

# **“OBTAINING STEPPED-UP BASIS FOR CREDIT SHELTER TRUSTS”**

**By: Robert J. Kolasa, Attorney, C.P.A., LL.M. (Tax)**

*Law Offices of Robert J. Kolasa, Ltd.  
1401 N. Western Avenue, 2nd Floor  
Lake Forest, Illinois 60045  
(847) 234-6262 / E Mail: robert@kolasalaw.com*

**ESTATE PLANNING SEMINAR**

**Lake County Bar Association  
2015 Trusts & Estates Annual Seminar**

**Friday, November 13, 2015**

# OBTAINING STEPPED-UP BASIS IN CREDIT SHELTER TRUSTS

**By: ROBERT J. KOLASA**

Robert J. Kolasa, Ltd.

Attorney, C.P.A., LL.M. (Tax)

(847) 234-6262

[robert@kolasalaw.com](mailto:robert@kolasalaw.com)

Lake County Bar Association

Trusts & Estates Committee Seminar

November 13, 2015

## The New Credit Shelter Trust Paradigm

- Estate Taxes are not a major concern for Many Clients
- Sky High” Estate Tax Exclusions
  - Federal - \$5,430,000 (2015 indexed)
  - Illinois - \$4,000,000
- Increasing Importance of Income Tax Planning
  - Basis Planning
  - **Estate Tax Planning can be Counterproductive for Smaller Estates because of Loss of “Stepped-up” Basis for Assets in Credit Shelter Trusts**



## Federal & IL Estate Taxes

(Estate Taxes Still Costly if Applicable)

2015 Tentative Taxable Estate	Federal Exclusion = \$5.43M Illinois Exclusion = \$4M		Fed & IL Marginal Rates Over \$5.43M
	Federal & IL Estate Taxes	IL Estate Taxes	
\$4,000,000	\$0	\$0	\$0
\$5,430,000	\$395,468	\$395,468	27.66%*
\$6,000,000	\$501,643	\$456,071	88.01%
\$7,000,000	\$967,362	\$565,603	61.62%
\$8,000,000	\$1,436,380	\$680,634	55.89%
\$9,000,000	\$1,908,629	\$801,049	53.46%
\$10,000,000	\$2,384,154	\$926,923	52.17%
\$20,000,000	\$7,207,379	\$2,298,965	49.47%

\*Marginal Rates over \$4M...sometimes it is beneficial to incur IL estate taxes over CST assets to achieved Stepped-up Basis

## Capturing the Estate Tax Exclusion of the 1<sup>st</sup> Deceased Spouse

### • CREDIT SHELTER TRUSTS

- **No Basis "Step-up" at death Spouse**  
Do Estate Tax Savings Outweigh Higher Income Taxes due to Loss of "Step-up"?
- High trust income tax rates
- Asset Protection & Control



### • ESTATE TAX PORTABILITY

- **Basis "Step-up" at death of Surviving Spouse**
- IL Estate Taxes if Assets > \$4M?  
(Drives CST Planning for IL residents; Portability skews analysis)

## Estimating Wealth of the Surviving Spouse

**Will the Client Need a CST?**

“Prediction is very difficult,  
especially if it’s about the  
Future!”



## The Credit Shelter Trust Debacle

*“Joe & Mary Clients”*

### **2001 - CST Living Trust Plan**

- Joe’s Living Trust      \$1M
- Mary’s Living Trust    \$1M
- Joint Tenancy/IRAs    \$1M



### **2002 - Joe Dies**

- Credit Shelter Trust    **\$1M**
- Mary’s Assets          \$2M

### **“Checkup” in 2015**

- Credit Shelter Trust    **\$2M**
- Mary’s Assets          \$1.5M

### **The Problem:**

- CST was “Unnecessary” (No Estate Taxes)
- Upon Mary’s Death - No “Stepped-up” Basis in CST
  - **\$400,000 of unnecessary income taxes?**

## **CST BASIS STEP-UP STRATEGIES**

- #1 Low Basis Assets Distributed to Spouse
- #2 3<sup>rd</sup> Party Grants Spouse Testamentary GPA
- #3 “Formula” GPAs
- #4 The “Delaware Tax Trap”

### **CST BASIS STEP-UP STRATEGY #1**

#### **Distribute Low Basis Assets to Surviving Spouse**

- Distribute CST Assets Pursuant to Broad Authority In Trust Document
  - Not held by Surviving Spouse or Children
  - By Independent 3<sup>rd</sup> Party:
    - Trustee or Co-Trustee
    - Distribution Committee
    - Trust Protector (“TP”)
    - “Absolute Discretion” or “Best Interests”
- Protecting the Fiduciary
  - Consider broad exculpatory clause?
  - Hire counsel?
  - Get Waivers from family member?



## **Strategy #1 – Distribute CST Assets to Spouse**

### **“Unauthorized” Distribution to Spouse?**

- Violates “HEMS” Standard for Spousal if Sole Trustee?
- IRS Constructive Trust Remedy or Deemed Sale of Assets?
- Trustee or Attorney Legal Malpractice?
  - If spouse has creditors; or
  - Spouse disinherits CST Beneficiaries
- Go ahead with a “Wink and a Nod?”



## **Powers of Appointment (“POA”)**

- **General POA (“GPA”)** = POA in favor of the Decedent, his Estate, Creditors, or Creditors of Estate
  - *Triggers Estate Tax Inclusion & Stepped-up Basis*
  - **Spousal GPA over CST = Stepped-up Basis**
- **Special POA (“SPA”)** = POA which is not a GPA
- **“Controlling” the GPA Exercise** *Narrow Scope*
  - Appoint to my Descendants and my Creditors
  - Require Consent of a “Non-Adverse Party” to Exercise
    - *Preserves Disposition Scheme & Discourages Litigation?*



## **CST BASIS STEP-UP STRATEGY #2**

### **3rd Party Grants Spouse Testamentary GPA over CST**

- Typically by Independent Trustee or TP
  - Should not be a “related or subordinate party” IRC 672(c)  
(not the Grantor’s spouse, father, mother, descendant, brother, sister, or employee...)
- Why not Grant a “Formula GPA”?
  - Exercise “Capped” so no Estate Taxes are incurred by Spouse
  - New” Twist – **Limit Appointive Assets to Heavily Appreciated Assets**
- Decant to Add this Power?
  - “Yes” under IL statute if Trustee has “Absolute Discretion”; if no such discretion, consider changing trust situs to access favorable decanting laws of other states...
- Does this Technique Work?

## **PROBLEMS - STRATEGIES #1 & #2**

**#1** - Distribute CST Assets to Surviving Spouse;

**#2** - Spouse Granted Testamentary GPA

- Burden to Exercise on Trustee or Trust Protector
- Duty to Maintain Communications with Spouse (Record keeping responsibilities - valuation and cost basis).
- **MALPRACTICE TRAP?**
  - Uncertainty of Exercise
  - If Spouse is sick, hard to get “quick” exercise...
  - Disgruntled beneficiaries may sue...
  - Should Trustee/TP hire counsel & obtain signed waivers from parties?



shutterstock · 155099780

## **CST BASIS STEP-UP STRATEGY #3**

### **FORMULA GPAs**

$$D = \frac{M}{V}$$

The “Formula”:

- **“Ordering Rule”** – Spousal GPA Limited to **Assets with the Greatest Appreciation**  
(Excludes loss property and IRA/Retirement Plans)
- **“Capping Rule”** – Spousal GPA limited to Exercise **which doesn’t cause Federal or IL Estate Taxes**
  - Means for IL residents, Spouse’s Estate generally won’t exceed \$4M after GPA exercise (Ouch!...possible “waste” of DSUE)
  - Consider removing IL Cap if value of Step-up basis of CST outweighs IL estate taxes

## **Sample “Formula” GPA Provision**

(See “Clause #1” of Appendix)

Subject to the limitations below the assets potentially subject to this general power of appointment shall only be those **assets of the Family Trust whose tax basis would increase in value...** subject to the following ordering rules:

The power shall **apply to the asset with the largest percentage of difference between fair market value at the time of my spouse’s death and the cost basis** immediately prior to my spouse’s death first, cascading in turn to each subsequent asset with the next largest percentage difference between fair market value and cost basis (e.g. an asset with basis of \$10, fair market value of \$100 would have a “percentage of difference” of 90/100, or 90%). **“ORDERING RULE”**

,,,Should the exercise of the above general power of appointment otherwise result in federal or state estate or generation skipping transfer tax liability... the appointive assets subject to this general power of appointment shall be **further limited...to that fraction or percentage that would not cause any estate tax liability.** **“CAPPING RULE”**



