EP101
Drafting Revocable Living Trusts and Ancillary Documents with WealthDocs™
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Part I
Introduction

1.01 What this course will cover
In this course we will discuss:

- The Estate Planning Process
- Drafting a Living Trust
- GSTT Drafting Issues
- Drafting the Ancillary Documents to Complete the Plan
- Drafting an Irrevocable Life Insurance Trust

1.02 Rules of the game
During this course we will refer to the Uniform Principal and Income Act, the Revised Uniform Principal and Income Act, the Uniform Fiduciaries’ Powers Act, the Uniform Trust Code, common sense, and general common law trust principles. *We will not cover state-specific issues.* Every practitioner should have a good understanding of his or her jurisdiction's unique state statutes and case law before commencing an estate planning practice.

This course also assumes that participants have a rudimentary understanding of federal estate and gift taxation, Generation-Skipping Transfer Taxation, and income taxation applicable to decedents’ estates.

1.03 Common estate planning terms and abbreviations
Estate planning has a language all its own, with a vocabulary full of acronyms and jargon. Although the following list is by no means complete, it should help with some of the common terms you’ll find in this outline and in other WealthCounsel materials (listed in alphabetical order – kind of):

- **CLAT/T-CLAT** – A Charitable Lead Annuity Trust (or Testamentary Charitable Lead Annuity Trust); A charitable trust that provides a term benefit to a charity, and then distributes the remainder interest to non-charitable beneficiaries.
- **CRT** – A Charitable Remainder Trust (lifetime or testamentary); the inverse of a CLAT. A CRT pays a term benefit to non-charitable beneficiaries, and then distributes the remainder interest to one or more charitable beneficiaries.
- **DPA/DPOA** – A durable power of attorney
- **FLP/FLLC** – A Family Limited Partnership, or Family Limited Liability Company
• GPOA – A general power of appointment, as classified under IRC §§2041 or 2514 (or both). It grants the power holder the ability to appoint property to:
  1. the power holder,
  2. the power holder’s estate,
  3. the power holder’s creditors, or
  4. the creditors of the power holder’s estate
• GRAT – A Grantor Retained Annuity Trust
• GST, or GSTT – The Generation-Skipping Tax, or Generation-Skipping Transfer Tax, imposed by IRC §2601
• HCPOA/MPOA – A medical power of attorney
• HIPAA – The Health Insurance Portability and Accountability Act of 1996
• IDGT/IDIT/GDOT – An “Intentionally-Defective” Grantor Trust/ Intentionally Defective Irrevocable Trust/ “Grantor Deemed Owner” Trust; a trust that is irrevocable and outside of the grantor’s estate for estate, GSTT, and usually gift tax purposes, but income taxable to the grantor
• ILIT – An Irrevocable Life Insurance Trust
• IRC – The Internal Revenue Code
• JT/JTWROS – Joint Tenancy (With Right of Survivorship)
• Lifetime Power of Appointment – A power of appointment (limited or general) exercisable only during the life of the power holder
• LPOA – A “limited” power of appointment, also sometimes referred to as a “special” power of appointment; that is, a power of appointment that does not rise to the level of a GPOA
• Marital Share – the portion of a dead grantor’s estate that qualifies for the marital deduction
• Non-Marital Share – the portion of a dead grantor’s estate that does not qualify for the marital deduction
• Pour-Over Will – Ancillary document transferring probate assets to an RLT
• QDOT – Qualified Domestic Trust; a method of delaying payment of estate tax when planning for a non-U.S. citizen surviving spouse
• QPRT – A Qualified Personal Residence Trust; an irrevocable “split-interest” trust
• QTIP – Qualified Terminable Interest in Property (trust); an option for claiming property as eligible for the unlimited marital deduction
• Regs. – Treasury Regulations promulgated by the IRS
• RLT – Revocable Living Trust; either joint or individual
• SNT – A “Special Needs” Trust, designed to provide benefits for a beneficiary who is or may become eligible to receive needs-based assistance due to a medical or other health condition. An SNT may be created as a component within another trust (such as a parent’s RLT), or it may be created as a standalone, separate trust agreement.

• SRT – A Standalone Retirement Trust, designed to qualify as a Designated Beneficiary under tax-deferred retirement accounts.

• Testamentary Power of Appointment – A power of appointment (limited or general) exercisable only at death by a testamentary instrument

Part II
Overview – The Estate Planning Process

2.01 A Process – Not a Transaction

As an estate planning attorney you have a unique opportunity to develop a relationship, rather than sell a product or service. Counseling clients on the many options to plan for their most precious assets, their family, their health, their goals and dreams, leads to a very rewarding practice. It will also result in increasing your stable of long-term clients and more referrals. While there is no one specific way to practice estate planning, we have found that the following process will enhance your relationships with clients and will set you apart from other practitioners. We encourage you to integrate this model into your practice, adapting it to your own personality, desires, strengths and client base.

(a) Turning Prospects into Clients: Educate to motivate

Prospective clients who understand the significance of estate planning can better understand the application of solutions to meet their needs. Clearly they need not (and likely cannot) understand the intricacies of planning solutions – that’s why you’re the attorney – but clients who understand key issues tend to more fully embrace the importance of their estate plans. Establishing yourself as a knowledgeable estate planner is important in building your client base. Here are some modes of inspiring prospects to become clients:

(1) Workshops/ “Retail” Seminars

Why don’t they work? Can they work? Fifteen years ago it was nearly unheard of for an estate planning attorney to hold informational or promotional seminars that were open to the lay public. But today, many attorneys and other professionals routinely present informational public seminars designed to inform potential clients and motivate them to action.

