causing the installment sale transaction to be a taxable transaction thereby frustrating the intent. It is therefore important to help assure that the powerholder does not exercise the power, and consideration should be given as to whether to include a the requirement where the powerholder must get the consent of one or more independent parties before exercising the power.

Because the transfer of assets to the trust was made in exchange for fair market value through the trust providing a note to the transferor IRC Sec. 1014(e) does not apply. IRC Sec. 1014(e) expressly applies only to transfers made "by gift." Therefore, if the installment sale transaction is structured as a bona fide sales transaction that purports with realities of sale, section 1014 (e) does not apply.[7] It is important to observe important formalities with respect to transfers of assets and is also important to assure that interest payments are made and the terms of the note are followed.

Despite Sec. IRC 1014(e) precluding a step up in basis where transfers of assets are made by gift to a powerholder, IRC Sec. 1014(e) also does not apply if the recipient of the assets on the death of the powerholder is not the transferor. Therefore, the transferor can transfer, by gift, appreciated assets to an irrevocable trust which gives an elderly family member or friend a testamentary general POA over appreciated assets, and can provide for such assets to be held in trust for the transferor's spouse, children, or other desired beneficiaries. After the powerholder's death, such appreciated assets should receive the step up in income tax basis and will continue to be held for the benefit to the transferor's desired beneficiaries. Accordingly, planners should consider whether to include elderly family members and friends as discretionary beneficiaries and holders of GPOAs under SLATs and other irrevocable trust that they establish for estate tax or other purposes.

To take this to an extreme, query whether one can transfer assets to a trust and give a litany of elderly individuals (some of whom may be unrelated to the transferor) discretionary beneficial interests in the trust and testamentary POA, and achieve a step up in basis in a cascading manner as such elderly individuals die. The authors are not aware of any authority on this point, but it would seem such conduct would be viewed by the IRS as abusive and illusory. It is somewhat surprising that we have not seen

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[6] Morrow, Edwin P., The Optimal Basis Increase and Income Tax Efficiency Trust: Exploiting Opportunities to Maximize Basis, Lessen Income Taxes and Improve Asset Protection for Married Couples after ATRA (Or: Why You'll Learn to Love the Delaware Tax Trap) (January 1, 2016). Available at SSRN: https://ssrn.com/abstract=2436964 or http://dx.doi.org/10.2139/ssrn.2436964

[7] For an excellent discussion of installments sales to grantor trusts, see: Michael D. Mulligan, A "Reality of Sale" Analysis of Installment Sales to Grantor Trusts: Properly Structured, the Best Transfer Tax Strategy, Annual Notre Dame Tax & Estate Planning Institute, Lewis Rice LLC (2015), available at https://www.lewisrice.com/content/uploads/2015/08/MulliganNotreDameSeminar1.pdf

agencies marketing the availability of less wealthy elderly individuals to be potential discretionary beneficiaries and testamentary general powerholders of an irrevocable trust.

In Appendix D, the authors have enclosed language that can be used to provide for a fractional testamentary POA in the hands of the beneficiary under a trust, and also are including language which provides for an independent fiduciary to be authorized to bestow a GPOA on a trust beneficiary in order to help achieve a step up in income tax basis upon death in Appendix E.

The Delaware Tax Trap

The Delaware Tax Trap is another way to achieve a step up in basis that relies on the use of a LPOA rather than a GPOA. Historically, it was not viewed favorably (hence the name) but has since been seen as a valuable tool in the estate planning arsenal. As aforementioned, a POA can be used to essentially "reset" a trust and therefore the rule against perpetuities. The way this is typically done before was by using the LPOA to create another trust which extended the Rule Against Perpetuities period. The new trust was treated as if it had been made by the original donor where the power came from rather than the new trust created by exercising the POA, and is treated as if the powerholder held a GPOA. This is the legal doctrine of "relation back."

Delaware changed its laws to allow a LPOA powerholder to grant a second POA with the new trust and therefore, create a perpetual trust that did not violate the rule against perpetuities. The stacked LPOAs provided for a way to avoid estate taxes on the assets forever. The IRS responded with IRC 2041(a)(3) which included the assets in a powerholder's estate if they "stacked" LPOAs in the manner described and therefore, subject the assets to estate tax.

If the date for new vesting period is not the same date the power was created, the assets get included in the estate of the powerholder and like upstream planning, achieve a step up in basis. [8]

Gift Tax Considerations of POAs

When exercised, a GPOA constitutes a taxable gift in the eyes of the IRS, meaning that the powerholder is considered as having made a gift of the appointive property. [9]

A lapse of a POA is considered a release (and therefore a taxable gift) only if the assets subject to the lapsed power exceeds $5,000 or 5% of the trust property value, whichever is greater.

A Crummey power is a temporary right granted to a trust beneficiary, allowing them to withdraw a recent contribution made to an irrevocable trust. This right is typically available for a limited period, often 30 to 60 days. After that time has passed, those assets that could have been withdrawn become a part of the trust's assets. A Crummey withdrawal right allows a transfer to be treated as a gift of present interest.

[8] I.R.C. §2041(a)(3).
[9] I.R.C. §2514

This can help it qualify for the annual exclusion[10] and possible GST tax exclusion[11] as well. The lapse of a Crummey Power is considered a release, potentially a gift, but only if it exceeds the $5,000 or 5% threshold. If the withdrawal right is unilateral, it is considered a GPOA.

A powerholder can disclaim or renounce their interest in the POA if the instrument that created the power does not expressly forbid doing so. To be valid, the disclaimer must be unequivocal, be made within nine months and comply with local laws.[12] This is treated differently from a release, if done properly, and therefore avoids gift or estate tax inclusion.

A powerholder could partially release a GPOA to reduce its scope. If the power lapses by its terms rather than affirmative action, it is treated as a release and possibly a gift. Hanging powers are drafted so that lapses never exceed the $5,000/5% safe harbor, preventing a taxable gift as to transfers made to the trust which full with the safe harbor.

(1) GPOAs

- Exercising a GPOA is a gift by the powerholder.

- Releasing a GPOA is also a gift if above the $5,000/5% threshold.

(2) Limited Powers of Appointment (LPOAs)

-Generally not taxable upon exercise.

- However, if the exercise affects the powerholder's own interests, it may be a gift:

    - E.g., if a powerholder appoints property in a way that terminates their own income interest or other mandatory interest, they may have made a gift equal to the value of that interest.

When a LPOA is exercised, the transfer generally is treated as made by the original donor, not the powerholder. This shields the powerholder from gift tax unless state law allows creditors to reach the property, which could negate the doctrine.

[10] I.R.C. §2503(b)
[11] I.R.C. §2642(c)
[12] I.R.C. §2518

Action	Gift Tax Trigger?	Notes
Exercise of GPOA	Yes	Treated as a gift by powerholder
Release/Lapse of GPOA	Yes, if over 5 and 5	Consider partial release or disclaimer
Exercise of LPOA	Generally No	Unless it affects powerholder's own mandatory interest
Disclaimer of POA	No	Must be timely and meet legal requirements
Crummey Power Lapse	Yes, if over 5 and 5	Hanging powers can mitigate risk
Unilateral Crummey Power	Possibly	May be treated as GPOA

Joint Exempt Step-Up Trust/Community Property Trusts, and Other Joint Trust Structures

POAs can be used in revocable-type trust structures in order to help obtain a step up in income tax basis on the death of each spouse in a married couple. Conventionally (at least in Florida), married couples would each have their own separate revocable trusts that would function as a will substitute and contain the dispositive provisions of the couple's estate plan. With the advent of the increased exclusion, joint trusts have been on the rise in order to make use of the significant exclusion to generate a step up in basis not only on the first dying spouse's death but also on the surviving spouse's death.

One revocable trust structure for married couples is the "Joint Estate Step-Up Trust" (JEST). It is designed to provide two step-ups in basis: one upon the death of the first spouse, and a second upon the death of the surviving spouse. Unlike a tenancy by the entirety trust or a standard joint trust, the JEST is specifically structured to achieve a full step-up in basis at the first death, rather than only a partial (i.e., one-half) adjustment. The JEST provides for each spouse to have their own separate share under the trust document, meaning that each spouse is considered to have transferred assets to the trust and to have a separate share that is fully revocable during the lifetime of the applicable spouse.

Additionally, on the death of the first dying spouse, the JEST provides for the funding of one or more credit shelter trusts and/or one or more marital deduction trusts to help position the trust to allow for a step up in income tax basis on all assets held under the trust. This is accomplished by giving the first dying spouse a GPOA over all assets of the trust (including the share of the surviving spouse). Because of the uncertainty involving IRC Sec. 1014(e), the JEST provides that assets included in the first dying spouse's estate as a

result of the above-referenced GPOA will pass to a separate credit shelter trust (referenced in the JEST document as "Family Trust B") and/or a separate marital deduction trust (referenced in the JEST document as "QTIP Trust B") with the surviving spouse excluded as a beneficiary of both Family Trust B and QTIP Trust B. The surviving spouse not being a beneficiary of these trusts means that IRC Sec. 1014(e) is not implicated and a step up in basis would apply on the first death. Nevertheless, the JEST provides for both Family Trust B and QTIP Trust B to be available for the surviving spouse if and when the surviving spouse is added as a beneficiary of such trusts by a committee of independent trust protectors, and provides for such trusts to be moved to an asset protection jurisdiction to help assure that such assets will not be subject to the creditors of the surviving spouse if Family Trust B and QTIP Trust B are considered "self-settled" trusts.

Additionally, the JEST allows for the funding of credit shelter trusts upon the first spouse's death, up to the full value of the assets held in the joint trust. This is accomplished through the inclusion of a general power of appointment granted to the first spouse over the second spouse's share, subject to the condition that it may only be exercised with the approval of independent parties.

A detailed review of the JEST is beyond the scope of this paper, but the article attached as Appendix A, entitled *JEST Offers Serious Estate Planning Plus for Spouses*[13], provides a discussion of how the JEST works and is structured.

Another revocable trust-type structure that can be used to help position for a double step up in basis is a community property trust. One of the quirks of IRC Sec. 1014 is that assets owned as community property receive a full step up in basis on the death of the first dying spouse, regardless of the fact that only one half of the assets are technically "owned" by the first dying spouse at death. As a result, many non-community property states (such as Alaska, Florida and Tennessee, to name a few) have adopted an elective community property trust regime whereby taxpayers can transfer assets to a community property trust that meets the applicable statutory requirements and help secure community property treatment of such assets. The theory is that such assets will qualify as community property and therefore will receive a step up in basis on the first death and again on the second death based upon the quirk on the in IRC Sec. 1014(b)(6). That said, there is some concern that these elective community property trusts jurisdictions do not necessarily have the same features as a conventional community property jurisdiction, and that the IRS might challenge the double step up in basis.

Again, a deep dive into community property law and community property trusts is beyond the scope of this paper, but the article enclosed at Appendix C, entitled *Community Property Planning in Non-Community Property States & Understanding the Florida Community Property Trust Act - Opportunities, Developments, And Traps For The Unwary*[14] provides a more in-depth look at these types of vehicles and the concerns associated therewith.

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[13] Alan S. Gassman, Christopher J. Denicolo & Kacie Hohnadell, JEST Offers Serious Estate Planning Plus for Spouses—Parts I & II, 40 Estate Plan. 3 (Oct. 2013), 40 Estate Plan. 14 (Nov. 2013).

[14] Alan Gassman & Brock Exline, Community Property Planning in Non-Community Property States & Understanding the Florida Community Property Trust Act – Opportunities, Developments, and Traps for the Unwary, 2 Stetson Bus. L. Rev. (2024), https://www.stetson.edu/law/business-law-review/media/Gassman.HC.sheridan.final.updated.2%20Linked%20in%20post%20with%20logo.pdf.

Partnerships as an Income Tax Planning Tool

With careful planning, partnership tax law may allow for basis in one partnership asset to be shifted to another partnership asset before sale in order to defer or avoid capital gains taxes, depreciation recapture and other types of income that are normally realized on sale or disposition of an asset.

Readers who are not familiar with this concept, or who have not understood its basic application, can benefit from reading the following example, which is also illustrated by exhibits available from the authors.

Grandpa owns 45% of a partnership and has a $5,000 basis in his partnership interest, Son 1 owns 45% of the partnership with a $1,000,000 basis, and Son 2 owns 10% of the partnership with a $222,222 basis. The partnership owns a building that Grandpa put in after it was almost fully depreciated worth $1,000,000, bonds that Son 1 put in worth $1,000,000 with a $1,000,000 basis, and $222,222 of cash that Son 2 put in. The partnership has made what is called a 754 election to cause basis adjustments as below described, and the property has been in the partnership for at least 7 years.

Assume that the partnership has a contract to sell the building for $1,000,000 and first distributes the building to Son 1 in liquidation of his 45% of his ownership interest. When Son 1, with a $1,000,000 outside basis in the partnership, receives an asset in exchange for his partnership interest, Son 1's basis in the exchanged asset is equal to his 1,000,000 outside basis in the partnership. As a result, Son 1 receives a $1,000,000 basis in the building and can sell it and pay no capital gains tax.

As a result of the above basis shift, the bond portfolio basis of the partnership moves from 1,000,000 to $5,000, Grandpa owns 81.82% of the partnership, and Son 2 owns 18.18% of the partnership.

When Grandpa dies his partnership interest basis goes to fair market value and this also increases the partnership's basis in the bonds, if a proper 743 election is in place.

This has saved income taxes on $1,000,000 of depreciation recapture on the building, and $1,000,000 of capital gains tax on the bond portfolio.

It is important to note that unless the partnership is considered an investment partnership, as discussed in more detail below, IRC §731(c) treats marketable securities as cash when distributed from the partnership, triggering capital gains to the extent the distribution exceeds the partner's outside basis in the partnership. An investment partnership is a partnership that has never been engaged in a trade or business if 90% or more of the partnership's value consists of investment type assets (i.e. stocks, bonds, cash, foreign currencies, commodities, etc.). Therefore, assuming that the partnership in the above example is not an investment partnership, the distribution of bonds to a partner would trigger capital gains to the extent that the distribution exceeds the partner's basis. For example, if bonds worth $100,000 were distributed to Grandpa prior to his death, Grandpa would have a capital gain of $95,000 ($100,000 - $5,000).

What if instead of the above there is a partnership owning only the building and cash, with Grandpa owning 90% and an S corporation owning 10%. Grandpa's basis is still only $5,000. The partnership has made a 754 election and has owned the building for over 7 years.