## **FORMULA GPA – Limited to “Gain” Assets**

**“Does this Technique Work? – “Possible” IRS Attacks**

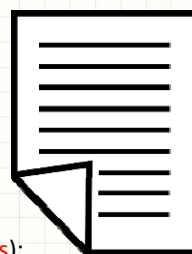
- GPA applies to Entire CST  
(Unlikely... “Old” Argument?)
- “Proportionate” Argument that Stepped-up Basis  
applies proportionately to ALL CST Assets
  - When Formula GPA Less than CST Assets
  - **No “cherry picking” of appreciated assets** for Stepped-up Basis  
(See Rev. Proc. 64-19 for analogous position for funding Marital Trusts)
- “Formula” GPA in Trust Document
  - **Strong contrary argument to IRS**
  - No “Trustee Choice” to Select Appointive Assets
  - Excludes Marital & Charitable Deductions in “Capping” clause (Kurz case)

$$D = \frac{M}{V}$$

## **CST BASIS STEP-UP STRATEGY #3**

**Where do we Find Formula GPAs?**

- In Trust Document -  
No “Extra Steps” Needed  
beyond CST Drafting Stage
- Not in Trust Document (extra steps):
  - Trust Protector grants Formula GPA to Spouse
    - “Ordering” and “Capping” Rules adopted in Granted GPA
    - Planning Strategy #2
  - “Old” GPAs without “Ordering Rules”
    - Adopt “Ordering Rules” in Document Exercising the GPA
    - More vulnerable to IRA “Proportionate” Argument?



## FORMULA GPAs

Spouse's Death – CST Receives Basis Step-up For "Gain Assets" (FMV > Basis)

### CREDIT SHELTER TRUST (for benefit Spouse/Children)

#### Gain Assets

Assets  
FMV > Basis

- Step-up Basis Capped at Spouse's Unused Exclusion
- Can "Define" what Appreciated Assets get Basis Step-Up

#### Loss Assets

Assets  
FMV < Basis

- No Change in Basis

## FORMULA GPAs – The Future?

### Advantages:

1. Preserve High Basis for Loss Properties
2. Superior over Marital Trust or Outright Bequest



### Disadvantages:

1. Does it Work?
2. Does it Expose CST Assets to Powerholder creditors?
3. Increases Form 706 filings
4. Note: Modify for State inheritance taxes...

## Basis in CST at Surviving Spouse's Death - Varying Results

Basis CST at Creation = <b>\$2M</b>			<div>“NEW” BASIS IN CST ASSETS</div> <div>(Higher = Better)</div>		
Value CST Assets at Surviving Spouse's Death = <b>\$3.5M</b>					
ASSETS (in thousands)			Traditional CST	Marital Trust/ Outright	CST w/ GPA Planning
	<u>Basis</u>	<u>Value</u>			
			<u>No-Step up</u>	<u>Full Step-up</u>	<u>Selected Step-up</u>
“Gain” Assets	\$1,000	\$2,000	\$1,000	\$2,000	\$2,000
“Loss” Assets	\$1,000	\$500	\$1,000	\$500 <i>Step-Down</i>	\$1,000
IRA	<u>\$0</u>	<u>\$1,000</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Total	<b>\$2,000</b>	<b>\$3,500</b>	<b>\$2,000</b>	<b>\$2,500</b>	<b>\$3,000*</b>

\*Best Tax Results

## CST BASIS STEP-UP STRATEGY #4

### The "Delaware Tax Trap" – IRC 2041(a)(3)

Existing POA creates New Trust with "Prohibited" POA

"Incomprehensible" Language? – enacted 1951

#### 2041(a)(3) Creation of another power in certain cases

To the extent of any property with respect to which the decedent—  
**(A)** by will, or

**(B)** by a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under section 2035, 2036, or 2037,

**exercises a power of appointment** created after October 21, 1942, **by creating another power of appointment** which under the applicable local law **can be validly exercised** so as to **postpone the vesting** of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable **without regard to the date of the creation of the first power.**

## **CST BASIS STEP-UP STRATEGY #4**

### **"Tripping" the "Delaware Tax Trap"**

- IRC Section 2041(a)(3)

**Estate Tax Inclusion = Stepped-up Basis**

- Anti-Abuse Rule that now is a Planning Opportunity



- The Abuse: 1933 Delaware Law that offered the possibility of having a Trust Last Forever without Estate Taxes (Result similar to current Dynasty Trust Plan)

## **Strategy #4: The Delaware Tax Trap**

**Exercising Testamentary SPA to Create Trust with "PEG Power"**

**Triggers the "Trap" by Resetting Perpetuities Clock**

- Rule Against Perpetuities:  
No interest in property is valid unless it vests within 21 years of a life in being at the time of the creation of the interest.
- "PEG Power" = Presently Exercisable GPA
  - "Trap" triggered because a new perpetuities period is started measured from the Exercise of the SPA (not Creation of the SPA)
  - **Stepped up Basis & Inclusion in Spouse's Taxable Estate**
- CST Planning: "Trap" Triggered by Spouse Exercising Testamentary SPA to Create a New Trust over which the Child Beneficiary has a "PEG Power"



## “Trap” Triggered by Spouse Exercising SPA to Create New Trust with “PEG Powers”

### **“PEG Power” = Presently Exercisable GPA**

- Adopt Formula GPA “Capping” & “Ordering” Rules?
- Can retain specially tailored testamentary SPA in Disclaimer Trusts granting PEG powers to children, without disqualifying Spouse’s disclaimer

#### Example:

Pursuant to paragraph X of my spouse’s trust dated xx/xx/xxxx, I [surviving spouse] was granted a testamentary limited power **[SPA IN OLD TRUST]** to appoint the assets of said trust by specifically referring to that power in my Will. I hereby exercise that power as follows:

I hereby appoint the following assets to the:

XYZ Appointive Trust **[NEW TRUST]** or incorporate trust from CST provisions) with the exception that this trust shall have the following additional paragraph applied:

“During my child’s [beneficiary’s] lifetime, **my child shall have a presently exercisable general power [PEG POWER]** to appoint any or all assets of this trust to his or her creditors, to him or herself or to any of my descendants in such amounts or under such terms as my child [beneficiary] deems appropriate.

[Adopt “Capping Rule” to avoid Federal or Illinois estate taxes and “Ordering Rule” to achieve stepped-up basis for highly appreciated assets...]

## “Springing” the Delaware Tax Trap by Granting PEG Powers

### • **WIDESPREAD APPLICABILITY**

- Any Existing Trust having a SPA (no extensive advanced preparation)
- For “Old” CSTs which do not save Estate Taxes

### • Draft PEG Power as a “Formula” GPA

(1) Limit to “Gain” Assets; & (2) “Capping” exercise to not cause Federal or IL estate taxes (some cases may be beneficial to incur IL estate taxes)

- Alternative to “Formula GPA” Drafting?
- CST Beneficiary can Disclaim PEG power?



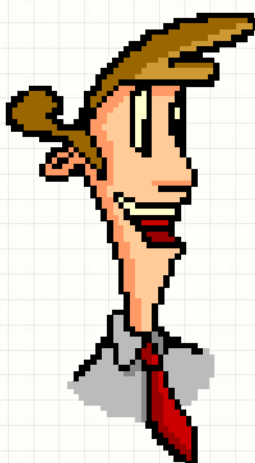
## **Strategy #4 The “Delaware Tax Trap”**

### **Reasons for not Granting PEG Powers To Spring the “Trap”**

- Youthful CST Beneficiaries
  - Spendthrift Problems
  - Creditor Problems
- Assets Subject to PEG Power Included in Beneficiary’s Estate
- Requires Affirmative Action by Spouse
- Reliance upon Obscure/Arcane Rules & State Law Variations of Rules
- Does this Technique Work?



THE END



Questions?



## **APPENDIX OF SAMPLE CLAUSES**

**WARNING: THESE SAMPLE FORMS ARE DRAFTS FOR CONSIDERATION BY PLANNERS. THERE IS NO WARRANTY FOR ITS USE FOR ANY PURPOSE. IT IS INTENDED ONLY TO PROVIDE GUIDANCE TO A PRACTITIONER IN DRAFTING AND SHOULD NOT BE RELIED UPON FOR ANY OTHER PURPOSE.**

<u><b>Clause</b></u>	<u><b>Description of Clause</b></u>	<u><b>Page</b></u>	<u><b>Sources</b></u>
#1	<u>Trust Protector Clause</u> , including power of Trust Protector to Grant Surviving Spouse a Testamentary General Power of Appointment over Credit Shelter Trust	<u><b>3-5</b></u>	<b><i>Self-Prepared</i></b>
#2A	<u>"Complex" Formula Testamentary General Power of Appointment Clause</u> (with "Capping" and "Ordering" Rules)	<u><b>6-8</b></u>	<b><i>Source #1</i></b>
#2B	<u>"Complex" Formula Testamentary General Power of Appointment Clause</u> (with "Capping" and "Ordering" Rules; Specific Assets Selected) <i>ALTERNATE CLAUSE</i>	<u><b>9-10</b></u>	<b><i>Source #2</i></b>
#2C	<u>"Complex" Formula Testamentary General Power of Appointment Clause</u> (with "Capping" and "Ordering" Rules) <i>ALTERNATE CLAUSE</i>	<u><b>11-12</b></u>	<b><i>Source #2</i></b>
#2D	<u>"Simple" Formula Testamentary General Power of Appointment Clauses</u> <i>ALTERNATE CLAUSES</i>	<u><b>13-14</b></u>	<b><i>Source #1</i></b>
#3	<u>Formula Testamentary General Power of Appointment Clause Capped at Available Generation Skipping Transfer Tax Exclusion</u> (i.e., for Dynasty and GST Trusts) <i>ALTERNATE CLAUSE</i>	<u><b>15</b></u>	<b><i>Source #1</i></b>
#4A	<u>Delaware Tax Trap Clause</u> - Exercising Special Power of Appointment over Credit Shelter Trust Triggering the Trap in Order to Adjust Basis for Appreciated Assets	<u><b>16-17</b></u>	<b><i>Source #1</i></b>
#4B	<u>Delaware Tax Trap Clause</u> - Exercising Special Power of Appointment over Credit Shelter Trust Triggering the Trap in Order to Adjust Basis for Appreciated Assets <i>ALTERNATE CLAUSE</i>	<u><b>18</b></u>	<b><i>Source #2</i></b>
#4C	<u>Delaware Tax Trap Clause</u> - Delaware Tax Trap Clause - Exercising Special Power of Appointment to Create Peg Power over Credit Shelter Trust Where Entire Trust Is Subject to Peg Power and Inclusion in Spouse's Estate Does Not Generate Federal or State Estate Taxes (No "Capping" or "Ordering" Rules) <i>ALTERNATE CLAUSE</i>	<u><b>19</b></u>	<b><i>Source #3</i></b>
#5	<u>Delaware Tax Trap Clause</u> - Clause for Special Power of Appointment Granting PEG Power in Credit Shelter Trust/disclaimer Trust Even When Trust Is Funded via a Qualified Disclaimer - Allows Triggering the Trap in Order to Adjust Basis for Appreciated Assets	<u><b>20</b></u>	<b><i>Source #1</i></b>

## **TABLE OF SOURCES FOR FORMS\*\*\***

- Source #1** Ed Morrow, “The Optimal Basis Increase and Income Tax Efficiency Trust” (July 2015)
- Source #2** Steve R. Akers, “Estate Planning: Current Developments and Hot Topics” (December 2014)
- Source #3** Howard M. Zaritsky, “Tax Planning for Family Wealth Transfers At Death: Analysis with Forms,” Section 2.04[3][b][vi], Thomson Reuters/ WG&L (2015)

*\*\*\*FOR SOME OF THE FORMS PRESENTED HEREIN, THE PRESENTER, ROBERT J. KOLASA, MODIFIED THE FORM’S ORIGINAL CONTENT IN A MANNER HE DEEMED APPROPRIATE.*

**CLAUSE #1**  
**TRUST PROTECTOR CLAUSE**  
**Including Power of Trust Protector to Grant Surviving Spouse a Testamentary General Power of Appointment over Credit Shelter Trust**

**ELEVENTH: TRUST PROTECTOR.** The following provisions shall apply to any Trust Protector acting under this instrument:

**SECTION 1: Appointment of Trust Protector.** I appoint the following persons, each to act alone and successively, in the order named as the "Trust Protector" of any separate trust created hereunder.

1. My \_\_\_\_\_;
2. My \_\_\_\_\_.

**SECTION 2: Resignation and Appointment of Successor Trust Protector.** A Trust Protector may resign at any time by signed notice to the trustee, except that a Trust Protector shall be deemed to have resigned if he or she is under a legal disability or by reason of illness or mental or physical disability is unable to give prompt and intelligent consideration to financial matters. The determination as to such inability at any time shall be made by the then acting trustee in concurrence with the Trust Protector's then acting physician, and the trustee may rely upon written notice of that determination.

The then acting Trust Protector is authorized to designate his or her own successor by written instrument at any time (and such designation, if exercised, shall have priority over any successor Trust Protector named in Section 1 above), except that a designated Trust Protector shall not be my spouse (if living), a descendant of mine, a spouse of a descendant of mine, or any person who is a related or subordinate party under Code Section 672(c) as to any beneficiary, or spouse of a beneficiary. Furthermore, the designated Trust Protector must be a United States Citizen who has attained the age of 35. Such designation shall be revocable during the time prior to the Trust Protector's death or resignation. If no Trust Protector is acting or has been designated pursuant to this article, the then acting trustee then acting may appoint a successor Trust Protector.

**SECTION 3: Trustee Removal Powers.** [OPTIONAL SECTION] The Trust Protector shall have the power, exercisable from time to time in his sole and absolute discretion and for any reason to remove the then acting trustee; provided that the Trust Protector must then appoint an individual(s) or corporate trustee to act as successor trustee thereto. The removal of a trustee shall be made by an acknowledged instrument in writing delivered to the trustee so removed. Copies shall be delivered to all income beneficiaries of the trust. The removal of a trustee hereunder shall not be effective until the last to occur of (i) acceptance of appointment by the successor trustee and (ii) the expiration of sixty (60) days after the date of delivery required hereunder, unless the trustee so removed consents to an earlier effective date. Reasons for removal of a corporate need not be such as would justify judicial removal and shall exist in the sole discretion of the Trust Protector.

**SECTION 4: General Power to Amend Trust.** [OPTIONAL SECTION] Amend the terms of any trust created hereunder, (i) in order to achieve tax advantage, (ii) as a result of changes in the Internal Revenue Code and the rulings and regulations thereunder which may adversely affect the tax benefits otherwise available with respect to the trust, (iii) in order to be in compliance with the law, including administrative pronouncements, as it exists, from time to time; or (iv) for any other reason that the Trust Protector believes to be necessary or desirable, and, if necessary, any such modification or amendment shall apply retroactively to the inception of the trust. Notwithstanding the above, the Trust Protector shall have no powers to (i) remove my descendants, if any, as beneficiaries of any trust created under this trust instrument (except with respect to amending a power of appointment which includes or excludes the beneficiary, or postponing or suspending distributions and

withdrawal rights as provided below); (ii) amend this trust instrument to benefit himself or herself, his or her spouse or descendants other than any person who is a beneficiary under the trust instrument as originally executed.

**SECTION 5: Power to Grant a General Power of Appointment. [OPTIONAL SECTION]** The Trust Protector is authorized, in its sole discretion, with respect to all or any portion of the principal of the Family Trust created hereunder (including a pecuniary amount), by an instrument in writing filed with the trustee to (i) grant to my spouse a testamentary general power of appointment within the meaning of Section 2041 of the Code (including a power the exercise of which requires the consent of some other person other than a person who has a substantial interest which is adverse to my spouse's exercise of the power of appointment (as defined in Section 2041(b)(1)(C)(ii) of the Code); (ii) limit a testamentary general power of appointment created under this section, as to all or part of such principal at any time prior to the death of my spouse by narrowing the class to whom my spouse may appoint the property subject to such appointment, so as to convert such power into a limited power of appointment; (iii) eliminate such power for all or any part of such principal as to which such power was previously created at any time prior to the death of my spouse; and (iv) irrevocably release the right to limit or eliminate such power with respect to such Family Trust. I hereby direct that the Trust Protector's decisions under this section shall be absolutely binding on all beneficiaries of the Family Trust.

I recognize and acknowledge that whether or not tax benefits will be realized as a result of the inclusion of the assets comprising the Family Trust in my spouse's gross estate, will depend upon a variety of factual and legal considerations, which may be difficult to discern at any given point in time and which are subject to frequent change. Therefore, I expressly state that at no time shall the Trust Protector be under any duty whatsoever to exercise or refrain from exercising the foregoing power, and neither my spouse nor any other beneficiary shall have any claim or cause of action against the Trust Protector for breach of trust for the Trust Protector's good faith exercise or failure to exercise such power. Nor shall any Trust Protector have any duty whatsoever to monitor my spouse's or any other beneficiary's individual circumstances or other legal or factual developments for the purpose of determining when and whether to exercise this power. To the contrary, it is my expectation that my spouse and/or any other beneficiary should take responsibility for their own estate and income tax planning and should request that the Trust Protector exercise the foregoing power as and when such beneficiary determines that it would be beneficial for the Trust Protector to do so, but at all times the final decision shall rest with the Trust Protector.