Grandpa asks his tax advisor what to do when he wants to sell the building, and wants to use the above technique. How can he get another asset into the partnership and another partner with a high basis to facilitate the planning described above?

If Son 1 happens to have $1,000,000 of bonds that cost him $1,000,000 then he can contribute the bonds to the partnership and after waiting for at least two years in order to avoid the disguised sale rules of IRC Section 707, Son 1 may receive the building in the same manner as described above with the same result.

What if Son 1 doesn't have these bonds but has good credit? Son 1 may arrange to guarantee a loan to borrow $1,000,000 from a bank to buy $1,000,000 of bonds in the name of the partnership, and Son 1 will agree to be responsible for the $1,000,000 loan. As a result of this, Son 1 has a $1,000,000 basis in the partnership and the partnership has a $1,000,000 basis in the assets.

After waiting two years, Son 1 can receive the building in liquidation of his partnership interest with a $1,000,000 basis, sell it for $1,000,000 and recognize no gain. Son 1 can then pay off the loan, and Grandpa can own 90% of the partnership and his estate and the partnership will receive a stepped up basis when he dies.

As the result of the above, and also for the reasons described below, it is arguable that almost any appreciated asset owned by a family member should be owned by an entity that can be taxed as a partnership so that this type of planning can be implemented.

For example, if Grandpa has stocks worth $1,000,000 with a basis of $5,000 and needs to sell these over time to pay for living expenses, the same technique can be used if Son 1 can contribute $1,000,000 worth of assets to the partnership with a basis of $1,000,000 and an appropriate period of time has passed.

In addition to the above benefits, it may be necessary in the future to recommend that senior family members own high basis assets, so as to not be subject to tax on death if the US adopts a "deemed sale on death" capital gains tax like Canada has. Until then Grandpa would want to own the low basis assets or partnership interests to get a step up on death.

By keeping both low and high basis assets in partnerships like the one described above, the family can shift basis to Grandpa or away from Grandpa based upon what the tax law and preferred family planning situation is in the future.

By putting the assets into partnerships now, the family enhances the chances of being grandfathered if the tax laws ever change to prevent this type of planning.

In addition to the above, LLC's and Limited Partnerships provide many other benefits, including creditor protection, management opportunities, and valuation discounts to avoid estate tax if needed. Where valuation discounts are not needed for estate tax purposes it can be important to give each partner a "put right" so that on death the valuation of the partnership interest held can be the value of the underlying assets multiplied by the percentage of ownership, therefore receiving a higher step up in basis rather than a step up on the discount value.

Where different classifications of assets are owned by a family, it will often be advisable to have separate assets in separate partnerships for both tax and state law planning purposes.

Advisors should consider looking at assets and the basis thereof and determining how to be sure that appreciated or hopefully appreciating assets will be under a partnership for at least 7 years when the time may come to sell them.

Care must be taken when structuring these types of transactions as the partnership tax rules can be complicated, and general anti abuse rules under Subchapter K must be considered. Further, these so called "basis shifting" transactions caught the attention of the IRS in recent years and were identified as a transaction of interest. In 2024 Proposed Regulations and Revenue Ruling 2024-14 were issued that called into question whether basis shifting using partnerships would still be a viable tax planning technique. Fortunately, the IRS reversed course in 2025 and removed partnership basis adjustment transaction as "transactions of interest" and withdrew the Proposed Regulations. Further, Revenue Ruling 2024-14 was revoked under Notice 2025-34. As a result, the planning technique has been given new life

The authors thank Paul Lee of Northern Trust and Jerry Hesch for their thorough and skillful analysis, white papers and lectures on this topic, and on other topics in the estate and tax area.

Appendix A: JEST Article

(See below)

JEST Offers Serious Estate Planning Plus for Spouses—Part 1

A joint exempt step-up trust (JEST) may produce a full step-up in tax basis and full funding of a credit shelter trust for clients in non-community property states.

ALAN S. GASSMAN, CHRISTOPHER J. DENICOLO, AND KACIE HOHNADELL, ATTORNEYS

Revocable trust planning for married couples living in non-community property states continues to be a challenge for planners and clients. Couples who have estate tax exposure and want to have at least some assets held in a credit shelter trust after the death of one spouse typically establish separate revocable trusts for each spouse. The trust of the first dying spouse then becomes an irrevocable credit shelter trust on death, which captures assets owned only by the first dying spouse.

This vehicle can work well where the first dying spouse's trust will have enough assets to fully fund the credit shelter trust, but a great many couples with estate tax exposure do not have $10.5 million of assets that can be split between them to facilitate this funding on the first death. Furthermore, separate traditional revocable trusts do not provide a mechanism that permits the surviving spouse's assets to receive a stepped-up basis on the first death.

Alternatively, joint trust ownership can basically work like a right-of-survivorship asset on the first death, for the primary purpose of avoiding probate. This can yield a one-half stepped-up basis on the joint trust assets, and may permit the surviving spouse to disclaim up to one-half of those assets—or even more if the first dying spouse placed the assets into the joint ownership arrangement.[1] The disclaimed assets can pass to a credit shelter trust, which can benefit the surviving spouse and descendants. As long as the surviving spouse does not retain a power of appointment over the trust assets and does not have discretionary power and is governed by an ascertainable standard to vest trust property in himself or herself, the disclaimed credit shelter trust can also avoid estate tax on the surviving spouse's death.

The above systems can work well to some degree for couples with assets expected to remain well below the estate tax threshold who want a partial stepped-up basis and good family and creditor protection by using a trust system after the first death. However, this system involves locking up only a portion of the assets, and also obtaining a stepped-up basis on only part of the assets, which falls far short of what can be done with traditionally drafted joint trusts in community property states.

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The authors thank Thomas J. Eliwanger for his careful review and assistance in the design of the JEST.

JEST advantages

The joint exempt step-up trust (JEST) is designed to enable a mar-

ried couple residing in a non-community property state to use a joint trust or coordinated separate trusts to maximize the ability to enjoy the stepped-up basis and estate tax protection benefits described above, without undue risk of harm or undue inconvenience to the couple or their family. It also helps to maximize familial protection and harmony.

Many practitioners are understandably reluctant to implement a strategy that will produce uncertain results. In contrast, however, the authors have found that many clients are amenable to adopting strategies with uncertain tax benefits if use of the structure has no material cost or downside. With the JEST arrangement, on the first spouse's death, the practitioner and his or her clients can determine how to best proceed with reference to tax reporting, and possibly even obtaining a private letter ruling if the law has not become clearer by that time. Furthermore, possible alternate tax benefits may apply if the expected tax results are not as designed, as explained below. The JEST is designed not only to derive the benefits of the technical advice memorandum (TAM) and three letter rulings discussed below, but also to overcome the obstacles to stepped-up basis, and to establish a strong lifetime trust system with advantageous back-up tax treatment if these four IRS pronouncements are for some reason not applicable.

This two-part article first describes the JEST structure, then analyzes estate tax, gift tax, and creditor protection concerns posed by others. It also builds on Edwin P. Morrow's recent writings on Optimal Basis Increase Trusts, and uses techniques he has helped develop to help assure a second basis step-up on the death of the surviving spouse.

Planning alternative. A more foolproof method exists for allowing a married couple residing in a non-community property state to obtain a stepped-up basis and full funding of a credit shelter trust on the first death. This involves setting up an Alaska Community Property Trust with an active Alaskan trustee.[2] Many clients will prefer this method, but fees and costs associated with it are considerably higher than with a JEST, and many layman and professionals who have not studied this area find the Alaska Community Property Trust to sound less credible than the JEST, although that is clearly not the case under present law, assuming that the IRS and applicable courts would not find the Alaska Community Property Trust to be a contrivance or alter ego arrangement.

Basic JEST structure

The basic structure of the JEST is as follows:

1. A married couple funds a jointly established revocable trust, with each spouse owning a separate share in the trust. (The shares can be unequal or specifically designated if that is preferred.)
2. Each spouse has the right to terminate the trust while both are living. In that event, the trustee will distribute each spouse's separate share accordingly. If the spouses already each have separate living trusts, these can be amended to become subshare trusts under the JEST. This avoids the need to retitle assets and change beneficiary designations.
3. The JEST becomes irrevocable when the first spouse dies. The first dying spouse has a power of appointment over all trust assets in order to have the trust assets considered to pass through his or her estate for estate tax and stepped-up basis purposes. Some spouses and advisors are concerned that the first dying spouse could disrupt the intended disposition of assets by disinheriting the surviving spouse through the use of the testamentary general power of appointment. However, this risk can be eliminated by restricting the exercise of the power of appointment by the first dying spouse, and also requiring advanced approval by non-adverse parties of the exercise, as discussed below.

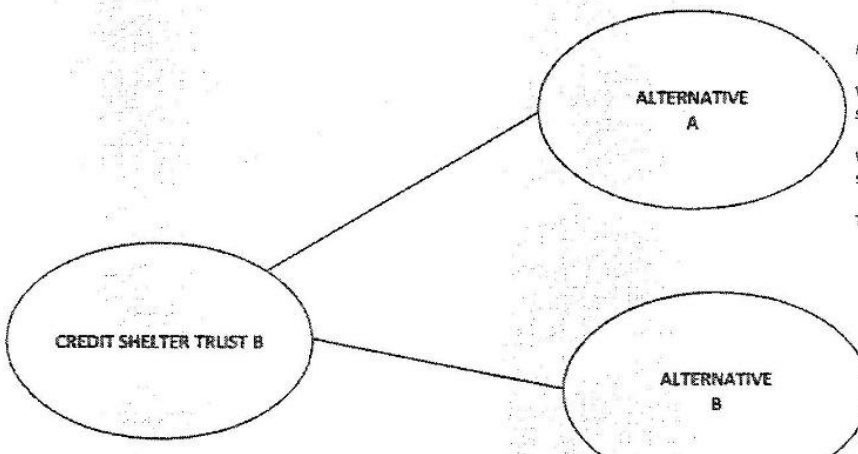
On the first death, the assets of the first dying spouse's share are applied in the following manner:

- First, assets equal in value to the first dying spouse's unused estate tax exemption are used to fund Credit Shelter Trust A for the benefit of the surviving spouse and descendants. These assets receive a stepped-up basis and escape estate tax liability on the surviving spouse's death.
- Second, if the first dying spouse's share exceeds his or her unused estate tax exemption, the excess funds go to QTIP Trust A to benefit the surviving spouse and descendants in a manner that qualifies for the federal estate tax marital deduction and allows the QTIP Trust A assets to receive a stepped-up basis, both on the first dying spouse's death, and again on the surviving spouse's death. Only the surviving spouse can benefit from QTIP Trust A during his or her lifetime.

1 Section 1014(b)(9). See also Reg. 1.1014-1.

2 See Blattmachr and Blattmachr, "*Huber*: Alaska Self-Settled Trust Held Subject to Claims of Creditors of Grantor-Beneficiary," LISI Asset Protection Newsletter #225 (5/22/2013).

EXHIBIT 1
JEST Credit Shelter Trust B Planning



Accepted as funded by first dying spouse.

Will not be subject to estate tax at the level of the surviving spouse.

Will not be subject to creditor claims of the surviving spouse.

This is the optimum result.

Considered as funded by surviving spouse.

Might be subject to estate tax at the level of the surviving spouse.

Might be subject to creditor claims of the surviving spouse, unless local law of the Trust provides otherwise

Formed from assets of the share of the surviving spouse.

Expected to be considered as being transferred to Credit Shelter Trust B by the first dying spouse for federal estate tax purposes pursuant to Ltr. Ruls. 200101021 and 200210051.

The IRS could claim that Credit Shelter Trust B was funded by the surviving spouse.

Strategy 1 - Incomplete Gift Treatment

The surviving spouse maintains a power of appointment over the Trust assets, which causes the Trust to be considered as an incomplete gift for federal gift tax purposes, and the Trust assets will be considered as owned by the surviving spouse for estate tax purposes on his or her death.

In light of the IRS' position in CCA 201208026, it is best to give the surviving spouse a lifetime power of appointment over the assets in Credit Shelter Trust B to assure that an incomplete gift results for federal gift tax purposes.

If there are separate children for each spouse or a concern that the surviving spouse might not appropriately exercise a power of appointment, then it could be limited to being exercisable only with a consent of non-adverse parties, or limited to the extent needed to avoid imposition of federal gift tax by funding under a formula clause.

Strategy 2 - Complete Gift Treatment

Considered as a complete gift by surviving spouse.

If the surviving spouse disclaims all powers of appointment over the Trust, then the transfer to Credit Shelter Trust B is considered to be a complete gift by the surviving spouse, and the Trust will not be subject to federal estate tax of the surviving spouse's estate.

The value of the assets passing to Credit Shelter Trust B would reduce the surviving spouse's $5,250,000 exemption.

Give the surviving spouse the power to replace Trust assets with assets of equal value so then it can be considered a defective grantor trust if this occurs.

NOTE applicable to both Strategy 1 and Strategy 2: Situs Credit Shelter Trust B in an asset protection trust jurisdiction to avoid having creditors be able to reach into the Trust, and also to avoid the Trust being included in the surviving spouse's estate if the surviving spouse was considered as a contributor to the Trust for federal estate and gift tax purposes.

- If the first dying spouse's share is less than his or her exemption amount, then the surviving spouse's share is used to fund Credit Shelter Trust B with assets equal to the excess exemption amount. The assets of Credit Shelter Trust B should avoid estate taxation at the surviving spouse's death, notwithstanding that the surviving spouse originally contributed these assets to the JEST and had the power to take them back up until the time of the first dying spouse's death, for reasons described below.

The assets of Credit Shelter Trust B should also receive a full stepped-up basis on the first death, as discussed below. To help assure the full stepped up basis, it is best for the surviving spouse not to be a beneficiary of Credit Shelter Trust B, or perhaps to be only an "addable beneficiary" of Credit Shelter Trust B if certain events occur and it is determined appropriate to do so at the discretion of independent Trust Protectors. For example, the surviving spouse might be added as a beneficiary if and when his or her personal net worth goes below a certain level, or on the occurrence of other circumstances.

The Section 1014(e) one-year rule (discussed in Part 2 of this article) should not apply to cause loss of a stepped-up basis where the surviving spouse is not a recipient of assets that he or she was considered to have gifted to the first dying spouse within one year of the first dying spouse's death.

The JEST credit shelter trust planning concept is summarized in Exhibit 1; the steps for implementation are summarized in Exhibit 2.

Segregation of assets. The assets passing from the surviving spouse's share into a Credit Shelter Trust B have been segregated, and the trust can be separately managed, tracked, and altered. Three reasons for segregating the assets are as follows:

1. If Credit Shelter Trust B may be subject to federal estate tax in the surviving spouse's estate, it probably should be spent before the assets of Credit Shelter Trust A, or invested in assets expected to grow less quickly than the assets in Credit Shelter Trust A.
2. If Credit Shelter Trust B is considered as having been funded by the surviving spouse, then he or she may be advised to disclaim any beneficial interest and any power of appointment over the trust assets. This would establish the trust as a completed gift for the benefit of the common descendants of the couple, as further discussed below.
3. If Credit Shelter Trust B is considered to have been funded by the surviving spouse for state law purposes, then creditors of the surviving spouse may be able to reach Credit Shelter Trust B assets, unless it is situsted in an asset protection trust jurisdiction. As a result, the trust could be subject to estate tax in the estate of the surviving spouse.

Drafting tips. The trust draftsperson should, therefore, consider providing one or more of the following features under Credit Shelter Trust B:

1. Fund and at least initially situs it in an asset protection trust jurisdiction, unless determined otherwise by one or more trustees or trust protectors, so as to provide creditor protection.
2. Do not name the surviving spouse as a beneficiary of the trust unless or until he or she is added as a beneficiary by trust protectors, and then only if circumstances exist that may appear unlikely at the time of funding.
3. Give the surviving spouse the right to disclaim or renounce the testamentary power of appointment that would typically be given to him or her under the trust. That way, if the IRS considers the trust to have been funded by the surviving spouse, the surviving spouse could choose one of the following alternatives: (a) have the trust's funding considered to be an incomplete gift for income tax purposes by retaining a lifetime limited power of appointment over the assets in such trust; (b) disclaim or renounce the powers of appointment and have the transfer of assets to the trust be considered as a completed gift,[3] or (c) request that the trust protectors take away the power of appointment, in which event the three-year look-back rule under Section 2035 should not apply, because the spouse himself or herself will not have released or relinquished the power.[4]

[3] See Reg. 25.2511-2.

[4] See Reg. 2035(a), which provides that property is included in the gross estate if: "(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death." The power would then be retained by the trust protector and should not be included in the estate of the surviving spouse.

4. The surviving spouse should have the power to replace Credit Shelter Trust B assets with assets of equal value, so that it can be considered a "defective" grantor trust for income tax purposes if the surviving spouse is considered to be the grantor of the trust. Then, if the IRS argues that the surviving spouse was the grantor and the IRS' position is accepted, the spouse will be able to pay the income taxes he or she would have incurred over the years to the trust without this being considered a taxable gift.
5. An independent trustee or trust protectors may have the renounceable power to pay the trust assets in Credit Shelter Trust B to the surviving spouse, which they may use if it is determined that Credit Shelter Trust B is not needed, or which they may renounce if it is determined that such transfer of assets to the surviving spouse is not in the best interests of the family.
6. An independent trustee or trust protectors should also have the power to give the surviving spouse a taxable general power of appointment over some or all of the trust assets under both Credit Shelter Trust A and Credit Shelter Trust B. This facilitates a step-up in basis for some or all of such assets, in the event that stepped-up basis planning will save more tax dollars than avoidance of estate tax for some or all of the credit shelter trust assets.
7. The trust language should encourage gifting and gift tax return filing. The surviving spouse may wish to make a small gift to Credit Shelter Trust B in the same calendar year as the first dying spouse's death and file a gift tax return disclosing the existence of Credit Shelter Trust B, how it was funded, the pertinent gift tax issues described in this article, and the assumption that the only gift made by the surviving spouse to Credit Shelter Trust B is the small transfer described above.

If the IRS does not challenge the position taken on the gift tax return (i.e., that the surviving spouse did not make a taxable gift to Credit Shelter Trust B other than the post death gift), then it should be prevented from later claiming that the surviving spouse's $5.25 million exemption was reduced by such transfer. While the IRS would not be prevented from later claiming that the spouse was a contributor to the trust for purposes of determining if trust assets should be subject to federal estate tax in the surviving spouse's estate if he or she retained a power of appointment, or a right or power over trust assets that would subject those assets to estate taxes under Section 2036, this estate tax inclusion should nevertheless not apply if the surviving spouse renounces all powers of appointment over Credit Shelter Trust B, and is either not a beneficiary of the trust, or the trust is situsued in an asset protection jurisdiction.

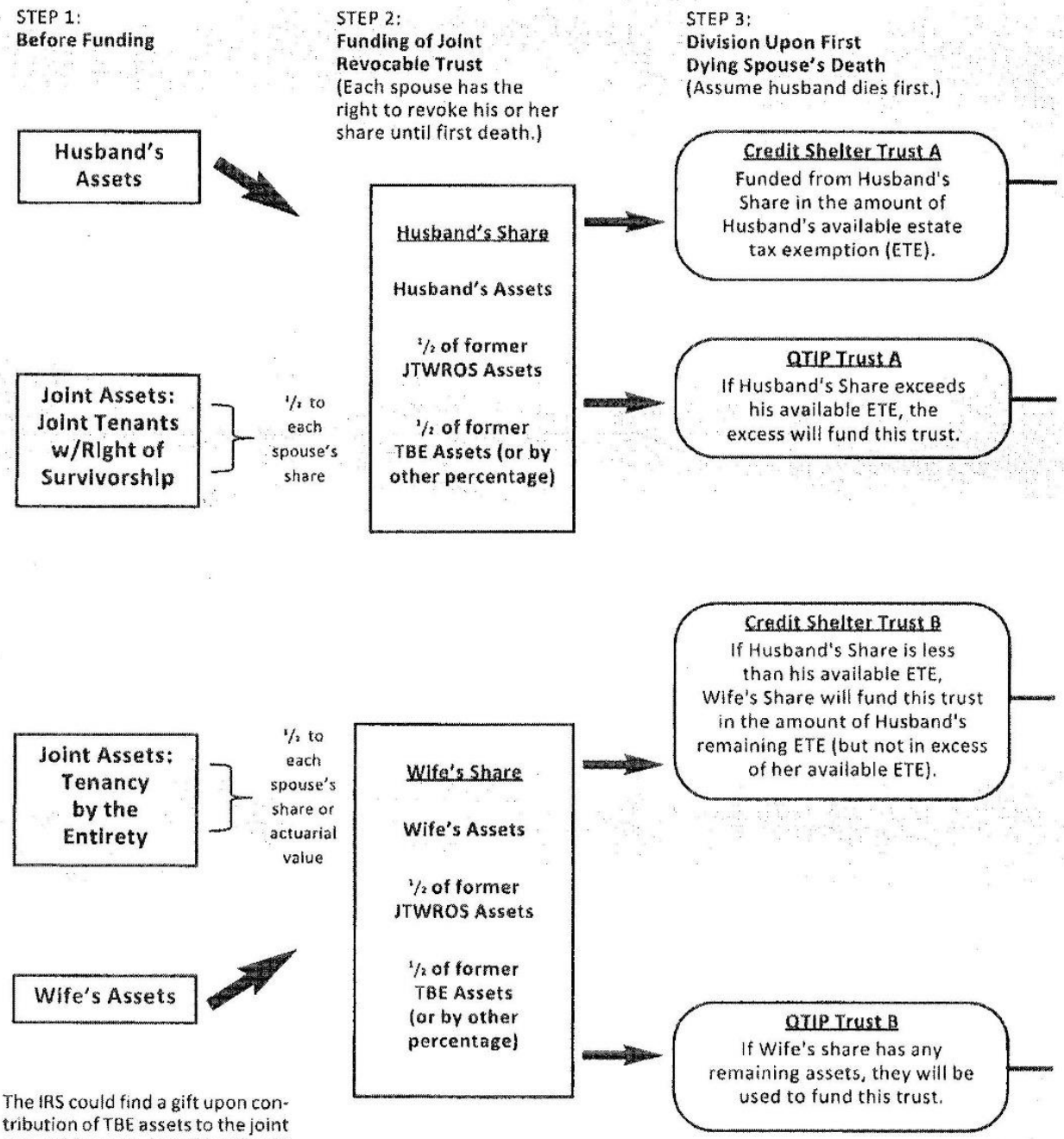
First dying spouse. When the estate tax return of the first dying spouse is filed, the IRS may take the position that Credit Shelter Trust B was actually funded as a gift by the surviving spouse. If this occurs, the surviving spouse will have a portability allowance (or a greater-than-first-claimed portability allowance) as the result of using less than all of the first dying spouse's exemption amount, assuming a federal estate tax return is filed for the estate of the first dying spouse. In any event, no estate or gift tax would be triggered by an IRS conclusion that Credit Shelter Trust B was funded from the assets of the first dying spouse, unless the surviving spouse's deemed contribution to Credit Shelter Trust B exceeds his or her estate tax exemption amount and no retained power of appointment prevents a completed gift from occurring.

Under federal gift tax principles, a gift made to a trust is incomplete if the person making the gift has a power to appoint the trust assets on death, and, according to CCA 201208026, also has the power to prevent trust assets from being paid to individuals other than the donor. Many authorities, including the authors, believe that the CCA is incorrect, and that no power to prevent trust assets from being paid to individuals other than the donor is needed.[5] Nevertheless, conservative planners will want to draft the trust agreement to give the surviving spouse a lifetime power of appointment over the Credit Shelter Trust B assets.

If the surviving spouse renounces the power of appointment over the Credit Shelter Trust B assets, it might be best to do so by a formula, with language such as "such renouncement shall be limited to that portion of the power of appointment that I can renounce without being subject to federal gift tax, based upon a fraction, the numerator of which is my estate tax credit exemption amount and the denominator of which is the value of the trust assets.

[5] See Gassman, Share, Crotty, and Hohnadell, 'Planning After IRS Memo 201208026: How Foreign Can Creditor Protection Trust Laws Get?,' LISI Asset Protection Planning Newsletter #207 (9/11/2012). See a so Zeydel, "When is a Gift to a Trust Complete—Did CCA 201208026 Ge t Right? " 17 J. Tax'n 142 'Se > emt.e 2 ?

EXHIBIT 2
JEST Chronology: The Four Steps From Drafting to Implementation



The IRS could find a gift upon contribution of TBE assets to the joint revocable trust, but this gift will qualify for the marital deduction if recipient spouse can withdraw what is added to his or her share. Also see Ltr. Rul. 200201021.

Step 3 note:

CST A and CST B can be merged if there is no concern with estate tax, stepped-up basis, creditor protection, or credit shelter trust effectiveness.

QTIP Trust A and QTIP Trust B can be merged if there is no concern with respect to stepped-up basis or credit protection effectiveness.

EXHIBIT 2, *cont'd*
JEST Chronology: The Four Steps From Drafting to Implementation, *cont'd*

STEP 4:
Results of JEST Technique

- For Wife' and descendants' benefit (limited by ascertainable standard).
- Assets will receive a stepped-up basis.
- Assets are protected from Wife's creditors.
- Assets escape estate tax on Wife's death.

- Wife can be beneficiary of income and principal.
- Assets will receive a stepped-up basis on Husband's death, and then again on Wife's death.
- Assets included in Wife's taxable estate.
- Will be protected from Wife's creditors.

- Assets may receive a stepped-up basis, but this is more likely if Wife is not a beneficiary.
- May escape estate tax liability on Wife's death.
- For creditor protection and estate tax exclusion purposes, CST B may be moved to an APT jurisdiction.

  Special consideration: If Wife is found to have a gift of trust assets to Husband upon Husband's death, this gift may qualify for the marital deduction.
- If the IRS argues that Wife has gifted to the trust, the gift will be incomplete because of her power of appointment.

- Wife will be the income beneficiary
- Assets may receive a stepped-up basis on Husband's death and again on Wife's death.
- Assets included in Wife's estate.
- May not be protected from Wife's creditors unless moved to APT trust jurisdiction.
- If the IRS argues that Wife has gifted to the trust, the gift will be incomplete because of her power of appointment.

Example. A surviving spouse has $1 million in available estate tax exclusion, and Credit Shelter Trust B has $3 million of assets. The surviving spouse would at most renounce only one-third of his or her general power of appointment.

Finally, the remainder of the surviving spouse's share (if any is left after the complete funding of Credit Shelter Trust A, and Credit Shelter Trust B to the extent needed to make full use of the first dying spouse's estate tax exemption allowance) will be used to fund QTIP Trust B, under which the surviving spouse will be at least an income beneficiary. We believe that there is a better chance that the assets funding QTIP Trust B will also receive a basis step-up if the surviving spouse retains only the right to receive income.

The tax and creditor protection issues raised by these techniques are further discussed below.

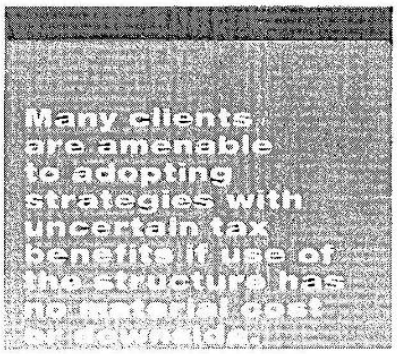
Evolving IRS guidance

Over the last 20 years, the IRS has issued three private letter rulings touching on joint trust arrangements and a TAM.[6]

TAM 9308002. The TAM predated the three letter rulings, and was issued in 1992. The facts indicated that both spouses funded a joint revocable trust, which granted each spouse a general power of appointment over the entire trust in the form of a right to direct payment of his or her debts and taxes from any of the trust assets. Both spouses also had the right to unilaterally revoke the trust during the spouses' joint lifetime. The IRS determined that all trust assets were included in the first dying spouse's estate under Section 2041. The IRS ruled, however, that assets con-

[6] See Ltr. Ruls. 200101021, 200210051, and 200403094; TAM 9308002.

tributed to the trust by the surviving spouse were in effect gifted to the first dying spouse on that spouse's death. Therefore those assets are treated as having come back to the surviving spouse within one year, so as not to be qualified to receive a basis step-up under Section 1014(e).



First two private rulings. Ltr. Ruls. 200101021 and 200210051 addressed the same issues. In both rulings, married couples formed joint revocable trusts. In one ruling, each spouse had a lifetime power to withdraw the income and principal; in the other, the first spouse to die was given a testamentary general power of appointment over the entire trust. In both rulings, on the first spouse's death, the assets of the joint trust were used first to fund a credit shelter trust (in the amount of the first dying spouse's unused exemption) for the surviving spouse's benefit. Both letter rulings made the following determinations:

1. All of the joint trust assets were included in the first dying spouse's estate. The assets contributed by the first dying spouse were included under Section 2038; the assets contributed by the surviving spouse were included under Section 2041.
2. On the first dying spouse's death, the surviving spouse made a completed gift to the first dying spouse of the assets contributed by the surviving spouse. The gift qualified for the gift tax marital deduction.
3. Because of Section 1014(e), only the assets contributed to the trust by the first dying spouse could receive a step-up in basis.