**SECTION 6: Specific Power to Delay Distributions and Withdrawal Rights. [OPTIONAL SECTION]** In regard to a trust for any child of mine or any other beneficiary established hereunder, the Trust Protector shall have the power, but is not required, to (a) postpone any distribution of income and/or principal otherwise allowable to be made from such trust to such beneficiary; (b) suspend any withdrawal rights of such beneficiary under such; and (c) to postpone the termination of such trust, if the Trust Protector, in the Trust Protector's sole discretion, determines that there is a compelling reason to postpone or suspend, as the case may be, such distribution, withdrawal right or trust termination, as including, but not limited, to such beneficiary's: (i) serious physical or mental disability, (ii) addiction to drugs or alcohol, (iii) incarceration, (iv) participation in any illegal or immoral activities, (v) membership in an organization which the Trust Protector reasonably deems to be a cult based upon abnormal adherence to an alleged religious doctrine requiring the beneficiary to expend extraordinary time and/or financial resources on behalf of such organization, (vi) pending divorce, (vii) potential or pending creditor claims, (viii) facing a serious tax disadvantage to such beneficiary (or to his or her family) if any or all of such trust estate were distributed to him, or (ix) failure to obtain gainful employment. The Trust Protector may continue any such postponement or suspension as contemplated in this section, in whole or in part, from time to time, up to and including the entire lifetime of the beneficiary. While such postponement or suspension continues, all of the other provisions applicable to such trust as the case may be, the trustee shall continue to administer such trust such that the beneficiary shall only receive distributions from the income and/or principal therefrom as the Trust Protector, in the Trust Protector's absolute and sole discretion, deems

appropriate and in the best interests of the beneficiary.

Notwithstanding the above, the powers of the Trust Protector to delay or postpone payment to any beneficiary shall not apply to the required minimum distributions from any employee benefit plan or individual retirement account, which are required to be paid to trust beneficiaries upon receipt by the trustee as provided above.

**SECTION 7: Release by Trust Protector.** The Trust Protector at any time acting may, by written instrument delivered to the trustee, irrevocably release the powers granted to the Trust Protector under this article. If the Trust Protector releases such powers, such powers shall thereafter no longer be exercisable by the Trust Protector or any successor Trust Protector.

**SECTION 8: Compensation.** The Trust Protector shall receive compensation for acting as Trust Protector based on time incurred, as the Trust Protector in its discretion determines.

**SECTION 9: No Requirement to Act or Monitor.** The Trust Protector shall have no duty whatsoever to act, monitor, review, inquire, investigate, recommend, evaluate, warn or provide advice with respect to the trustee's actions or inactions and/or any decisions made by the trustee. This includes, but is not limited to, any duty related to the acquisition, disposition, retention, management or valuation of any asset or investment. The Trust Protector shall keep the trustee informed in the event the Trust Protector takes an action under this article, but otherwise shall have no other duty to report to the trustee whatsoever.

**SECTION 10: Exoneration and Indemnification of Trust Protector.** A Trust Protector acting in good faith pursuant to the terms of this instrument shall not be liable for any act or omission. Furthermore, as partial consideration for the Trust Protector agreeing to act hereunder, the Grantor agrees (on behalf of the Grantor and the Grantor's successors, assigns, estate, descendants and transferees) to indemnify, defend, protect and hold the Trust Protector harmless, individually and in his capacity as Trust Protector, from any claims, demands, suits, causes of action, rights, promises, debts, losses, expenses, obligations, damages, liabilities or responsibilities of any kind or nature, whether known or unknown, arising out of or in connection with his actions and/or omissions as Trust Protector and individually, concerning this Agreement and any trust created hereunder, including but not limited to the fulfillment of any or all of the provisions of this Agreement, except for any actions of the Trust Protector in the nature of personal conversion or other theft of the trust estate. If any provision of this article shall be deemed void or unenforceable, it shall be rewritten in scope to be enforceable, if possible, and whether rewritten in scope or deemed void or unenforceable, the remaining provisions of this article shall remain in full force and effect.

**CLAUSE #2A**  
**“COMPLEX” FORMULA TESTAMENTARY GPA CLAUSE**  
**-With “Capping” and “Ordering” Rules**

**SIXTH: POWERS OF APPOINTMENT OVER FAMILY TRUST.** Upon the death of my spouse if my spouse survives me, my spouse shall have certain testamentary powers to appoint a certain portion of assets, be they allocable to principal or undistributed income, remaining in the Family Trust at my spouse's death. These powers shall apply differently or not at all to different assets. The potentially appointive assets shall be constrained and limited as follows:

**SECTION 1: General Power of Appointment.** My spouse may appoint certain assets of the Family Trust (as defined below) to my spouse's creditors or to my descendants, with such powers and in such manner (including trusts) and proportions as my spouse may appoint by my spouse's will making specific reference to this general power of appointment. For purposes of this agreement, the term "spouse" shall include a widow or widower, whether or not remarried.

*[OPTIONAL SECTION MANDATING THAT SPOUSE EXERCISE POWER OF APPOINTMENT ONLY WITH A NON-ADVERSE PARTY CONSENT]*

**SECTION 2: Non-Adverse Party Consent Required for General Power of Appointment.** Notwithstanding the above, my spouse may only appoint to my spouse's creditors or to my descendants with the consent of \_\_\_\_\_ and/or \_\_\_\_\_” [non-adverse party]

OR

Notwithstanding the above, any appointment that is other than equal to my children or to trusts for my children, per stirpes, may only be made with the consent of \_\_\_\_\_. [non-adverse party]

**SECTION 3: Assets Subject to General Power of Appointment.** Subject to the limitations of Section 4 below, the assets potentially subject to this general power of appointment shall only be those assets of the Family Trust whose tax basis would increase in value pursuant to Section 1014 of the Internal Revenue Code (“Code”) if such appointive assets are included in my spouse's gross estate, subject to the following ordering rules.

- A. The power shall apply to the asset with the largest percentage of difference between fair market value at the time of my spouse's death and the cost basis immediately prior to my spouse's death first, cascading in turn to each subsequent asset with the next largest percentage difference between fair market value and cost basis (e.g. an asset with basis of \$10, fair market value of \$100 would have a “percentage of difference” of 90/100, or 90%).
- B. *[OPTIONAL PARAGRAPH GIVING PREFERENCE TO DEPRECIABLE PROPERTY & COLLECTIBLES]*

In ordering these trust assets, and purely for the purpose of ordering which assets are appointive assets, depreciable assets shall be deemed to have a percentage of difference 50% higher and collectible assets 30% higher. To illustrate, if the trust owns (i) a depreciable building with a basis of \$100,000 and fair market value at the time of my spouse's death of \$200,000; (2) stock with a basis of \$90,000 and fair market value at the time of my spouse's death of \$200,000; and (3) art with a basis of \$110,000 and fair market value at the time of my spouse's death of \$200,000, the percentage of difference for purposes of this paragraph shall be: (i) 75% for the



depreciable building (50% times 1.5); (ii) 55% for the stock; and (iii) 58.5% for the art (45% times 1.3) respectively. Accordingly, the power of appointment shall apply first to the depreciable building, then to the art and finally to the stock. For purposes of this paragraph, entities taxed as a partnership that hold depreciable assets shall be considered depreciable assets, regardless of whether an election is made under IRC Code Section 754.

*[OPTIONAL PARAGRAPH RELATING TO STOCK WITH NET UNREALIZED APPRECIATION]*

- C. Property that is employer securities received as a lump sum distribution from a retirement plan with net unrealized appreciation shall consider said net unrealized appreciation for this purpose (e.g. 1000 shares of Abbott Laboratories stock with a tax basis of \$50,000, net unrealized appreciation of \$20,000 and fair market value of \$85,000 shall consider the basis to be \$70,000 for purposes of application of this section. If the stock's value were equal to or less than \$70,000, it would accordingly not be an appointive asset subject to my spouse's power of appointment under this section.

**SECTION 4: General Power of Appointment Limited to Exercise Resulting in no Federal or State Estate Taxes.** Should the exercise of the general power of appointment specified above otherwise result in federal or state estate or generation skipping transfer tax liability due to the appointive assets being included in my spouse's estate (computed without taking into consideration any charitable or marital bequest that would be deductible by my spouse's estate under Code Sections 2055 or 2056), the appointive assets subject to this general power of appointment shall be further limited, and apply or not apply to each remaining asset of the trust not previously excluded as a potential appointive asset above in the order specified in Section 3.

Once an asset's (or group of assets') inclusion as appointive assets would otherwise cause an increase in my spouse's federal or state estate tax liability (without taking into consideration any charitable or marital bequest by my spouse that would be deductible by her estate pursuant to Code Sections 2055 or 2056), the power to appoint them shall be limited to that fraction or percentage that would not cause any estate tax liability. Upon reaching this limit, all other assets are excluded from this general power of appointment shall be subject to the special power of appointment described below. For purposes of applying this paragraph, property with different cost basis for different lots or purchases shall be considered completely separate property (e.g. 100 shares of ABC stock bought at \$350 per share shall be considered different from 100 shares bought at \$500 per share a year later), and may be divided or fractionalized accordingly.