Third private ruling. Ltr. Rul. 200403094 addressed similar issues in a slightly different context. Rather than a joint trust, the ruling dealt with a revocable trust to be created and funded by a husband. If the wife died first, the trust agreement provided her with a testamentary general power of appointment over trust assets equal in value to her remaining exemption, less her own assets. In that case, the wife's will provided that the appointed assets would pass to a credit shelter trust for the husband's health, education, support, and maintenance. The IRS ruled as follows:

1. The husband's creation of the power of appointment would be a gift to the wife, which would be considered completed at her death if she died before him. The husband's gift would qualify for the gift tax marital deduction.
2. If the wife died first, assets contributed by the husband to the trust but appointed by the wife to a credit shelter trust for the husband would not be included in the husband's estate for estate tax purposes at his later death.
3. Stepped-up basis was not discussed.

JEST scenarios

Below are two examples of where clients might prefer the JEST arrangement over conventional non-community property state planning.

Example 1. John and Mary are both successful professionals who have very little liability exposure and plenty of insurance coverage. They also have a $500,000 house, $1 million in IRAs and pension plans, and $3 million of investments in brokerage accounts.

They are in their early 40s and expect to become estate taxable based on savings rates and investment assumptions. They project that $4.5 million of assets, growing at 7% per year, will be worth $67,385,060 in 40 years. In contrast, their combined exemption of $10.5 million, growing at an assumed consumer price index rate of 3%, will be only $34,251,397 at that time.

They have two teenage children and feel very strongly that their joint assets should never be spent on anyone other than one another and their common descendants.

John and Mary have reviewed their situation and would like to have their entire $3 million of investment assets held under a protective trust system on the first death, to help assure that a remarriage by the surviving spouse would not cause loss of significant assets for the surviving spouse and the two children.

They would also like to have the best chance possible for a stepped-up basis on the death of one of them, so that the survivor would be able to better diversify by selling some of their investments without incurring capital gains tax, and also to fund a credit shelter trust with $3 million in assets.

They understand that with the JEST arrangement, the IRS could assert that on the first death, the surviving spouse made a $1.5 million gift to what will be called Credit Shelter Trust B, but that this can yield estate tax savings and creditor protection advantages that could be very worthwhile for the

surviving spouse and their common descendants.

Example 2. Bill and Maria are in their mid-70s, and have a house worth $500,000 and personal assets (i.e., non-IRA, non-pension accounts) worth approximately $7 million that have a tax basis of $2 million. They have not been diversifying or otherwise adjusting their investments because they are unwilling to pay a 23.8% capital gains tax, but would like to be able to adjust their investments without paying any taxes if one of them dies. Bill and Maria do not expect to become estate taxable, but they recognize that this could occur.

They would like to have all of their assets held under protective trusts if one of them dies, because the survivor would be under significant emotional pressure, and might be inclined to remarry. They would also like the best chance possible of receiving a stepped-up basis on all $7 million worth of joint assets, but would prefer not to pay an annual trustee fee to a trust company in Alaska if this is the only other choice.

They recognize that by the present numbers, $3.5 million would pass to Credit Shelter Trust A on the first death and $1.75 million would pass to Credit Shelter Trust B. They recognize that the surviving spouse might be considered to have funded Credit Shelter Trust B, but that if so, this could be considered to be an irrevocable trust for the primary benefit of their children that could still grow estate tax free. After weighing these considerations, they decide to go with the JEST trust arrangement.

Conclusion

With a JEST arrangement, married couples in non-community states have an expanded opportunity to achieve a stepped-up basis that comes with inheriting assets. While the tax law is not completely clear, the worst case scenario of implementing this strategy with the safeguards described above can be a much better result than not using the strategy at all. The second installment of this article, which will be published in an upcoming issue of ESTATE PLANNING, further describes the creation and funding of the JESTs and amelioration of risks that apply. ■

JOINT TRUST

JEST Offers Serious Estate Planning Plus for Spouses—Part 2

A joint exempt step-up trust (JEST) can be drafted to provide creditor protection as well as a full step-up in tax basis and use of a credit shelter trust.

ALAN S. GASSMAN, CHRISTOPHER J. DENICOLO, AND KACIE HOHNADELL, ATTORNEYS

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Couples living in community property states are generally in line to benefit more from the stepped-up basis available to inherited assets than are couples in non-community property states. Estate planners have, however, identified strategies to expand the favorable basis treatment to spouses living in non-community property states, and one such strategy involves use of a joint exempt step-up trust (JEST). As is explained in Part 1 of this article,[1] the JEST arrangement has not received clear approval from the IRS, but IRS guidance that is available does give positive indications. Furthermore, use of a JEST does not carry much downside risk, so many clients will be amenable to adopting the strategy in their estate plans. Part 2 of this article continues the analysis of the JEST.

JEST creation and funding

In implementing the JEST, the married couple first establishes a joint revocable trust. Each spouse has a separate share consisting of any assets contributed to the trust by that spouse. To avoid having to retitle assets, pre-existing revocable trusts can become separate shares of the joint revocable trust by amendment and restatement.

The trust agreement can give each spouse an equal share of the trust assets. While both spouses are living, either spouse can revoke the agreement and terminate the trust. In that event, the trustee transfers the trust assets back to the spouses in equal shares.

The first dying spouse should also be given a testamentary general power of appointment over all trust assets. As described in Part 1 of this article, the first dying spouse's power can be limited to being exercisable in favor of the creditors of his or her estate, while still qualifying as a general power of appointment under Section 2041.[2]

If the IRS ever argues that a deemed gift was made from the surviving spouse to the first dying spouse immediately before the first dying spouse's death, it would be best to have the general power of appointment mirror the language in Section 2523(e), so that the gift tax marital deduction would apply to avoid use of the surviving spouse's estate tax exclusion. This appears to require that the first dying spouse would need to have the power to exercise such general power of appointment in favor of himself or herself, or his or her estate, alone or in all events. The law is not absolutely clear as to whether such a power of appointment can be limited to requiring the consent of one or more adverse parties and still facilitate qualification for the gift tax marital deduction. If estate tax avoidance is less important than concerns with respect to needing consent of one or more adverse parties, an adverse party approval clause can be included.

To address the concern that the first dying spouse could disrupt the intended disposition of assets by disinheriting the surviving spouse through the use of the testamentary general power of appointment, the trust can provide that the first dying spouse's power is only exercisable with the written consent of a non-adverse party. Although anyone who has a substantial interest in the trust property is typically deemed an adverse party,[3] there is authority for the proposition that a beneficiary of the trust, such as a child or grandchild, is a non-adverse party if he or she is acting as a trustee, or

1 Gassman, Denicolo, Hohnadell, "JEST Offers Serious Estate Planning Plus for Spouses—Part 1," 40 ETPL 3 (October 2013).

2 Section 2041(b)(1).

3 Section 2041(b)(1)(C)(ii) (stating that "[i]f the power is not exercisable by the decedent except in conjunction with a person having a substantial interest in the property, subject to the power, which is adverse to exercise of the power in favor of the decedent—such power shall not be deemed a general power of appointment").

otherwise in a fiduciary capacity.[4] The first dying spouse could also be given a limited power of appointment over trust assets, which then cascades into a general power of appointment to the extent it is not used.[5]

For pension and IRA planning purposes, the power can be further limited to being exercisable only in favor of creditors of the first dying spouse's estate who are younger than the oldest beneficiary of a given trust, which will often be the surviving spouse. When an IRA is payable to a properly designed trust, the life expectancy of the oldest beneficiary may be used to determine the required minimum distribution amounts in order to allow for distributions to be made over the life expectancy of the oldest beneficiary in lieu of the otherwise applicable five-year rule.[6]

As discussed above, the full stepped-up basis and full funding of a credit shelter trust may not occur without an IRS challenge, but will yield at least the equivalent of what a two-trust marital estate plan would provide, with significant upsides beyond that.

The following discussion reviews the risks described above, and how the JEST has been designed to reduce these risks significantly, while preserving all opportunities that would be offered by a two-trust or conventional joint trust arrangement.

Risk 1: Gift upon funding. Unequal funding of the JEST while both spouses are alive raises the possibility of a gift upon funding. A spouse who contributes more than 50% of the assets but has the power to get back only 50% in a unilateral termination has presumably made a completed gift of the difference to the other spouse. Transferring property held as tenancy by the entireties to the JEST could also result in such a gift because under the law of tenancy by the entireties, the tenancy can be severed by only joint action of the parties. Giving each spouse the power to unilaterally revoke the trust likely severs the tenancy upon funding. This severance may be considered to be a gift of differential value by the younger spouse, who has a higher actuarial interest in the property.[7]

In Ltr. Rul. 200101021, however, the IRS held that the contribution of tenants by the entireties assets to a joint trust was not a gift by either spouse where each of them retained the right, acting unilaterally, to revoke his or her transfer,and revest title in himself or herself, rendering the gift incomplete. As desirable as this result may be, it ignores the actuarial difference between the spouses' interests—a younger, healthier spouse is more likely to survive the other spouse, and therefore has an ownership interest in the trust that exceeds 50% of the value of the trust assets, according to Reg. 25.2511-2. The other rulings did not explicitly address the issue of a gift upon funding.

Estate tax planning attorney Michael Mulligan has also suggested that any gift upon funding may be considered incomplete and, therefore, not to have occurred until the first death, regardless of whether a spouse can terminate the trust and take back assets. He states that "[u]nder the laws of most states, the retained right to distributions of income and principal would cause any contribution by a beneficiary to the trust to remain subject to claims of the beneficiary's creditors. If applicable state law permits a settlor's creditors to reach property conveyed to a trust, such conveyance does not constitute a gift for federal gift tax purposes."[8]

If a gift on funding does occur, so long as both spouses are U.S. citizens, the gift tax marital deduction presumably would eliminate tax concerns. (If the spouse is a non-citizen, the marital deduction would not apply).

Risk 2: Loss of creditor protection for tenancy by the entireties assets. Mr. Mulligan's comment as to funding raises another issue. Holding properties as tenancy by the entireties, where state law permits, usually provides creditor protection because the properties can be reached by only creditors with a claim against both spouses. Tenancy by the entireties property that is transferred into a typical joint trust loses entireties status, and this creditor protection, unless either of the following occurs:

1 The joint trust satisfies all unities required by tenancy by the entireties law (which will not be the case with a JEST).

2 The governing law explicitly provides that trust assets can be designated by a married couple to be treated as tenancy by the entireties

4 See Estate of Vissering, 96 TC 749 (1991), *reversed on other grounds* 990 F.2d 578, 71 AFTR2d 93-2190 (CA-10, 1993) (stating "[t]he fact that a decedent holds the power in a fiduciary capacity as a trustee or that a decedent can only exercise the power jointly with another does not prevent the power from being a general power of appointment"). See also Blattmachr, Kamin, and Bergman, "Estate Planning's Most Powerful Tool: Powers of Appointment Refreshed, Redefined and Reexamined," 47 Real Prop. Tr. & Est. L.J. 529 (2013), where the authors discuss decanting as a fiduciary power. Estate of Jones, 56 TC 35 (1971); Miller, 387 F.2d 866, 21 AFTR2d 1592 (CA-3, 1968).

5 In LISI Newsletter #2080 (3/20/2013), Edwin P. Morrow recognized that this technique was upheld in the Tax Court case of Chisholm, 26 TC 253 (1956).

6 See Ltr. Rul. 201203033, discussing Reg. 1.401(a)(9)-5.

7 See Reg. 25.2511-2(c).

8 Mulligan, "Is It Safe to Use a Power of Appointment in Predeceasing Spouse to Avoid Wasting Applicable Exclusion Amount?" 23 Tax Mgmt. Fin. Plan. J. (9/18/2007).

property, even if the unities are not satisfied. Delaware, Virginia, Hawaii, and Illinois are examples of jurisdictions that have such statutes.

When the first death occurs

Upon the first dying spouse's death, the joint trust becomes irrevocable. The trust assets are still in two equal shares—one attributable to the first dying spouse and the other attributable to the surviving spouse. The analysis that follows assumes that the first dying spouse has not exercised either his or her power to revoke the trust unilaterally, or the testamentary general power of appointment.

Assets of the first dying spouse's share equal in value to the first dying spouse's unused estate tax exemption will be used to fund Credit Shelter Trust A for the benefit of the surviving spouse and descendants. If the first dying spouse's share exceeds his or her unused exemption, then the excess amount can be used to fund QTIP Trust A for the lifetime benefit of the surviving spouse.

Turning to the surviving spouse's share, if the first dying spouse's share is less than his or her remaining exemption amount, the surviving spouse's share is used to fund Credit Shelter Trust B. Like Credit Shelter Trust A, this trust can be created for the benefit of the surviving spouse and descendants, although including the surviving spouse as a beneficiary may imperil a basis step-up for these assets at the first death, as discussed below.

If assets remain in the surviving spouse's share after full funding of Credit Shelter Trust B, the remainder of the surviving spouse's assets will be used to fund QTIP Trust B, with the surviving spouse as lifetime beneficiary and the descendants as remainder beneficiaries. Again, the extent of the surviving spouse's interest may affect the basis argument.

The results of this technique are discussed below.

Credit Shelter Trust A

The assets of Credit Shelter Trust A are treated as coming from the first dying spouse. They are included in the first dying spouse's gross estate for estate tax purposes pursuant to Section 2038, because of the first dying spouse's lifetime right to revoke the trust and receive back these assets. These assets are sheltered from estate tax liability at the first death by the first dying spouse's estate tax exemption. Unless the Section 1014(e) one-year rule applies, the inclusion of these assets in the first dying spouse's gross estate produces a stepped-up basis.[9]

A spendthrift provision in Credit Shelter Trust A provides creditor protection for the surviving spouse because the first dying spouse (rather than the surviving spouse) will be deemed to be the grantor/transferor of the trust. To increase creditor protection, it may be best to limit the surviving spouse's right to receive distributions in the discretion of the trustee according to an "ascertainable standard," that limits distributions to being for health, support, maintenance, and education. In most jurisdictions, limiting discretionary distributions to the surviving spouse by such a standard prevents creditors of the surviving spouse from being able to reach the trust assets or demand trust distributions.[10]

QTIP Trust A

Similarly, the assets of QTIP Trust A will also be included in the first dying spouse's estate under Section 2038. These assets will avoid estate tax on the first dying spouse's death because Section 2056(b)(7) permits an estate tax marital deduction for QTIP trust assets, so long as the surviving spouse has a qualifying income interest for life. These assets should also receive a stepped-up basis on the first dying spouse's death, unless the one-year rule under Section 1014(e) applies. Because the assets remaining in this trust at the surviving spouse's death will be includable in the surviving spouse's estate under Section 2044, those assets will receive another basis step-up at that time.

Even with a spendthrift provision, QTIP Trust A cannot provide total creditor protection because the surviving spouse must have a right to income in order to qualify for the marital deduction. Therefore, creditors will be able to reach the income distributions after they are received by the spouse, if the trust has income. However, the principal can be protected by making principal distributions discretionary and limited by an ascertainable standard.

The trustee can potentially minimize or eliminate the surviving spouse's income exposure by investing in low or zero dividend stocks or other cash neutral investments. Of course, this will require implicit consent of the surviving spouse be-

9 Ltr. Ruls. 200101021 and 200210051; see also Mulligan, *supra* note 8 (stating that "[p]roperty which is contributed by the predeceasing spouse and included in such spouse's estate under § § 2036 and 2038 rather than § 2041 is unaffected by § 1014(e), and acquires a new income tax basis under § 1014(a)"). Of course, Section 1014(e) could apply if the first dying spouse receives the property from the surviving spouse and dies within a year after contributing it to the trust.

10 See e.g. Fla. Stat. 736.0504(3) (2012) (providing that "[i]f the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee").

cause of the surviving spouse's right to income.[11] However, although the surviving spouse may be able to require the trust to hold income-producing assets, there is no requirement that the trust produce a minimal amount of income.[12]

Credit Shelter Trust B

Now we will examine how the first death affects the trust or trust funded from the surviving spouse's share of the JEST.

Estate tax. Credit Shelter Trust B is designed to use up whatever is left of the first dying spouse's estate tax exemption after the funding of Credit Shelter Trust A. In order to make use of this remaining exemption amount, assets from the surviving spouse's share must be used to fund Credit Shelter Trust B after being included in the first dying spouse's estate for estate tax purposes.

By providing the first dying spouse with a testamentary general power of appointment over all of the trust assets, the assets of Credit Shelter Trust B are includable in the first dying spouse's estate under Section 2041, as was the case in most of the rulings.[13]

The rulings made clear the IRS' view that, with proper drafting, Credit Shelter Trust B would not be includable in the gross estate of the surviving spouse, and accordingly, would not be considered as funded by the first dying spouse, even if the surviving spouse is a beneficiary of this trust.

Risk 3: Inclusion of Credit Shelter B assets in surviving spouse's estate. Although the IRS rulings were favorable, they are not binding on the Service and cannot be cited as precedent. Therefore, the IRS could possibly reach a different conclusion on this issue in the future.

One concern expressed by Mr. Mulligan is that Section 2041 may not apply to the joint trust assets because the first dying spouse's power of appointment is effectively contingent on the surviving spouse's failure to withdraw his or her share of the trust assets before the first death. His fear is that the contingency may turn the testamentary power of appointment into a power exercisable only in conjunction with the creator of the power, which would not be considered a general power of appointment under Section 2041(b)(1)(C)(i).[14]

Less than all of the first dying spouse's estate exemption amount would be used if the first dying spouse's testamentary power is not considered a general power of appointment. In that event, the surviving spouse may have the benefit of a portability allowance, and may use his or her exemption amount to fund Credit Shelter Trust B as a gift. The assets in Credit Shelter Trust B would then arguably be includable in the gross estate of the surviving spouse under Sections 2036 and 2038, unless special structuring is employed.

A 1935 court decision from the Ninth Circuit, in *Johnstone*[15] provides support for the argument that the testamentary power of appointment held by the first dying spouse is in fact a general power. In this case, the Ninth Circuit determined that the decedent who died before the grantor of a revocable trust had a testamentary general power of appointment over trust assets, even though the grantor had retained the power to alter or amend the trust during their joint lifetimes. Finding a general power, the court stated the following:

> [I]n trust C there was a reserved power in the donor, during her lifetime, to alter or modify the trust agreement, but not to revoke the same. These reserved powers, if exercised, might also have prevented the exercise by the decedent of the general power of appointment by will. However, these reserved powers were not exercised, and at the time of his death the decedent was entitled to exercise the general power of appointment under the terms of the trust agreements. *In trust C, although the decedent, the donee of the power, predeceased the donor, the power of the donor to alter or modify the trust agreement terminated with the death of the decedent at which time the trust, under the terms of the trust agreement, terminated. Thus at the time of his death the decedent had a general power of appointment over the property here involved.*

Although this case was decided under old law, it provides a strong argument that the first dying spouse has a general power over the joint trust assets, despite both spouses having the power to revoke the trust assets during their lifetimes.

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11 Reg. 20.2056(b)-5(f)(4).

12 Reg. 20.2056(b)-5(f)(4) (stating that "a power to retain trust assets which consist substantially of unproductive property will not disqualify the interest if the applicable rules for the administration of the trust require, or permit the spouse to require, that the trustee either make the property productive or convert it within a reasonable time. Nor will such a power disqualify the interest if the applicable rules for administration of the trust require the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets").

13 The same conclusion was also reached in Ltr. Rul. 200210051, where each spouse had the power to withdraw all of the trust assets while both were living. This approach is not recommended because it would most likely subject all of the trust assets to creditor claims against either spouse prior to the first death. Otherwise, claims against one spouse should imperil only that spouse's share of the trust.

14 Mulligan, *supra* note 8.

15 76 F.2d 55, 15 AFTR 382 (CA-9, 1935).

Mr. Mulligan points out that the IRS could also determine that the assets of Credit Shelter Trust B are includable in the surviving spouse's estate under a "conduit" or "step transaction" analysis, whereby the IRS would view the separate transactions as one, ultimately determining that the surviving spouse is the actual contributor of the assets of Credit Shelter Trust B. Again, this will trigger Sections 2036 and 2038 rather than Section 2041. He cites cases in which one party who transferred assets to a second party is deemed to be the actual grantor of a trust created by the second party with those assets.[16]

In the end, however, Mr. Mulligan points out that the lifetime QTIP rules justify ignoring these arguments where spouses are involved. Under the QTIP rules, Spouse A can set up a lifetime QTIP for Spouse B with Spouse A's assets, and the trust can benefit Spouse A after the death of Spouse B. Sections 2036 and 2038 do not bring the assets back into Spouse A's estate. Apparently, inclusion in the estate of Spouse B under Section 2044 "cleanses" the trust assets so that Spouse B is considered to be the source of these assets. Mr. Mulligan sees no reason why the same concept should not apply in the joint trust arena.

In their 2008 article, Mitchell Gans, Jonathan Blattmachr, and Austin Bramwell share Mr. Mulligan's concern about the step-transaction doctrine.[17] They note that the IRS could determine that the surviving spouse is the transferor of the Credit Shelter Trust B, causing inclusion in his or her estate under Section 2036 (if the surviving spouse had the right to receive income from Credit Shelter Trust B) or Section 2038 (if the surviving spouse has a special power of appointment over the trust).

They note that even if the surviving spouse has neither an income interest nor a power of appointment over the trust assets, by being merely a discretionary beneficiary, the IRS could include the assets in the surviving spouse's estate for one of two reasons:

1 The Service could find an "implied understanding" that the surviving spouse would receive distributions from the trust.

2 The Service could decide that, under state law, the trust is self-settled and the surviving spouse's creditors could therefore reach the assets.[18]

The risk of estate tax inclusion may be reduced through proper planning and trust management. Careful drafting and conduct may negate an "implied understanding." Further, drafting to avoid creditors (such as by setting up Credit Shelter Trust B in a jurisdiction that protects self-settled trusts) can be helpful both for tax and nontax reasons (the nontax reasons are discussed below).

In addition, an attempt could be made to structure the funding of the joint trust to minimize the need for a Credit Shelter Trust B created with the surviving spouse's assets. Of course, this eliminates one advantage of joint trust planning—the ability to ensure full use of both spouses' exemptions without having to split assets up or move them around.

Messrs. Gans, Blattmacher, and Bramwell express concern that the IRS' reasoning in these rulings could invite abuse by taxpayers seeking to overcome the step-transaction doctrine in other contexts. Mr. Mulligan, however, seems to feel that the QTIP analogy will continue to support the IRS' favorable determinations. Planners forced to confront this issue and seeking certainty may consider getting IRS rulings of their own.

In determining whether Credit Shelter Trust B can be properly funded, planners should consider two questions:

1 Does inclusion of Credit Shelter Trust B in the surviving spouse's estate cause a significant problem? If the alternative to a joint trust arrangement would not fully use both exemptions anyway, what

16 Footnote 14 of Mr. Mulligan's article, *supra* note 8, supports this concept by citing the cases of Mahoney, 831 F. 2d 641, 60 AFTR2d 87-6152 (CA-6, 1987); Marshall Estate, 51 TC 696 (1969); Estate of Sinclaire, 13 TC 742 (1949); and Estate of Schwartz, 9 TC 229 (1947). In each of these cases, the IRS successfully showed that trust assets were included in the beneficiary's estate, even though the beneficiary did not directly contribute the assets to the trust.

In Mahoney, a father created a trust for his son's benefit and funded it with stock. The son then executed a promissory note to his father in an amount equal to the stock's value. The son died, and the IRS concluded that the trust assets were included in the son's estate because he was the party who in substance transferred assets to the trust by paying consideration to his father at time the stock was transferred to the trust. Citing to Marshall, Sinclaire, and Schwartz, the court concluded "that although [the father] nominally created the Trust, the decedent must be considered the effective grantor of the Trust to the extent of his contribution."

In Sinclaire, the decedent transferred assets to her father, and her father funded a trust for the decedent using those assets before her death. The Tax Court found that the trust assets were included in the decedent's estate, noting that "in substance and reality decedent was the settlor of the trust and that her father acted only as her agent in its creation."

17 Gans, Blattmachr, and Bramwell, "Estate Tax Exemption Portability: What Should the IRS Do? And What Should Planners Do in the Interim?," 42 Real Prop. Prob. & Tr. J. 413 (2007-2008).

18 *Id* (stating that "[i]n other words, if as a matter of state law the donor spouse is treated as having funded the trust and her creditors could therefore reach the trust's assets, the spouse's estate would include the assets under 2041 even though she is not deemed the transferor for estate tax purposes").

is the harm if that aspect of the joint trust arrangement does not work?

2 Can any harm caused by inclusion be minimized?

As to the second point, consider the result if Credit Shelter Trust B is structured as a defective grantor trust with the surviving spouse as grantor. This might be accomplished by giving the surviving spouse the power to replace Credit Shelter Trust B assets with assets of equal value. The surviving spouse would owe income tax on the income remaining in the trust or distributed to other beneficiaries, and the tax payments would reduce his or her taxable estate without being considered gifts. Having Credit Shelter B treated as a defective grantor trust established and funded by the surviving spouse could actually save more estate tax than would otherwise be the case by having the surviving spouse's estate reduced by the income taxes paid by him or her on the trust income, assuming that the surviving spouse has no power of appointment or rights over the trust assets that would cause Credit Shelter Trust B to be included in his or her estate for estate tax purposes.

Marital deduction

In the rulings, the IRS concluded that upon the first spouse's death, the surviving spouse would make a completed gift to the deceased spouse of the assets that the surviving spouse contributed to the joint trust.[19] This is because as of the first death, the surviving spouse relinquishes dominion and control over those assets, either by losing the power to revoke those assets or because the assets are subject to the first dying spouse's testamentary general power of appointment (or, under the suggested arrangement, for both reasons). The rulings conclude that this completed gift by the surviving spouse would qualify for the estate tax marital deduction (assuming that the first dying spouse is a U.S. citizen).

Risk 4: The gift to first dying spouse may not qualify for the marital deduction. Common sense suggests that the IRS is correct on the marital deduction issue. Of course, common sense is not always a reliable guide to the workings of the tax laws. While the IRS rulings do not go into detail on the marital deduction question, the Service had to reach two conclusions in order to determine that the marital deduction applied:

1 The gift occurred when the spouses were married.

2 The gift did not involve a nondeductible terminable interest.

While pointing out that this determination has been made in nonbinding rulings, the commentators have suggested that the IRS may later abandon these conclusions.[20] They point out that whether the gift was considered to be made when the spouses were married turns on exactly when the gift was made. If the surviving spouse is considered to have made the gift after the moment of the first dying spouse's death, the parties were not then married, and the marital deduction would not apply. However, if the surviving spouse is deemed to have made the gift before or at the moment of the first dying spouse's death, then the first requirement of the deduction is met.

Messrs. Blattmachr, Gans, and Bramwell take comfort from the authorities dealing with the death of spouses in common disasters.[21] In that situation, it has been held that a gift occurs at the moment of death, rather than after death.[22] They note that "no policy justification exists for refusing to extend this rationale to the [joint trust] strategy."

Messrs. Blattmachr, Gans, and Bramwell also discuss the Ninth Circuit Court of Appeal's 1935 decision in *Johnstone*, in which the court suggested that a transfer occurs the moment before death rather than after death. However, their discussion reveals that later cases have cited *Johnstone* on this issue with inconsistent results. On the other hand, *Johnstone* did not involve a transfer between spouses, while the simultaneous death authorities involve interspousal transfers. In light of these authorities, the authors believe that practitioners can be fairly confident that the gift at death will be deemed to be made during the marriage.

The terminable interest issue may be more problematic. The facts in the rulings show no outright gifts or QTIP election. The question is whether the surviving spouse receives enough rights in the gifted

19 See Ltr. Ruls. 200101021, 200210051, and 200403094.

20 Mulligan, *supra* note 8; Gans, Blattmachr, and Bramwell, *supra* note 17.

21 Gans, Blattmachr, and Bramwell, *supra* note 17. The "common disaster" presumption applies only when there is no evidence as to the order of death. Reg. 20.2056(c)-2(e).

22 See Reg. 20.2056(c)-2(c); Estate of Bagley, 443 F.2d 1266 27 AFTR2d 71-1852 (CA-5, 1971). In Bagley, Mr. Bagley's will created a testamentary trust for his wife's benefit during her lifetime and gave her a general testamentary power of appointment over this trust. Mr. Bagley's will provided that this power of appointment could be exercised in his wife's will by specific reference to the power. His will also provided that in the event of a simultaneous death, his wife would be deemed the survivor. His wife's will made no reference to the power of appointment. Both spouses died in a car accident, and no evidence existed as to the order of their death. The court determined that "[t]he power of appointment given to Mrs. Bagley under her husband's will was created immediately upon the death of the husband, subject to later perfection by probate."

property to satisfy Section 2523(e): a right to receive lifetime income and a general power of appointment over the applicable interest.