For purposes of illustrating the intent of this section, if \$50,000 could be added to my spouse's gross estate prior to application of this article without causing state or federal estate or generation skipping transfer tax, and the asset with the largest percentage difference between cost basis and fair market value is 100 shares of ABC stock with a basis of \$35,000 and fair market value of \$100,000, then this general power of appointment shall extend to only 50 shares from that lot of stock.

*[OPTIONAL PARAGRAPH RELATING TO GRANTING SPOUSE SPECIAL POWER OF APPOINTMENT OVER ASSETS NOT SUBJECT TO GPA. NO TAX EFFECT. USE IF INTENT IS TO GIVE SPOUSE FLEXIBILITY]*

**SECTION 5: Special Power of Appointment.** My spouse may appoint all other assets not subject to the above general power of appointment to my descendants or to any trust primarily therefore, which shall specifically exclude my spouse, my spouse's estate, my spouse's creditors, or creditors of my spouse's estate, with such powers and in such manner (including trusts) and proportions as my spouse may appoint by my spouse's will making specific reference to this power of appointment.

**SECTION 6: Distribution in Default of Powers of Appointment.** After the death of my spouse any part of the principal of the trust estate not effectively appointed under this article (or after my death if my spouse does not survive me, the trust estate) shall be held and disposed of...

*[INSERTED DISPOSITIVE PROVISIONS OR MAKE REFERENCE  
TO DISPOSITIVE PROVISIONS IN TRUST]*

**SECTION 7: Intended Trust Modifications.** A material purpose of this article is to grant my spouse a power of appointment over appointive assets which triggers estate inclusion under Code Section 2041 limited in such a way as to maximize the income tax basis increase under Code Section 1014 of the property held in the Family Trust without increasing my spouse's federal or state estate or *generation* skipping transfer tax, and without subjecting substantial trust assets to my spouse's creditors should my spouse's estate be insolvent, so as to provide the maximum benefit to our ultimate beneficiaries. This trust may accordingly be amended or decanted pursuant to applicable state law [*NOTE: OR, REFERENCE A TRUST PROTECTOR OR INDEPENDENT TRUSTEE AMENDMENT CLAUSE IF THERE IS ONE ALREADY IN THE TRUST TO PERMIT AMENDMENTS*] to comply with this intended purpose should:

- A. Code Sections 1014, 2041 or other applicable tax law be materially changed;
- B. the state, federal or foreign estate or inheritance tax applicable to my spouse's estate be materially changed;
- C. my spouse remarry and reside in a jurisdiction with a spousal elective share definition that would otherwise include appointive assets subject to a third party created testamentary general power of appointment, without having a valid pre or post nuptial agreement that would otherwise exclude these trust assets
- D. my spouse's projected estate appear likely to be insolvent and my spouse resides in a state which does not protect assets subject to a testamentary general power of appointment from a decedent's or decedent's estate's creditors;
- E. an improved formula yield superior tax results for the beneficiaries; or
- F. any other situation arise which would frustrate the intention of this section.

**CLAUSE #2B**  
**[ALTERNATIVE CLAUSE]**  
**“COMPLEX” FORMULA TESTAMENTARY GPA CLAUSE**  
**-With “Capping” and “Ordering” Rules**  
**-Specific Assets Selected**

1. General Power of Appointment Over Asset #1 of the Appreciated Assets. I give to my spouse a testamentary general power of appointment, exercisable alone and in all events to appoint a fractional share of Asset #1. The numerator of the fraction shall be the largest amount which, if added to my spouse's taxable estate, will not result in or increase the federal estate tax payable by reason of my spouse's death. The denominator of the fraction shall be the value of Asset #1 as of my spouse's death. Asset #1 shall mean that asset from among the Appreciated Assets (as defined hereinbelow), if any, that if sold by the By-Pass Trust immediately prior to my spouse's death would generate the greatest aggregate amount of federal and state income tax.
2. General Power of Appointment Over Asset #2 of the Appreciated Assets. I give to my spouse a testamentary general power of appointment, exercisable alone and in all events to appoint a fractional share of Asset #2. The numerator of the fraction shall be the excess of (a) the largest amount which, if added to my spouse's taxable estate, will not result in or increase the federal estate tax payable by reason of my spouse's death over (b) the denominator of the fraction in Paragraph 1 above. The denominator of the fraction shall be the value of Asset #2 as of my spouse's death. Asset #2 shall mean that asset from among the Appreciated Assets, if any, that if sold by the By-Pass Trust immediately prior to my spouse's death would generate the second greatest aggregate amount of federal and state income tax.
3. General Power of Appointment Over Asset #3 of the Appreciated Assets. I give to my spouse a testamentary general power of appointment, exercisable alone and in all events to appoint a fractional share of Asset #3. The numerator of the fraction shall be the excess of (a) the largest amount which, if added to my spouse's taxable estate, will not result in or increase the federal estate tax payable by reason of my spouse's death over (b) the sum of the denominators of the fractions in Paragraphs 1 and 2 above. The denominator of the fraction shall be the Value of Asset #3 as of my spouse's death. The Asset #3 shall mean that asset from among the Appreciated Assets, if any, that if sold by the By-Pass third greatest aggregate amount of federal and state income tax.
4. Additional General Powers of Appointment Over Additional Assets of the Appreciated Assets. I give to my spouse additional testamentary general powers of appointment following the pattern of Paragraphs 1 - 3 over additional assets of the Appreciated Assets, with each successive asset of the Appreciated Assets being that asset of the By-Pass Trust subject to the next highest aggregate amount of federal and state income tax if sold by the By-Pass Trust immediately prior to my spouse's death. The numerator of the fraction of each successive power of appointment shall be the excess of (a) the largest amount which, if added to my spouse's taxable estate, will not result in or increase the federal estate tax payable by reason of my spouse's death over (b) the sum of the denominators of the fractions used in the prior powers of appointment.
5. Last General Power of Appointment. Notwithstanding the above, the last general power of appointment granted by this Section shall be the power whose fraction has a numerator less than its denominator.

6. Appreciated Assets of the By-Pass Trust. For purposes of this Section, the term "Appreciated Assets" shall mean those assets owned by the By-Pass Trust upon my spouse's death the income tax basis of which may increase (and not decrease) pursuant to Section 1014(a) of the Code if such assets passed from my spouse within the meaning Section 1014(b) of the Code [OPTIONAL PROVISION: ,provided, however, that any Family Assets shall be considered last (and then classed based on greatest aggregate amount of federal and state income tax in a similar manner as provided above) For purposes of this Section the term "Family Assets" means (e.g., the family farm or private family company, which is unlikely to be sold in the near future, etc.)]. For this purpose, blocks of shares of the same stock in the same company and having the same basis shall be consider as a block as one asset.
7. How Exercised. My spouse may exercise the powers granted by this section by appointing the said fractional shares of the particular assets of Appreciated Assets free of t rust to my spouse's estate or to or for the benefit of one or more persons or entities, in such proportions, outright, in trust, or otherwise as my spouse may direct in my spouse's Will that specifically refers to this general power of appointment.

**CLAUSE #2C**  
**[ALTERNATIVE CLAUSE]**  
**“COMPLEX” FORMULA TESTAMENTARY GPA CLAUSE**  
**-With “Capping” and “Ordering” Rules**

Section X. Contingent Powers of Appointment. Notwithstanding any provision herein to the contrary except the provisions of Section \_\_\_\_\_ and in addition to any other power of appointment granted hereunder, each beneficiary of any trust hereunder (an "Applicable Trust") who is a member of the most senior generation of the beneficiaries of such trust (an "Applicable Beneficiary") shall have the following powers:

Contingent General Power of Appointment to Reduce Death Taxes. Each Applicable Beneficiary shall have the power to appoint the smallest fractional share of an Applicable Trust, if any, that would reduce to the minimum the aggregate federal and applicable state estate tax and generation-skipping transfer taxes ("Death Taxes") payable upon the Applicable Beneficiary's death. If the Applicable Beneficiary has a power of appointment equivalent to the power under this paragraph (a) with respect to other trusts, the Applicable Beneficiary's power under this paragraph (a) shall apply to the Applicable Trust in the proportion that the value of the Applicable Trust bears to the value of all such trusts to which the Applicable Beneficiary has such a power of appointment. If any trust property is included in the estate of an Applicable Beneficiary for purposes of any Death Taxes as a result of this power of appointment, the Trustee shall pay over to the Applicable Beneficiary's estate, or pay directly, from such property, an amount equal to that increment of such tax liability attributable to the inclusion of such property in the Applicable Beneficiary's estate.

Contingent General Power of Appointment to Reduce Capital Gains Taxes. Each Applicable Beneficiary shall have the power to appoint those Appreciated Assets of an Applicable Trust that (i) are not subject to a power of appointment under paragraph (a) preceding; (ii) have in the aggregate a value less than or equal to the largest amount that would not cause an increase in the Death Taxes payable upon the Applicable Beneficiary's death; and (iii) have in the aggregate the greatest Appreciation. If the foregoing power may apply to some but not all assets with the same Appreciation as a percentage of basis, it shall apply to all those assets in the proportion that the value of each such asset bears to the total value of all such assets. The following rules and definitions shall apply to this paragraph:

If the Applicable Beneficiary is the beneficiary of more than one trust that includes the power provided in this paragraph (b) or an equivalent power, the following provisions shall apply:

Trusts with the Same Remainder Beneficiaries shall be aggregated and treated as a single trust for purposes of applying the power in this paragraph (b).

With respect to all other trusts, the power under this paragraph (b) shall apply in the proportion that the value of the Appreciated Assets in each such trust bears to the value of the Appreciated Assets in all such trusts.

"Trusts with the Same Remainder Beneficiaries" shall mean trusts for which, after taking into account any exercise by the Applicable Beneficiary of a power of appointment over such trust other than a power granted under this paragraph (b), the identity and type of interests of the vested and contingent remainder beneficiaries are identical: provided, however, that differences in the timing of the distribution of property, differences in whether distribution is outright or in trust, and differences in powers of appointment held by beneficiaries following the Applicable Beneficiary's death shall not be considered.

"Appreciated Assets" shall mean property that, if included in the Applicable Beneficiary's estate for purposes of Chapter 11 of the Code, would have its basis determined pursuant to Section 1014(a)(1), 1014(a)(2) or 1014(a)(3) of the Code immediately after the Applicable Beneficiary's death, subject to the limitations of

subparagraph (4) following.

With respect to an Applicable Trust that (i) has an inclusion ratio of zero, as defined in Section 2642(a) of the Code, and (ii) does not pass on the Applicable Beneficiary's death, in default of the exercise of the power of appointment, solely to non-skip persons, as defined in Section 2613 of the Code, assets of such Trust shall not be Appreciated Assets to the extent that the value of such assets exceeds the Applicable Beneficiary's exemption from generation-skipping transfer tax pursuant to Section 2631 of the Code available at the time of the Applicable Beneficiary's death, reduced by the value of any transfers occurring at the Applicable Beneficiary's death, other than pursuant to this paragraph (b) or an equivalent provision, to which an effective allocation of the Applicable Beneficiary's exemption from generation-skipping transfer tax could be made.

"Appreciation" shall mean the amount by which the value of property exceeds its income tax basis immediately prior to the Applicable Beneficiary's death.

General Provisions Applicable to this Section. For purposes of determining the property, or fraction thereof, subject to a power of appointment provided under this Section: Taxes shall be computed assuming that the power is not exercised.

Property shall be valued in accordance with Chapter 11 of the Code applied as if such property were included in the Applicable Beneficiary's estate.

The Trustee may rely on information provided by the legal representative of an Applicable Beneficiary's estate in determining the trust property subject to the power of appointment.

A power of appointment under this Section may be exercised by an Applicable Beneficiary by will duty admitted to probate upon any terms and conditions, including further trusts, to or for the benefit of the creditors of the Applicable Beneficiary's estate. No exercise of this power of appointment shall be effective unless it shall make specific reference to this provision. Any portion of such property which such Applicable Beneficiary shall not have effectively appointed shall be distributed as otherwise provided in this Trust Agreement.



**CLAUSE #2D**  
**“SIMPLE” FORMULA TESTAMENTARY GPA CLAUSES**

*ALTERNATIVE #1*

**SIXTH: POWERS OF APPOINTMENT OF MY SPOUSE OVER FAMILY TRUST.** Pursuant to the provisions of this article, my spouse shall have a testamentary power to appoint a certain portion of assets, be they allocable to principal or undistributed income, remaining in the Family Trust at my spouse's death. This power shall apply differently or not at all to different assets. The potentially appointive assets shall be constrained and limited as follows:

**SECTION 1: General Power of Appointment.** My spouse may appoint certain assets of the Family Trust (as defined below) to my spouse's creditors or to my descendants in such amounts and subject to such terms, including trusts, as my spouse directs.

*IF DESIRED, INSERT REQUIREMENT OF NON-ADVERSE PARTY CONSENT (See Clause #2A)*

**SECTION 2: Assets Subject to General Power of Appointment.** Subject to the limitations of Section 3 below, the assets potentially subject to this general power of appointment shall only be those assets of the Family Trust whose tax basis would increase in value pursuant to Section 1014 of the Internal Revenue Code (“Code”) if included in my spouse’s gross estate.

**SECTION 3: General Power of Appointment Limited to Exercise Resulting in no Federal or State Estate Taxes.** Notwithstanding the above, the exercise of the general power of appointment specified in this article shall be limited to not increase any federal, state estate tax or generation skipping transfer tax liability payable by my spouse’s estate (without taking into consideration any charitable or marital bequest by my spouse that would be deductible by her estate pursuant to Code Sections 2055 or 2056) due to the appointive assets being included in my spouse’s estate.

*IF DESIRED, INSERT ADDITIONAL SECTIONS (See Clause #2A)*

*ALTERNATIVE #2*

**SIXTH: POWERS OF APPOINTMENT OF MY SPOUSE OVER FAMILY TRUST.** Pursuant to the provisions of this article, my spouse shall have a testamentary power to appoint the largest portion of the assets of the Family Trust which shall not increase any federal or state estate tax payable by my spouse’s estate (without taking into consideration any charitable or marital bequest by my spouse that would be deductible by her estate pursuant to Code Sections 2055 or 2056) to my spouse’s creditors or to my descendants in such amounts and subject to such terms, including trusts, as my spouse directs.

*[NO “ORDERING” RULE IN THIS CLAUSE]*

ALTERNATIVE #3

**SIXTH: POWERS OF APPOINTMENT OF MY SPOUSE OVER FAMILY TRUST.** Pursuant to the provisions of this article, my spouse shall have a testamentary power to appoint a certain fraction of the assets remaining in the Family Trust at my spouse's death. My spouse may appoint the largest fraction of the assets of this trust which would not increase any federal or state estate tax payable by my spouse's estate (without taking into consideration any charitable or marital bequest by my spouse that would be deductible by my spouse's estate pursuant to Code Sections 2055 or §2056) to my spouse's creditors or to my descendants in such amounts and subject to such terms, including trusts, as my spouse directs. The assets subject to the general power of appointment shall be those assets which, within the fraction, have the greatest difference between the basis of the asset, and the fair market value of the asset, excluding any income in respect of a decedent.

ALTERNATIVE #4 - based on PLR 200403094

**SIXTH: POWERS OF APPOINTMENT OF MY SPOUSE OVER FAMILY TRUST.** At my spouse's death, if I am still living, I give to my spouse a testamentary general power of appointment, exercisable alone and in all events to appoint part of the assets of the Family Trust, having a value equal to (i) the amount of my spouse's remaining applicable exclusion amount less (ii) the value of my spouse's taxable estate determined by excluding the amount of those assets subject to this power, free of trust to my deceased spouse's estate or to or for the benefit of one or more persons or entities, in such proportions, outright, in trust, or otherwise as my spouse may direct in my spouse's Will.

*[NO "ORDERING" RULE IN THIS CLAUSE]*

**CLAUSE #3**  
**FORMULA TESTAMENTARY GPA CLAUSE CAPPED AT AVAILABLE GENERATION**  
**SKIPPING TRANSFER TAX (GST) EXCLUSION**  
**-i.e., for Dynasty and GST Trusts**

**SIXTH: POWERS OF APPOINTMENT OF MY SPOUSE OVER FAMILY TRUST.** Pursuant to the provisions of this article, my spouse shall have a testamentary power to appoint a certain portion of assets, be they allocable to principal or undistributed income, remaining in the Family Trust at my spouse's death. This power shall apply differently or not at all to different assets. The potentially appointive assets shall be constrained and limited as follows:

**SECTION 1: General Power of Appointment.** My spouse may appoint certain assets of the Family Trust (as defined below) to my spouse's creditors or to my descendants in such amounts and subject to such terms, including trusts, as my spouse directs.

*IF DESIRED, INSERT REQUIREMENT OF NON-ADVERSE PARTY CONSENT (Section 2, Clause #2A)*

**SECTION 3: Assets Subject to General Power of Appointment.** Subject to the limitations of Section 4 below, the assets potentially subject to this general power of appointment shall only be those assets of the Family Trust whose tax basis would increase in value pursuant to Section 1014 of the Internal Revenue Code ("Code") if included in my spouse's gross estate, subject to the following ordering rules.