In Ltr. Rul. 200210051, each spouse had the right to demand distributions of income and principal while both were living, effectively having a lifetime general power of appointment. In the other rulings, the first spouse to die received only a testamentary general power of appointment with no particular income rights. Although the IRS allowed a marital deduction in these rulings, it did not provide any discussion of the terminable interest issue.

Messrs. Blattmachr, Gans, and Bramwell express concern about the fact that the surviving spouse was granted a "naked" testamentary general power of appointment (a power without an income interest) in the rulings. They caution that the Service may reexamine its position on this issue in the future, because a power of appointment without an income interest does not satisfy the non-terminable interest exception under Section 2523(e). They therefore suggest that the surviving spouse would have to rely on an exception created by case law, which allows a marital deduction when the spouse has the option to either accept or reject a gift within a reasonable time and ultimately accepts the gift. Finding acceptance here would seem to require that the surviving spouse actually exercise the testamentary power of appointment. Although one ruling did involve the exercise of the power,[23] the others did not. Further, these commentators feel that even exercising the power may not be enough, because the relevant cases all involve spouses who personally accept outright gifts rather than receiving a power of appointment.

The authors expect that the IRS will retain this favorable position on the marital deduction issue and eventually issue a definitive ruling. In the meantime, short of requesting a ruling for each joint trust we prepare, how can estate planners reduce the chance of a marital deduction problem if the IRS takes the position that the surviving spouse made a gift to the first dying spouse that would otherwise be taxable?

Certainly, there is no harm in using language that is so closely identified with the marital deduction that the Service may grant the deduction without giving the subject much thought. As an example, two of the rulings made the first dying spouse's testamentary general power of appointment "exercisable alone and in all events." This language added nothing, but it does scream out, "marital deduction!"

To help bring the gift within the statutory requirements of Section 2523(e), it may also be useful to include a provision in the trust that allows both spouses to withdraw principal from the trust while both are living, as found in Ltr. Rul. 200210051.[24]

If all else fails, a savings clause in the trust agreement could directly or indirectly provide that if the gift tax marital deduction does not apply, Credit Shelter Trust B would be funded only to the extent of the surviving spouse's estate tax exemption (or to an amount slightly less than the surviving spouse's exemption to permit future gifting and a cushion for valuation issues that could apply in later years). That way, the surviving spouse could avoid a gift tax on assets going into that trust at the first death. So long as the terms of Credit Shelter Trust B do not subject the remaining assets to estate tax at the second death, the parties should be no worse off than if they had not tried to use a joint trust to protect both exemptions. Of course, a description of the contingency could alert the Service to the marital deduction issue if it is not otherwise aware of it.

For example, if Credit Shelter Trust B is funded with $2 million worth of assets and the surviving spouse has a $5.25 million estate tax exemption, it would seem that, at worst, the surviving spouse would have been deemed to have made a $2 million gift to the trust. If the trust is sitused in an asset protection jurisdiction and the spouse does not have a power of appointment over trust assets, all growth in the trust that occurs during the surviving spouse's remaining lifetime can escape federal estate tax, notwithstanding that the trustee may have discretion to make distributions to the surviving spouse.

Creditor protection

The next risk to consider involves creditor protection concerns.

Risk 5: No creditor protection from the surviving spouse's creditors. Where an individual transfers assets to a trust for his or her own benefit, most states allow the individual's creditors to reach those assets. Just as there is a risk that the surviving spouse may be considered to have transferred assets to the trust for estate tax purposes, there is a risk that the surviving spouse could be considered to be the trans-

23 Ltr. Rul. 200403094.

24 Each spouse would seem to have a lifetime general power of appointment, which eliminates the need for income payments to qualify for the marital deduction. See Reg. 25.2523(e)-1(f)(6). Whether each spouse is comfortable with the other spouse having such a power is another question. In Ltr. Rul. 200210051, however, each spouse had the right to receive principal *and* income from the trust during their joint lifetime, which Mr. Mulligan believes to satisfy the requirements of Reg. 25.2523(e)-1(f)(8).

feror of the assets for creditor protection purposes. This could allow creditors of the surviving spouse to reach the assets of Creditor Shelter Trust B if the surviving spouse is a beneficiary.

Note that estate tax and creditor protection issues would arise in different contexts, probably in different legal jurisdictions, and the decisions might not be consistent. Depending on the outcome, the estate tax could take part of Credit Shelter Trust B on the surviving spouse's death, but even worse, creditors could take all of the assets.

The best way to minimize the risk of creditors would be to situate Credit Shelter Trust B in an "asset protection trust" jurisdiction such as Nevada, Alaska, Delaware, Ohio, or Nevis, where creditor protection is available for self-settled trusts.

An alternative that could help for creditor protection purposes, but not federal estate tax purposes, would be to require the trustee to invest in a family LLC or limited partnership to obtain charging order protection so that the surviving spouse's creditors would have a more difficult time obtaining assets from Credit Shelter Trust B. But this would not prevent the IRS from concluding that the surviving spouse's creditors can reach into Credit Shelter Trust B, and thereby cause its assets to be considered as owned by the surviving spouse for estate tax purposes.

Stepped-up basis

In its rulings, the IRS determined that the assets in the surviving spouse's share of the joint trust could not obtain a stepped-up basis under Section 1014(a) on the first death, even though the assets are includable in the gross estate of the first dying spouse. The authors believe that the IRS is wrong and that a basis step-up should be available, particularly if the surviving spouse's rights in the trust assets are limited after the first death. Although the authors expect the Service to continue to take this position, there are ways to significantly increase the chances of a successful outcome.

In the rulings, the IRS asserted that the step-up was prohibited by Section 1014(e).

Section 1014 generally provides that the basis of property in the hands of a person acquiring the property from a decedent, or to whom the property passed from a decedent, is the fair market value of the property at the date of the decedent's death. Section 1014(e), however, provides the following exception to this rule:

> [I]f appreciated property *was acquired by the decedent by gift during the one-year period ending on the date of the decedent's death, and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property*, the basis of such property in the hands of the donor is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.[25] [Emphasis added.]

For Section 1014(e) to apply, the property must be "acquired by" or "pass to" the original contributor of such property—in this case, the surviving spouse. How does this language apply when the property does not pass directly to the surviving spouse, but instead passes to a trust for the possible benefit of the surviving spouse? In its rulings, the Service has concluded that this language precludes a basis step-up without providing any explanation. The authors share the belief of many others that the Service has stretched the literal language of the law in reaching this conclusion. "Acquired by" or "pass to" should apply only if full ownership is transferred back to the surviving spouse.

Assets originating with the surviving spouse will wind up in Credit Shelter Trust B; therefore, the less interest that the surviving spouse has in this trust, the more likely that the IRS will accept that Section 1014(e) should not bar a step-up.

For example, a step-up should be allowed if the surviving spouse is not a beneficiary of the Credit Shelter Trust B. Of course, economic considerations may require that the surviving spouse be a beneficiary. Some planners have asserted that Section 1014(e) should not apply if the surviving spouse is only a discretionary beneficiary.[26] No rulings or cases explicitly confirm this conclusion, but it is difficult to say that property "passed to" or was "acquired by" a discretionary beneficiary, who by definition has no certain rights to the property.

QTIP Trust B

As mentioned above, QTIP Trust B is funded only if assets remain in the surviving spouse's share after funding Credit Shelter Trust B. Many of the same risks applicable to Credit Shelter Trust B, discussed above, are also applicable to QTIP Trust B; however, the QTIP nature of this trust creates a few important differences, which are discussed below.

Estate tax and marital deduction. The assets of QTIP Trust B will be includable in the first dying spouse's estate, but will not be sub-

25 Ltr. Ruls. 200101021 and 200210051.

26 See Barreira, "Proper Medicaid Planning May Permit Keeping the Home in the Family" 28 ETPL 177 (April 2001) (stating that "[t]he discretionary nature of the trust should allow a complete step-up in basis as of the deceased spouse's date of death for capital gains tax purposes").

ject to estate tax at the first death pursuant to the marital deduction. To qualify for the marital deduction, however, the surviving spouse must receive all income from this trust at least annually.[27] Estate tax will be deferred for QTIP Trust B assets until the surviving spouse's death. At that point, the assets of QTIP Trust B will be included in the surviving spouse's gross estate and be subject to estate tax, if the surviving spouse's personal assets and QTIP Trust B assets exceed the surviving spouse's remaining estate tax allowance.

Creditor protection. Unlike Credit Shelter Trust B, where the surviving spouse is not required to be an income beneficiary, the surviving spouse must receive all income (if any) from QTIP Trust B in order to meet the marital deduction requirements under Section 2056(b)(7). Accordingly, the surviving spouse's creditors can reach any income that is actually distributed to the surviving spouse. However, if the surviving spouse is only an income beneficiary, his or her creditors cannot reach the principal of QTIP Trust B, and the income can be minimized.

Stepped-up basis. As previously noted, the estate tax marital deduction requires that the surviving spouse be an income beneficiary of QTIP Trust B. Again, the authors and others feel that a stepped up basis should still occur notwithstanding that a surviving spouse who was considered to have gifted the assets involved to the first dying spouse would have the right to receive principal in the discretion of a trustee, an income interest, or a special power of appointment. The surviving spouse, however, will have a stronger argument for a step-up in basis if the spouse retains fewer rights in QTIP Trust B.

Conclusion

The JEST technique eliminates many of the concerns that have prevented estate planners in non-community property estates from using joint trusts in the manner approved by the IRS in private letter rulings. Although not without uncertainty as to whether both a full stepped-up basis and full funding of a credit shelter trust will occur on the first death, many couples and their descendants will be better off for having used this arrangement for the reasons described above. While the IRS may not agree with all tax advantages described in this article, if the client would be no worse off having only the advantages the IRS might allow (one-half of a stepped up basis and one-half of a credit shelter trust funding) then it should be more than worthwhile to attempt to position the family in the best manner possible, and to monitor the tax law as it will eventually work itself out in the future.

Practitioners should invest time to understand these issues, and to understand and develop trust documents that take the above and many other considerations into account. Practitioners should also make sure that clients understand the risks and possible advantages of this system. Each client's situation merits special drafting that can save much in taxes while positively enhancing family and creditor protection planning.

Unequal funding of the trust while both spouses are alive raises the possibility of a gift upon funding.

To increase creditor protection, it may be best to limit the surviving spouse's right to receive distributions in the discretion of the trustee according to an "ascertainable standard."

It may also be useful to include a provision in the trust that allows both spouses to withdraw principal from the trust while both are living.

The less interest that the surviving spouse has in this trust, the more likely that the IRS will accept that Section 1014(e) should not bar a step-up.

If the surviving spouse is only an income beneficiary, his or her creditors cannot reach the principal of QTIP trust B, and the income can be minimized.

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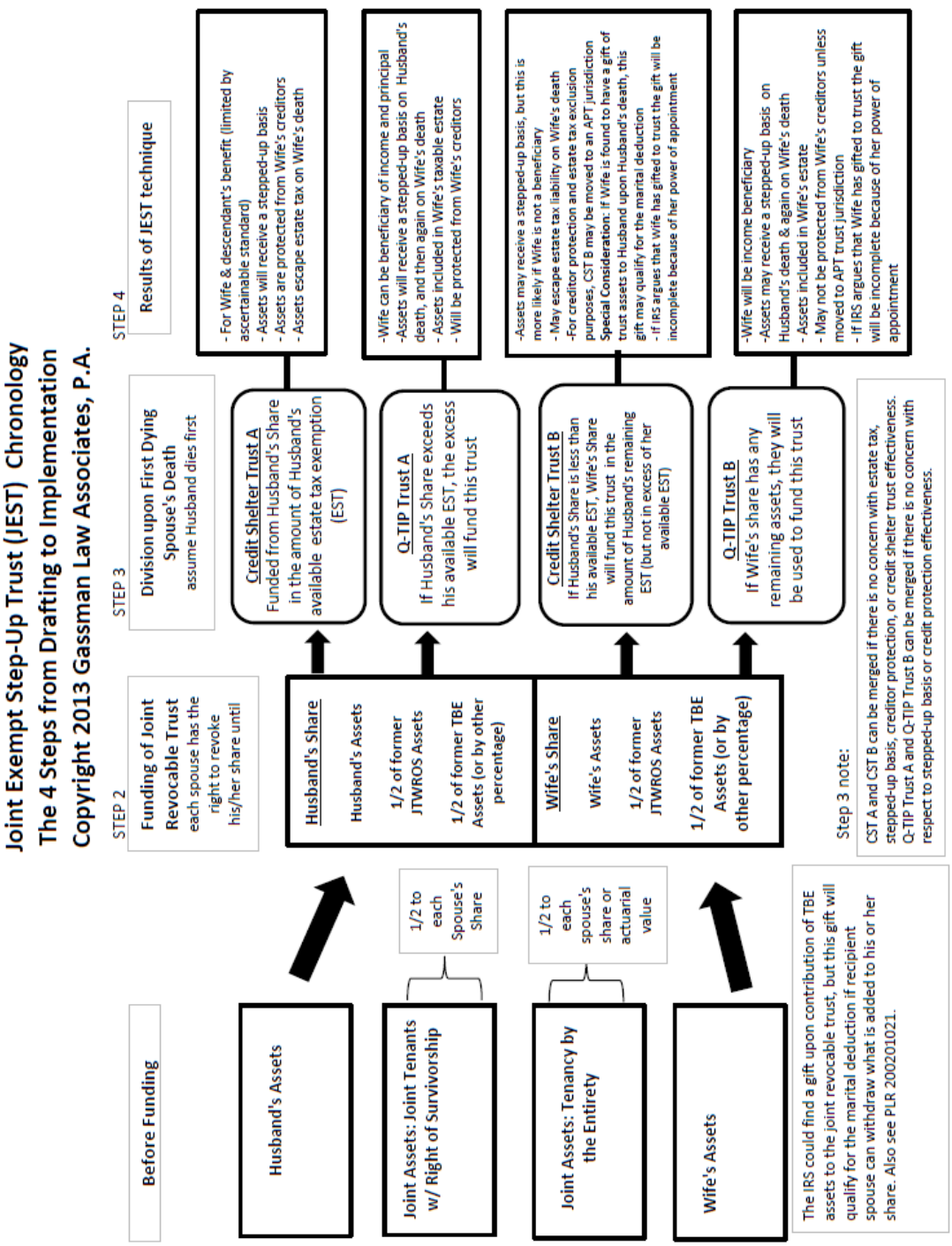
27 Section 2056(b)(7).

Appendix B: JEST Chronology Chart



Appendix C: Community Property Planning In Non-Community Property States & Understanding The Florida Community Property Trust Act - Opportunities, Developments, And Traps For The Unwary

Alan Gassman and Brock Exline

I. KEY TAKEAWAYS:

Before the reader gets bogged down with 100 rules and 300 exceptions, please keep your eyes open for the following key takeaways.[15]

1. **Community Property Defined.** Community property consists of all assets acquired by one or both spouses of a married couple while they reside in a community property jurisdiction.[16] This will include IRAs, assets held in only one spouse's name other than those acquired by gift, bequest, or devise, and the right to receive payment or assets in the future.[17] Gifts of community property typically require the consent of both spouses, and a gift of community property without dual consent of the spouses is voidable by the non-consenting spouse.[18] As a result, a gift lacking consent of both spouses will generally be deemed incomplete for purposes of the federal gift tax.[19]

2. **Selected Definitions**. The following definitions can be helpful.

A. Transmute- to convert the character of community property to another status of ownership. Property can be transmuted from community property to separate property, or from separate property to community property by a couple who lives in a community property jurisdiction.[20] Typically, this occurs through the execution of an appropriate document by a married couple, which may need to be recorded in the public records when dealing with real estate.

B. Mutable. Derived from the Latin root "mut" for "changeable" or "tendency to change," this meaning is found in such words as 'commute, immutable, mutability, transmute, permute, and mutate.' Mutability ("the ability to change") is a fundamental aspect of choice of law principles in the United States which provide that legal rules governing the property of a married couple change depending on the couple's place of residence at different points in time, as further discussed below.[21]

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15. Special thanks to Dr. Gerry W Beyer, whose presentation entitled *Community Property: Tips and Traps for Lawyers in Common Law States*, a 2021 presentation at the 47th Annual Notre Dame Tax & Estate Planning Institute was of tremendous help to the authors in the writing of this article. Many of the takeaways in the Notre Dame outline were derived from M. Read Moore and Nicole M. Pearl, *Coming Soon to Your State: Community Property*, ACTEC 2020 Fall Meeting, October 27, 2020.

16. Gerry W. Beyer, *Community Property: Tips and Traps for Lawyers in Common Law States*, 47th Annual Notre Dame Tax & Estate Planning Institute, at 1 (Oct. 22, 2021).

17. *See* IRM 25.18.1.3.10 (Feb. 15, 2005); *e.g.,* 26 U.S.C. § 408(g) (1983) (stating that tax laws apply regardless of whether IRAs are located in, and therefore affected by, community property law jurisdictions).

18. Beyer, *supra* note 2, at 38 (citing Trimble v. Trimble, 26 P.2d 477 (1933)).

19. *Id.* (citing Treas. Reg. § 25-2511-2(b)); Harper v. Commissioner, 6 T.C. 230,238 (1946) (applying California law); Estate of Kelly v. Commissioner, 31 T.C. 493,502 (1958) (applying Louisiana law.)

20. *See generally* William D. Farber, J.D., LL.M, *Transmutation of Separate Property into Community Property*, 37 AM. JUR. Proof of Facts 2d 379 (originally published in 1984).

21. Beyer, *supra* note 2, at 17.

C. Commingle. Commingling refers broadly to the mixing of funds belonging to one party with funds belonging to one or more other parties. Commingling may also refer to the mixing of assets characterized as community property with assets characterized as separate property, such that the original character of the assets mixed into the same account may become indeterminable. For example, in Florida divorce cases where marital property and non-marital property have been commingled, the non-marital assets can be transformed into marital assets and will be subject to equitable disposition on divorce if the original character of the marital and non-marital assets are not reasonably traceable.[22]

D. The Double Step-up in Basis. The double step-up in basis under Internal Revenue Code §1014(b)(6) allows for a full step-up in basis to fair market value for community property jointly owned by a married couple on the death of one spouse. Under 1014(a), when a person inherits property, the property's tax basis is "stepped up"[23] to its fair market value as of the date of the owner's death.[24] This means that the heir's basis in the inherited property is adjusted to its date of death value, so that any appreciation in value that occurred during the decedent's lifetime is not subject to capital gains tax. Internal Revenue Code §1014(b) lists the seven types of property that are considered to have been acquired from or to have passed from the decedent for purposes of §1014(a). Further, §1014 (b)(6) provides that "property *which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State*, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate," shall be considered to have been acquired from or to have passed from the decedent.

As a result, the surviving spouse receives a stepped-up basis as to their one-half of the community property, and because this half, along with the decedent's half, are considered to have both been acquired from or to have passed from the decedent, both ownership interests in the community property are stepped up to the fair market value on the first spouse's death (assuming at least one-half of the whole of the community interest was includible the decedent's gross estate).[25]

The double step-up in basis is one of the central reasons why a married couple may wish to have their property treated as community property.

3. **Be Careful.** Be very careful when a married couple has or has had community property and has moved to a separate property state. It is safest to confer with a lawyer who practices in the state where the community property came about or exists and a lawyer who understands how community property functions in the non-community property state that the couple has moved to in order to be sure that nothing is missed.

4. **Step-Up In Basis vs. Creditor Accessibility.** Notwithstanding the advantage of obtaining the step-up on income taxes if one spouse dies, many married couples are more concerned about the possible loss of community property assets to creditors while they are both living. For example, there may be potential

22. Dravis v. Dravis, 170 So. 3d 849 (Fla. Dist. Ct. App. 2015). In *Dravis*, cash gifts that a wife's mother gave to the wife during marriage lost their non-marital character when the gifts were commingled with marital money in a savings account. *Id.*

23. Or "stepped down" when the fair-market value is less than the original cost of the property.

24. I.R.C. § 1014(a).

25. *See, e.g.*, Holt v. U.S., 39 Fed. Cl. 525, 527 (Fed. Cl. 1997) (providing that "the surviving spouse's one-half interest in community property, even though not actually passing through the decedent's estate, is defined, for basis purposes, as an interest acquired from the decedent). By virtue of this fiction then, the entirety of the community property achieves a step-up in basis-one-half by actual transfer from the decedent (as recognized in 1014(b)(1)); the other half (the surviving spouse's interest) pursuant to the constructive transfer recognized in 1014(b)(6)." *Id.*

exposure of assets to creditors, and a constructive gift made by one spouse when the other spouse transfers assets in his or her name to an irrevocable trust or otherwise, if the assets are community property.[26]

The debtor and creditor laws vary greatly among the community property states, as discussed in depth below.

5. <u>When the Couple Moves to a Non-Community Property State</u>. When a married couple moves from a community property state to Florida there is case law and literature to support the proposition that the community property assets remain as community property assets, if they are not sold or exchanged for other assets, unless and until they are transmuted out of community property status.[27,28] If they are sold or exchanged for other assets then the law is not as clear.

Where a couple that has moved from a community property state to a non-community property state wishes to primarily use a lawyer in the non-community property state, it may work best to keep the community property assets that were acquired in the community property state under a joint trust to ensure identification and to avoid the commingling of such assets. An added benefit of this arrangement is the ability to have the trust assets pass one-half to a new revocable trust established by the first dying spouse and one-half to a separate revocable trust established by the surviving spouse. This permits the lawyer in the non-community property state to use the same general forms and strategies as would normally apply under traditional community property law, with coordination to allow the joint community property trust to continue and pay into the non-community property trusts on the first death**.**

Married couples may also agree in a premarital agreement or marital property agreement that the laws of a particular state, including a state other than their domicile, will govern the married couple's rights in property acquired during the marriage.[29]

6. **<u>Florida Case Law.</u>** In the 1967 Florida case of *Quintana v. Ordono*, a husband took community property and sold it in exchange for a note, the note was found not to be community property, but the husband was found to be holding the note one-half as his own property and one-half as his wife's.[30] The wife's equitable interest in the note was considered to be held under a constructive trust for her benefit because it originally came from community property.[31] This case illustrates that in transactions affecting community property in non-community property states, where one spouse buys property in their own name, a resulting trust is generally found to exist in favor of the other spouse. This case further supports the legal position observed in Takeaway #4 above.

7. **<u>Uniform Disposition of Community Property Rights at Death Act (UDCPRDA).</u>** Florida and the below enumerated fifteen states have adopted the Uniform Disposition of Community Property Rights at

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26. *Id*. (stating community property may not be devised by a single spouse and may be "encumbered with debt").

27. A. M. Swarthout, *Annotation, Change of Domicile as Affecting Character of Property Previously Acquired as Separate or Community Property*, 14 A.L.R.3d 404 § 2[a] (originally published in 1967).

28. *See generally* FLA. STAT. §§, 736.1501-736.1512 (2021).

29. RESTATEMENT (SECOND) OF CONFLICT OF L. § 258.

30. Quintana v. Ordono, 195 So. 2d 577, 580 (Fla. Dist. Ct. App. 1967).

31. *Id*. The elements that must be established for a court to impose a constructive trust are: (1) a promise, express or implied, (2) a transfer of property and reliance thereon, (3) a confidential relationship, and (4) unjust enrichment. Gersh v. Cofman, 769 So. 2d 407 (Fla. Dist. Ct. App. 2000). In the context of marital property disputes, constructive trusts are used to enforce the principles of equitable distribution. "Even when a property has not been acquired by fraud, a constructive trust will be imposed if equity would be offended should the property be retained by the person holding it . . . . This is so because a constructive trust is a remedial device with the dual objectives of restoring property to its rightful owner and preventing unjust enrichment . . . .The wife presents a classic case where the imposition of a constructive trust is necessary to do justice and 'prevent the unjust enrichment of one person at the expense of the other." PROPERTY DISPOSITIONS, FACS FL-CLE 6-1, citing Geiser v. Geiser, 693 So. 2d 59 (Fla. Dist. Ct. App. 1997).

Death Act,[32] which generally indicates that community property laws are replicated in Florida for inheritance purposes, unless or until community property that is brought to Florida by a former community property couple is transmuted.[33] The UDCPRDA has also been enacted in Alaska, Arkansas, Colorado, Connecticut, Hawaii, Kentucky, Michigan, Minnesota, Montana, New York, North Carolina, Oregon, Utah, Virginia, and Wyoming.[34]

Dr. Gerry Beyer has observed that "[t]he UDCPRDA is not a tax statute and on its face is limited to the spouse's rights of testamentary disposition over the property."[35] There is no binding federal tax authority known of by the authors that uses the UDCPRDA as support for obtaining the double step-up in basis under Internal Revenue Code §1014(b)(6). However, a 1993 IRS Field Service Advisory, which cannot be cited as authority, acknowledged that the UDCPRDA was enacted to ensure that the surviving spouse would have the same ownership rights in Oregon as she would have had if still domiciled in California.[36] The Advisory, in determining what a surviving spouse's tax basis would be in Oregon real estate purchased with the proceeds of the sale of a couple's California community property residence, found that both halves of the Oregon property were afforded the double step-up in basis on the death of the first spouse.[37]

8. **Trust Planning Constraints**. On the death of one spouse in a community property state, individually owned community property passes one-half through the probate or revocable trust estate of the first dying spouse, and thus pursuant to his or her Last Will and Testament, or intestate succession, while the other half is considered to be owned outright by the surviving spouse, regardless of titling, unless a specific state or federal law applies otherwise [such as Homestead or TBE in Florida].[38]

It is very common in community property states for spouses to form and fund a Joint Trust that declares its assets to be community property, and directs or confirms that on the first death 50% of the Trust assets will be owned directly and immediately by the surviving spouse, and 50% will pass as directed in the Trust to a Credit Shelter Trust to be held for the health, education, maintenance and support of the surviving spouse, subject to possible changes. If the assets so passing, along with other assets, will exceed the first dying spouse's estate tax exemption amount, such assets may pass to the surviving spouse through a marital deduction trust (which will almost always be a "Qualified Terminable Interest Property ("QTIP") Trust"), if facilitated under the Trust documents.[39]

9. **Consider a JEST.** As an alternative to the above, the married couple can transmute out of community property treatment and use separate revocable trusts by balancing assets between the spouses, or they may use a Joint Exempt Step-Up Trust ("JEST Trust") that may replicate the step-up in basis on the first dying spouse's death by use of a Power of Appointment exercisable by the first dying spouse.[40] The JEST offers the possibility of having more than just half of the Trust assets pass to fund a

32. Conveniently referred to as the "UDCPRDA," which also stands for "Understanding the Disposition of Community Property is Really Difficult and Agitating."

33. FLA. STAT. §§ 732.216-732.228. *See also* Beyer, *supra* note 2, at 22.

34. Beyer, *supra* note 2, at 22.

35. *Id.*

36. *Id.* Field Service Advisories are not binding on the IRS or taxpayers, but often provide good background and an indication of how the IRS or a court might rule under particular circumstances. Field Service Advisories are issued in response to requests from IRS field personnel and are generally requested for purposes of legal guidance with regard to a specific situation of a specific taxpayer. Federal district courts have ruled that the IRS is not bound by field-service advisories and that the IRS need not treat similarly situated taxpayers similarly. Schering-Plough Corp. v. United States, No. 2:05cv-02575 (D. N.J. Dec. 3, 2007).

37. *Id.* (citing 1993 WL 1609164 (1993)).

38. 41 C.J.S. *Husband and Wife* § 383 (2023).

39. Richard L. McCandless, *Drafting Marital Deduction Provisions*, 64 DICK. L. REV. 425, 425 (1960) (stating that marital deduction trusts offer tax deductible advantages).

40. Martin M. Shenkman, *Hecklering 2015 Nuggets Grantor Trusts, the Quest for Basis, and More!*, NAEPC J. Est. & Tax Plan., at 40 (2015).