*INSERT BASIS ORDERING RULES (Section 3, Clause #2A)*

**SECTION 4: General Power of Appointment Limited to Exercise Resulting in no Federal or State Estate Taxes or Increased Exclusion Ratio in Appointed Trust.** Should the exercise of the general power of appointment specified in Section 3 above otherwise result in federal or state estate or generation skipping transfer tax liability due to the appointive assets being included in my spouse's estate (without taking into consideration any charitable or marital bequest that would be deductible by my spouse's estate under Code Sections 2055 or 2056), or exceed my spouse's available generation skipping transfer tax exemption such that an appointment of potentially appointive assets as defined above could cause an GST inclusion ratio of an appointive trust to increase, the appointive assets subject to this general power of appointment shall be further limited, and apply or not apply to each remaining asset of the trust not previously excluded as a potential appointive asset above in the order specified as follows. Whether my spouse actually appoints to a trust that would benefit from GST exclusion is completely irrelevant to determining whether a general power of appointment applies under this section.

Once an asset's (or group of assets') inclusion as appointive assets would otherwise cause an increase in my spouse's federal or state estate tax liability (assuming the marital or charitable deduction were denied the estate), or go beyond my spouse's available GST exemption, the power to appoint them shall be limited to that fraction or percentage that would not cause any estate tax liability or go beyond any available GST exclusion. Upon reaching this limit, all other assets are excluded from this general power of appointment and shall be subject to the limited power of appointment described below.

*IF DESIRED, INSERT SECTIONS 5, 6 & 7 FROM CLAUSE #2A)*

**CLAUSE #4A**  
**DELAWARE TAX TRAP CLAUSE - EXERCISING SPECIAL POWER OF APPOINTMENT**  
**OVER CREDIT SHELTER TRUST TRIGGERING THE TRAP IN ORDER TO ADJUST BASIS**  
**FOR APPRECIATED ASSETS**

**SIXTH: EXERCISE OF POWER OF APPOINTMENT.** Pursuant to Section \_\_\_\_ of the Jane Doe Living Trust dated xx/xx/xxxx ("Jane Doe Living Trust"), I am given a testamentary power of appointment as to the Family Trust established under Article \_\_\_\_ of such instrument (the "Family Trust"). I hereby exercise this testamentary special power of appointment upon my death as follows:

*[OPTION #1 - APPOINT ASSETS TO NEWLY FORMED STAND ALONE TRUST]*

**SECTION 1: Exercise of Power.** Subject to the limitations of Section 2 and 3 below, I hereby appoint the assets of the Family Trust which would otherwise (but for this appointment) be distributed for the benefit of my surviving children\*\* (the "appointive property"), to the ABC Appointive Trust created by me on today's date for the benefit of such children, granting each surviving child a presently exercisable general power of appointment.

*[OPTION #2 - APPOINT ASSETS TO TRUST CREATED BY REFERENCE]*

**SECTION 1: Exercise of Power.** Subject to the limitations of Section 2 and 3 below, I hereby appoint the assets of the Family Trust which would otherwise (but for this appointment) be distributed for the benefit of my then living children\*\* (the "appointive property"), to be allocated in equal shares to separate trusts for each of my then living children. Each such separate trust shall be identical to trusts administered under the separate trust withholding provisions of Article \_\_\_\_ of the Jane Doe Living Trust, which terms are incorporated by reference herein, except that each such separate trust shall grant the child the following additional power under its terms:

"During the child's lifetime, the child shall have a presently exercisable general power to appoint any or all assets of this trust to his or her creditors, to him or herself or to any of my descendants in such amounts or under such terms as the child deems appropriate."

**SECTION 2: Assets Subject to Power of Appointment.** Subject to the limitations of Section 3 below, the assets potentially subject to this power of appointment shall only be those assets of the Family Trust whose tax basis would increase in value pursuant to Section 1014 of the Internal Revenue Code (ACode@) if included in my gross estate under Code Section 2041(a)(3), subject to the following ordering rules.

- A. The power shall apply to the asset with the largest percentage of difference between fair market value at the time of my death and the cost basis immediately prior to my death first, cascading in turn to each subsequent asset with the next largest percentage difference between fair market value and cost basis (e.g. an asset with basis of \$10, fair market value of \$100 would have a Apercentage of difference@ of 90/100, or 90%).
- B. *[OPTIONAL PARAGRAPH GIVING PREFERENCE TO DEPRECIABLE PROPERTY]*  
In applying paragraph A., depreciable assets shall be deemed to have a percentage of difference 50% higher. To illustrate, if the trust owns (i) a depreciable building with a basis of \$100,000 and fair market value at the time of my death of \$200,000; and (2) stock with a basis of \$75,000 and fair market value at the time of my death of \$100,000, the percentage of difference for purposes of this paragraph shall be: 75% for the depreciable building (50% times 1.5); (ii) and 25% for the stock; respectively. Accordingly, the power of appointment shall apply first to the depreciable building and then to the stock. For purposes of this paragraph, entities taxed as a

partnership that hold depreciable assets shall be considered depreciable assets, regardless of whether an election is made under IRC Code Section 754.

**SECTION 3: Power of Appointment Limited to Exercise Resulting in no Federal [or State\*\*\*] Estate Taxes.** Should the exercise of the power of appointment specified hereunder result in federal [or state\*\*\*] estate tax liability due to the appointive property being included in my estate pursuant to Code Section 2041(a)(3), the appointive property subject to this power of appointment shall be further limited, and apply or not apply to each remaining asset of the trust not previously excluded as potential appointive property above in the order specified in Section 2 so that that the total appointive property does not rise to a level to generate any federal [or state\*\*\*] estate tax liability. Once an asset=s (or group of assets=) inclusion as appointive property would otherwise cause an increase in my federal [or state\*\*\*] estate tax liability, the power to appoint them shall be limited to that fraction or percentage that would not cause any federal [or state\*\*\*] estate tax liability. Upon reaching this limit, all other assets are excluded from this power of appointment. Property with different cost basis for different lots or purchases shall be considered completely separate property for this purpose, and may be divided or fractionalized accordingly.

**SECTION 4: Statement of Intent.** It is my intention that the foregoing exercise of my power of appointment shall trigger Code Section 2041(a)(3) by postponing the vesting of an estate or interest in the property which was subject to the power for a period ascertainable without regard to the date of the creation of my power, and to thereby obtain for the assets of the Family Trust the maximum possible increase in the cost basis of those assets as may be permitted under Code Section 1014 as a result of my death without causing any increase in my federal [or state\*\*\*] estate tax liability. This article shall be administered and interpreted in a manner consistent with this intent. Any provision of this article which conflicts with this intent shall be deemed ambiguous and shall be construed, amplified, reconciled, or ignored as needed to achieve this intent.

\*\*If predeceased children cause the appointive property to be insufficient to obtain the required stepped-up basis for trust assets, consider granting PEG Powers to grandchildren.

\*\*\*Consider deleting if income tax benefit of stepped-up basis exceeds state estate taxes.

**CLAUSE #4B ALTERNATE CLAUSE**  
**DELAWARE TAX TRAP CLAUSE - EXERCISING SPECIAL POWER OF APPOINTMENT**  
**OVER CREDIT SHELTER TRUST TRIGGERING THE TRAP IN ORDER TO ADJUST BASIS**  
**FOR APPRECIATED ASSETS**

**A. Identification of Power.** Under the Last Will and Testament of my deceased [spouse] dated \_\_\_\_\_, ("my [spouse]'s Will") the \_\_\_\_\_ Trust (the "Trust") was created for my primary benefit. Pursuant to Section \_\_\_\_ of my [spouse]'s Will, I have a Testamentary Power of Appointment to appoint all of the remaining property of the Trust (outright, in trust, or otherwise) to any one or more of my [spouse]'s descendants.

**B. Exercise of Power.** I hereby appoint the property described in Subsection 2.3.C. below to my children who survive me, in equal shares. However, if any child fails to survive me but leaves one or more descendants who survive me, I give the share that child would have received (if he or she had survived) per stirpes to his or her descendants who survive me. All of the preceding distributions are subject to the provisions of Article \_\_\_\_ (providing for lifetime Descendant's Trusts [*that grants the primary beneficiary thereof a presently exercisable general power of appointment*] for my children and other descendants).