Credit Shelter Trust on the first death.[41] In fact, all of a JEST trust's assets may pass in this way.[42] The IRS has not approved the full step-up in basis but has issued private letter rulings and a Technical Advisory Memorandum ("TAM") (which have been criticized by some) to allow for up to all of the Trust assets to fund a Credit Shelter Trust.[43]

10. **Community Property Trusts.** Alaska, South Dakota, Tennessee, Kentucky, and Florida as of 2021 provide that a married couple living anywhere in the world can establish a Community Property Trust in the applicable jurisdiction by having a Trustee in the applicable state as sole Trustee or Co-Trustee of a specially drafted Community Property Trust.[44]

The Community Property Trust assets will be exposed to creditor claims of one or both spouses in differing degrees, depending upon the state chosen, and the step-up in income tax basis for all Community Property Trust assets on the first death can be claimed on income tax returns, although the IRS has not blessed this result, and has specifically indicated in Publication number 555 entitled "Community Property" that was last updated in March 2020 that the IRS is not concluding whether a double step-up occurs by way of an elective community property regime.[45] IRS Publications are not binding on the IRS.[46]

11. **Support for Community Property Trusts.** The Tax Court opinion of *Angerhofer*, described below,[47] supports the proposition that individuals residing in a jurisdiction that allows a couple to decide if they want community property or not, permits the community property to be treated as such for income tax basis step-up planning purposes once the election is made. *Angerhofer* involved a German couple and Germany's choice of characterization rules and can be read to indicate that "if a state incorporates characteristics of community property statutes from the eight original community property jurisdictions in its community property trust legislation, it should be respected by the IRS (or at least by the Tax Court if the IRS challenges a taxpayer's classification of property as community in nature)."[48]

Alaska has a similar law that allows a couple residing in Alaska to elect into the community property regime.[49] Wisconsin law allows couples to elect out of its community property regime.[50] The other community property states and jurisdictions provide that community property jurisdiction is mandatory, but that a couple can "transmute out" of community property status.[51]

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41. *Id.*
42. *Id.*
43. *Joint Ownership, Joint Trusts and Basis-Step-up*, GREENLEAF TRUST (May 24, 2023), https://greenleaftrust.com/missives/joint-ownership-joint-trusts-and-basis-step-up/; I.R.S. Tech. Adv. Mem. 93-08-002 (Feb. 26, 1993); I.R.S. Priv. Ltr. Rul. 200101021 (Jan. 05, 2001); I.R.S. Priv. Ltr. Rul. 200210051 (Mar. 08, 2002); I.R.S. Priv. Ltr. Rul. 200403094 (Jan. 16, 2004).
44. Michael A. Sneeringer, *An Introduction to Community Property Trusts*, 35 PROB. & PROP. 34 (2021)..
45. *Publication 555 (03/2020)*, Community Property, IRS (Mar. 27, 2000), https://www.irs.gov/publications/p555#en_US_202001_publink1000264796.
46. 26 C.F.R. § 601.201 and 26 U.S.C. §6110(k)(3). Additionally, in *Bobrow v. C.I.R.*, 107 T.C.M. (CCH) 1110 (Tax 2014), the court emphasized that IRS published guidance is not binding precedent and that taxpayers "rely on IRS guidance at their own peril." *See also* Janet Novack, *`Taxpayers Rely On IRS Guidance At Their Own Peril,' Tax Judge Rules*, FORBES (Apr. 18, 2014), https://www.forbes.com/sites/janetnovack/2014/04/18/taxpayers-rely-on-irs-guidance-at-their-own-peril-tax-judge-rules/?sh=99225502ceab.
47. *See* Angerhofer v. C.I.R., 87 T.C. 814 (1986).
48. Joseph M. Percopo, *Understanding The New Florida Community Property Trust, Part II,* THE FLORIDA BAR (Oct. 2022), https://www.floridabar.org/the-florida-bar-journal/understanding-the-new-florida-community-property-trust-part-ii/#u6e00, quoting Travis Hayes, *To Share and Share Alike: An Examination of the Treatment of Community Property in Florida and the New Florida Community Property Trust Act*, at 28 (unpublished manuscript) (on file with the author). *See Angerhofer* at 827-29. Thank you to Steve Akers and Jonathan Blattmachr for their comments and insight on the Angerhofer decision.
49. Beyer, *supra* note 2, at 13.
50. *Id.* at 11.
51. Noel Joseph Darce, *Interspousal Contracts*, 42 LA. L. REV. 727, 733 (1982); *see, e.g.*, CA Fam. Code § 850 (2022) (allowing the transmutation of property to change its status from community property to separate property).

12. **Don't Let Your Estate Plan be the Titanic.** There is much more to know, but the above is hopefully a good tip of a somewhat confusing and unstable iceberg.

Appendix D: Power of Appointment Sample Language

(b) Power of Appointment Held by the Grantor's Mother. _____ shall have a power, exercisable upon the death of such named individual, to appoint the Trust assets held under this Trust or any trust herein established to creditors of such named individual's estate, and the following shall apply with respect to such power, notwithstanding anything to the contrary in Section 1.09 above:

> The applicable power exercisable on the death of _____ shall be an amount that is determined as of the date of death of the named deceased individual, based upon a fraction, (a) the numerator of which is the lesser of (i) the value of all assets in the Trust that have a fair market value which is greater than the adjusted basis of such assets at the time of _____'s death; (ii) the amount that is $10,000 less than the amount of the available unused United States federal estate tax exclusion amount of _____at the time of _____'s death (but not less than zero dollars ($0.00)) after taking into account any assets owned by _____for federal estate tax purposes (including, without limitation, any assets subject to a general power of appointment held by _____under any other document or trust instrument other than this Trust Agreement) to assure that the estate of _____does not become subject to United States federal or any state estate tax by reason of this power, or (iii) the amount that is $10,000 less than the amount of the available State estate tax or inheritance tax exclusion amount (the amount that can pass free of State estate or inheritance tax that _____may pass without being subject to State estate tax or inheritance taxes), as applicable after taking into account any assets owned by _____for federal estate tax purposes (including, without limitation, any assets subject to a general power of appointment held by _____under any other document or trust instrument other than this Trust Agreement), to assure that the estate of _____does not become subject to estate tax by reason of this power; and (b) the denominator is the value of all assets then held at the time of _____'s death, under the Trust, provided that in order for the exercise of such power to appoint to be effective it must be delivered to the Trustee of this trust in advance of the death of _____by a written instrument executed in the presence of two witnesses and a notary public that specifically refers to this Trust Agreement and this section of this Trust Agreement. Notwithstanding anything to the contrary in this paragraph, this Power of Appointment shall not apply to any asset that has a fair market value that is less than its income tax basis at the time of _____'s death. If the value of the assets subject to such Power of Appointment bestowed under this paragraph is less than the value of the assets under the Trust having a fair market value exceeding their basis at such time, then such Power of Appointment shall apply first to the asset having the greatest Fair Market Value to Basis Ratio, then to the asset having the second

greatest Fair Market Value to Basis Ratio, and then successively asset by asset based upon their Fair Market Value to Basis Ratios in decreasing order so that this Power of Appointment applies first to the assets with the greatest Fair Market Value to Basis Ratios. The term "Fair Market Value to Basis Ratio" shall mean the fair market value of the asset in question as of the date of death of _____that would apply for federal estate tax purposes, divided by the adjusted basis of such asset immediately before _____'s death. Where an asset that such power may be exercisable over consists of a limited liability company or other entity taxed as a partnership for federal income tax purposes (the "Partnership"), then the underlying assets of such Partnership shall be considered to be aggregated, based upon the Partnership's basis in such assets (the "Inside Basis"), and compared to the fair market value of such assets to determine the Fair Market Value to Basis Ratio of such Partnership which will determine the prioritization of such entity being subject to such Power of Appointment, and if such Partnership owes debt that would make a step-up in income tax basis "leveraged," then such leverage shall be taken into consideration with respect to prioritization so that the total step-up of income tax basis resulting from allocation to the Partnership interest would cause it to be prioritized. Thus, in the example below, if Asset B was subject to $2,000,000 of indebtedness, then Asset B would be prioritized over Asset A because Asset B would have a Fair Market Value to Basis Ratio of 794%, after taking into account the indebtedness that Asset B was subject to ($3,400,000 + $2,000,000 = $5,400,000; $5,400,000 / $680,000 = 794%).

By means of example, if on _____'s death, (1) _____is not subject to any State estate tax or inheritance tax, and _____'s federal estate tax exemption was $3,000,000, and (2) the assets included in _____'s gross estate excluding the assets under this Trust Agreement are equal to $1,750,000, then (3) up to $1,240,000 of assets held pursuant to this Trust Agreement would be subject to _____'s Power of Appointment ($3,000,000 - $1,750,000 = $1,250,000; $1,250,000 - $10,000 = $1,240,000). In the event that the total value of Trust assets with a fair market value in excess of basis is less than $1,240,000, then, _____'s Power of Appointment would apply to all of the assets of the Trust. In the event that the total value of Trust assets with a fair market value in excess of basis is greater than $1,240,000, then, _____'s Power of Appointment would first apply to those assets having the largest Fair Market Value to Basis Ratio.

By means of further example, if (1) the total value of the assets of the Trust are equal to $10,000,000, (2) only $8,000,000 of the Trust assets had a Fair Market Value in excess of Basis, and (3) the assets of the Trust consisted of the following five assets:

Asset	Fair Market Value	Basis	Fair Market Value to Basis Ratio	Amount Subject to Power of Appointment
Asset A - Real Estate 1	$600,000	$100,000	600%	$600,000
Asset B - Membership Interest in LLC Taxed as Partnership	$3,400,000	$680,000	500%	$640,000
Asset C - Real Estate 2	$3,000,000	$750,000	400%	$0
Asset D - Real Estate 3	$1,000,000	$500,000	200%	$0
Asset E - Real Estate 4	$2,000,000	$3,000,000	Not Applicable	Not applicable

Asset E would not be subject to _____'s Power of Appointment because its basis exceeded its fair market value.

If _____ had $1,240,000 worth of exemption available. The asset with the greatest Fair Market Value to Basis Ratio was Asset A. The total value of Asset A was equal to $600,000. Therefore, all of Asset A would be subject to _____'s Power of Appointment.

The asset with the next greatest Fair Market Value to Basis Ratio is Asset B, the Partnership interest. As a result of the application of the Power of Appointment to the value of Asset A, $640,000 of Asset B would be subject to _____'s Power of Appointment. ($1,240,000 - $600,000 = $640,000). As a result, 18.824% of the Partnership interest would be subject to _____'s Power of Appointment and would receive a step-up in basis equal to its fair market value as of the death of _____. ($640,000 / $3,400,000 = 118.824%).

Appendix E: Independent Fiduciary Sample Language

Independent Fiduciary. The term "Independent Fiduciary" shall refer to one or more individuals who are named under this document and who may appropriately be independent certified public accountants who have at least ten (10) years experience working full-time as a certified public accountant with a reputable certified public accounting firm with at least $1,000,000 of malpractice insurance to cover normal certified public accounting activities. No individual or institution that is a beneficiary of this Trust or any trust herein established may serve as an Independent Fiduciary, and if a beneficiary is inadvertently named for such role, he or she shall be considered to have resigned and not be able to serve, and can be replaced with an alternate Independent Fiduciary to facilitate fulfilling the intentions set forth under this Trust Agreement.

The Independent Fiduciary or Fiduciaries shall be indemnified and held harmless by the Trustee for any liability or expense incurred as a result of providing the Primary Beneficiary of a separate trust, as applicable, with such Power of Appointment, and are encouraged to consider whether providing such Power would make the trust assets subject to creditor claims of said Primary Beneficiary, and whether the situs of the trust should appropriately be transferred to a different state for creditor protection purposes before such Power is granted.

If no individual or institution is appointed to serve as Independent Fiduciary, or if one or more appointed individuals or institutions are named but are unable or unwilling to serve, then one (1) Certified Public Accountant selected by GASSMAN, DENICOLO &, KETRON P.A. shall serve as Independent Fiduciary. If more than one individual or institution is appointed to serve as Independent Fiduciaries and no two (2) of them are able or willing to serve as Independent Fiduciaries, then any two (2) Certified Public Accountants selected by GASSMAN, DENICOLO &, KETRON P.A. shall serve as Independent Fiduciaries. If GASSMAN, DENICOLO &, KETRON P.A. is unable or unwilling to select an Independent Fiduciary or Independent Fiduciaries then the party that would appoint the Trustees in the event of a vacancy in the office of Trustee under Section 6.05 of this Trust Agreement may appoint one or more of a duly licensed lawyer that is Board Certified by any State Bar Association, the District of Columbia, or the National Association of Estate Planning Counsels (NAEPC) in Wills, Trusts & Estates, or Taxation, a Certified Public Accountant who has done work for our family for at least fifteen (15) years, and/or a Licensed Trust Company to serve as Independent Fiduciaries, provided that at all times there shall be at least two individuals or a Licensed Trust Company serving as Independent Fiduciaries. Notwithstanding the previous sentence, in no event can any person or entity be appointed to serve as Independent Fiduciary if such person or entity is considered as a "related or subordinate party" with respect to me as such term is defined under Internal Revenue Code Section 672(c).

Power of Appointment. The Primary Beneficiary shall have a limited Power of Appointment (as defined in Section 1.09 of this Trust Agreement) with respect to his or her separate trust, and upon the Primary Beneficiary's death, the Trustee shall pay the remaining income and principal, or such portion thereof over which said Power is exercised, as the Primary Beneficiary directs pursuant to the exercise of such Power. Notwithstanding the above, and in order to assure that the Primary Beneficiary has been properly counseled with respect to the advantages of keeping assets under trust for future generation, such power shall not be exercisable unless such Primary Beneficiary shall meet physically with a lawyer who is Board Certified in trusts and estates, taxation, or elder law, and has at least ten (10) years' experience to discuss the advantages of maintaining assets under trust to facilitate protections of

beneficiaries from creditors, divorce, estate taxes, and improvidence, and no exercise of such power shall be considered to have occurred unless such qualified lawyer signs a letter contemporaneously with the execution thereof to confirm that the executions follows a consultation with such lawyer which provided input and advice with respect thereto.

Further, I recognize that the party nominated under Section 1.11 of this Trust Agreement may appoint an Independent Fiduciary who will have the power to act for the sole and limited purpose of bestowing upon the Primary Beneficiary the power to appoint all or a portion of Trust assets to creditors of the Primary Beneficiary's estate, if deemed appropriate by a majority of the said Independent Fiduciaries at any time that the Trust is in existence, exercisable by a written instrument signed by a majority of the Independent Fiduciaries. The successorship, responsibility, and governance associated with such Independent Fiduciary or Fiduciaries shall be as set forth in Section 1.11 of this Trust. I have been given the option of appointing who the initial Independent Fiduciary or Independent Fiduciaries may be, and have done so only if the following blanks are filled in with the names of one or more Independent Fiduciaries, which is completely optional. If filled in, such names are as follows: (1) _____ and (2) _____, provided that if these lines are not filled in with names, then selection of an Independent Fiduciary shall occur as described in Section 1.11.