**C. Extent of Exercise.** The foregoing exercise does not apply to the following assets held by the Trust: (i) cash or cash equivalent accounts (such as savings accounts, certificates of deposit, money market accounts or cash on hand in any brokerage or equivalent accounts); (ii) property that constitutes income in respect of a decedent as described in Code Section 1014(c); (iii) any interest in any Roth IRA accounts or Roth variants of other retirement plans, such as Roth 401(k)s, 403(b)s, 457(b)s, and the like; and (iv) any interest in any property that has a cost basis for federal income tax purposes that is greater than or equal to the fair market value of the property at the time of my death (the "Excluded Assets"). If, after eliminating the Excluded Assets, the inclusion of the value of the other assets in the Trust in my taxable estate for federal estate tax purposes would not increase the federal estate tax and state death taxes payable from all sources by reason of my death, this power of appointment shall apply to all remaining assets of the Trust other than the Excluded Assets (the "Included Assets"). However, in the event that the inclusion of the value of all of the Included Assets in the Trust in my taxable estate for federal estate tax purposes would increase the taxes so payable, the assets of the Trust appointed by this Section 2.3 shall be further limited as follows: The Trustee shall for each of the Included Assets evaluate the ratio of the fair market value at the time of my death to the cost basis immediately prior to my death first (the "Gain Ratio"). The Trustee shall thereafter rank the Included Assets in order of their respective Gain Ratio. The appointment shall apply first to the Included Asset with the largest Gain Ratio, and thereafter in declining order of Gain Ratio to each of the subsequent Included Assets; however, as such point that inclusion of the next in order of the Included Assets would otherwise cause an increase in my estate's federal or state estate tax liability as described above, my appointment pursuant to this Section 2.3 shall be limited to that fraction or percentage of that Included Asset that will not cause any federal or state estate tax liability, and all lower ranked Included Assets shall be excluded from the exercise of this power of appointment.

**D. Statement of Intent.** It is my intention by the foregoing exercise of my power of appointment to trigger Code Section 2041(a)(3) by postponing the vesting of an estate or interest in the property which was subject to the power for a period ascertainable without regard to the date of the creation of my power, and to thereby obtain for the assets of the Trust the maximum possible increase in the cost basis of those assets as may be permitted under Code Section 1014 as a result of my death without causing any increase in the federal estate tax and state death taxes payable from all sources by reason of my death. This Will shall be administered and interpreted in a manner consistent with this intent. Any provision of this Will which conflicts with this intent shall be deemed ambiguous and shall be construed, amplified, reconciled, or ignored as needed to achieve this intent.



**CLAUSE #4C ALTERNATE CLAUSE**  
**DELAWARE TAX TRAP CLAUSE - EXERCISING SPECIAL POWER OF APPOINTMENT TO  
CREATE PEG POWER OVER CREDIT SHELTER TRUST WHERE ENTIRE TRUST IS  
SUBJECT TO PEG POWER AND INCLUSION IN SPOUSE'S ESTATE DOES NOT GENERATE  
FEDERAL OR STATE ESTATE TAXES**  
**No "Capping" or "Ordering" Rules**

**ARTICLE \_\_\_\_ Exercise of Power of Appointment.**

I am granted a power of appointment under Article \_\_\_\_\_, Paragraph of the nonmarital trust created under the law will of my \*husband/wife\*, \_\_\_\_\_. I am, under that instrument, authorized to appoint the trust held for my benefit to and among the descendants of my \*husband/wife\*, outright or in further trust and on such terms as I select. I hereby exercise that limited power to appoint the said trust share as follows:

A. Existence of Limited Power of Appointment. The trustee shall divide the appointed trust fund into as many separate equal shares as shall be required to provide one (1) separate equal share for each of my \*husband/wife\*'s children who survives me, and one (1) separate equal share for the then-living descendants, per stirpes, of each of my \*husband/wife\*'s children who does not survive me but who is survived by then-living descendants.

B. Creation of Presently Exercisable General Power of Appointment. The trustee shall hold the share for each child or other descendant of my \*husband/wife\* in trust as follows:

1. Until the termination date, defined below, the trustee shall distribute to or for the benefit of each such child or descendant (a) all of the net income of the trust, not less often than annually; (b) so much of the principal of the trust as is appropriate for such child or descendant's health, education, support, or maintenance, taking into account other income available to such child or descendant from any source; and (c) so much of the trust fund (including all or none) held for such child or descendant as such child or descendant shall direct by specific exercise of this presently exercisable general power of appointment.

2. Upon the termination date, the trustee shall distribute the remaining trust fund as follows:

- a. The trustee shall distribute the remaining assets of a child's or descendant's separate trust under this article as such child or descendant may direct, by specific reference to this limited power of appointment in his or her last will or in a signed, dated, and written instrument delivered to a trustee. This power may be exercised to appoint a child's or descendant's separate trust fund, either outright or in further trust, to or among any of my descendants, excluding the person holding the power of appointment, his or her creditors, his or her estate, and the creditors of his or her estate.
- b. The trustee shall distribute the unappointed assets of such child's or descendant's separate trust to the child's or descendant's then-living descendants, per stirpes. If there are no such then-living descendants, the trustee shall distribute the unappointed assets of such child's or descendant's separate trust to my then-living children and other then-living descendants, per stirpes, except that the share for any child or other descendant of mine who has not then reached the age of \*TerminationAge\* years shall be added to the trust for that child or descendant under this article.

C. "Termination Date" Defined. The termination date is the date on which the child or descendant dies.

**CLAUSE #5**  
**DELAWARE TAX TRAP - CLAUSE FOR SPECIAL POWER OF APPOINTMENT GRANTING  
PEG POWER IN CREDIT SHELTER TRUST/DISCLAIMER TRUST EVEN WHEN TRUST IS  
FUNDED VIA A QUALIFIED DISCLAIMER**

**SIXTH: DISCLAIMER TRUST.** [OR FAMILY TRUST] The Disclaimer Trust shall be held and disposed of as follows:

**SECTION 1: Income & Principal During Life of Spouse.** Commencing with my death, the trustee shall pay the income from the Disclaimer Trust in convenient installments, at least quarterly, to my spouse during my spouse's lifetime.

The trustee may also pay to my spouse such sums from principal as the trustee deems necessary or advisable from time to time for my spouse's health and maintenance in reasonable comfort, considering my spouse's income from all sources known to the trustee. The trustee may not use trust property to satisfy my spouse's legal obligations.

**SECTION 2: Spouse's Testamentary Special Power of Appointment over Portion of Trust Includible in Spouse's Gross Estate under Code Section 2041(a)(3).** Upon my spouse's death, my spouse shall have the power to appoint, from income or principal, in cash or in kind, all assets (or any portion thereto) of this trust to a trust or trusts for any or all of my descendants that causes such assets to be included in my spouse's gross estate under Code Section 2041(a)(3), such as a trust for my descendants that grants my descendants a presently exercisable general power of appointment that would otherwise trigger taxable inclusion under Section 2041(a)(3) and applicable state law. All other appointees are excluded, specifically my spouse, my spouse's estate, my spouse's creditors, and creditors of my spouse's estate, in addition to any other party not described above.

The above power of appointment is intended to be retained while still qualifying any transfers made to this trust pursuant to my spouse's disclaimer, pursuant to Code Section 2518 and the exception for retained spousal rights to direct the beneficial enjoyment of property under Section 25.2518-2(e)(2) of the Treasury Regulations.

*NOTE: ALTHOUGH THE "GENERAL RULE" IS THAT A SPOUSE'S RETENTION OF A TESTAMENTARY POWER OF APPOINTMENT TAINTS A SPOUSE'S QUALIFIED DISCLAIMER UNDER TREAS. REG. 25.2518-2(e)(2) [SEE ALSO 25.2518-3(d), EX. #9], A SURVIVING SPOUSE MAY RETAIN A SPECIAL POWER OF APPOINTMENT GRANTING A PEG POWER, AS SUCH APPOINTIVE ASSETS ARE INCLUDIBLE IN THE SPOUSE'S ESTATE AND 25.2518-2(e)(2) SPECIFICALLY GRANTS AN EXCEPTION FOR SUCH TAXABLE POWERS. SEE ALSO EXAMPLE #7 UNDER SECTION 25.2518-2(e)(5) (RETAINED "5 & 5 POWER" [A GENERAL POWER OF APPOINTMENT] OVER CREDIT SHELTER TRUST DID NOT TAINT SPOUSE'S DISCLAIMER) AND ESTATE OF LASSITER V. COMMISSIONER, T.C. MEMO 2000-324 (RETAINED TESTAMENTARY POWER OF APPOINTMENT OVER QTIP TRUST DID NOT TAINT SPOUSE'S DISCLAIMER, SINCE SUCH TRUST IS INCLUDIBLE IN SPOUSE'S ESTATE).*

Robert J. Kolasa ([robert@kolasalaw.com](mailto:robert@kolasalaw.com)) is a Lake Forest attorney and CPA who holds an LL.M. in taxation from Georgetown University Law Center. Before entering private practice he was an attorney for the IRS Office of Chief Counsel in Washington, D.C. Robert concentrates his legal practice on estate planning, trust and probate administration, asset protection and preparing estate and gift tax returns.