There are several PowerPoint® presentations available on the WealthCounsel Knowledge Base. They were prepared by other WealthCounsel members and graciously shared by them for your use. Feel free to use and modify those

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1 This course is not intended to be a primer on marketing. For more information on retail and other modes of estate planning marketing, consider attending an EP100 program and reviewing the materials provided there.
presentations and to the extent you make them better, post your improvements back to the Knowledge Base.

As you get to know financial advisors and other professionals in your area, you will likely find that many will willingly (or eagerly) share the cost of offering joint presentations to mutually-beneficial audiences.

(2) Creating a referral network – Building and filling a “client pipeline”

Mining your own client base. Don’t overlook your existing clients. Many of your existing clients may have estate plans in need of updating, or they may need additional estate planning work. You may also have clients for you have provided other legal services. These clients are often the easiest, because you have already established a trusting attorney-client relationship with them.

Obtaining referrals through affiliated professionals. CPAs, financial advisers, insurance professionals, trust officers, and other professionals whom you meet can be good sources for client referrals. The endorsement of a prospective client’s trust advisor is priceless!

Encourage your satisfied clients to refer their friends and acquaintances. Personal testimonials by pleased clients may be the best referral source available. Take care of your clients, and ask them to tell others how pleased they are with your services.

Personal knowledge. You just know people. You know people who know people. Let people know what you do. Meet people, be nice, and let them know you’re knowledgeable. As you develop your reputation in your community, you will become known as “that nice man/woman who does estate planning, and must really know what they’re talking about.”

(3) Initial Client Meeting

Education is a 2 way street. You have 2 ears and one mouth for a reason! Ask relevant leading questions and let the clients do the talking. Find out their concerns, hopes, plans, and expectations for the people who are most important to them.

(a) Client Information Worksheet

What should it contain? How and when do you deliver it to the client? How and when does the client deliver it to you?

You must have certain information and a fairly clear picture of the clients’ estate composition and net worth to adequately counsel them through the estate planning engagement. But no one likes “home work.” Make it easy for clients to give you the information you need to provide high-quality representation.

(b) Connect2A

A web-based alternative for gathering and updating client information and documentation. For more information, go to www.connect2a.com.
(c) Ask permission to ask the tough questions

Unfortunately, we must ask difficult questions and discuss things that clients often prefer to leave alone. Soften the tone a little before wading through some of these tough issues:

- If any potential beneficiary has substance abuse problems;
- If any beneficiary is in an unhealthy relationship;
- How well the beneficiaries and their mates, children, etc. relate to the clients;
- If any beneficiary has difficulty keeping a job;
- If any beneficiary has poor spending or investment habits;
- If any beneficiary has health concerns or disabilities;
- If any beneficiary is in a “high risk” profession for litigation (doctors, lawyers, business owners, etc.)

(4) How much is too much?

Avoid overloading the client. The client meeting is designed to inspire confidence, establish good chemistry, and motivate the clients to move forward with clear, mutual expectations. Resist the temptation to show them how smart you are.

(b) Design

Include the client in the design process. Clients who understand the basic design of their estate plan feel a strong sense of ownership and are more likely to follow your advice in maintaining and updating the estate plan as their lives evolve.

(1) Design Worksheet

Make sure you gather the information you need. WealthDocs™ contains several different options (see the image, below), and many more may be
downloaded from the Knowledge Base on the WealthCounsel members’ website. But avoid making the design meeting look “formulaic”; let the design meeting flow as you guide it, relying heavily on the clients’ input.

(2) Create a visual: Design an estate plan flow chart

Most people are visual learners. Certainly people comprehend complicated issues when they receive information in multiple modes. As you counsel clients and describe their estate plan design, they receive auditory learning. When you combine a visual learning by illustrating their estate plan, they more thoroughly understand the abstract concepts of estate planning.

There are many design templates available for download from the Knowledge Base to help you perfect your illustration techniques. As you sketch clients’ estate plans for them, your options range from low-tech doodles on blank paper to high-tech electronic media.

Some planners install a simple paper flipchart or dry erase white board in their conference rooms, and then photograph the image using a Polaroid® camera. You may wish to invest in a PanaBoard® (a dry erase board with a built-in printer to print the image), or a SMARTBoard®, Interactive® white board, or IBID® board (a dry erase board that sends the image to your computer).

(c) Drafting

After you have thoroughly counseled the clients and have designed their estate plan graphically, it’s time to create the documents. The content of the outline below provides an in-depth review of the RLT assembly in WealthDocs™.

(1) Automating the document assembly process

WealthDocs™ makes it fairly easy to create drafts of sophisticated estate planning documents designed for clients’ unique needs. To that end, clients will not usually understand the sophistication of the system, and would wonder why they should pay you to draft their documents using an automated
system. We never recommend that you draft documents in the presence of clients. Counsel them and design their plan, and then begin drafting after the clients leave your office.

(2) Should you send drafts or summaries to Clients?

Many estate planners have made it a practice to send complete draft copies of estate planning documents to clients for their review before the document execution meeting. Some attorneys express concern that clients will be overwhelmed by the apparent complexity of the estate planning documents, and others have had clients execute the draft documents on their own.

Other attorneys prefer to send document “summaries,” which capture the essence of the client’s plan design. WealthDocs™ creates article-by-article summaries of the RLT and Will, keyed directly to the client’s answer file. We suggest that sending a summary is more effective and less intimidating than sending the complete trust or will.

(3) Preparing a print schematic

As discussed above, clients often appreciate a visual image of their estate plan in addition to the printed documents. Many attorneys create estate planning schematics – flowcharts with boxes, arrows, and text – for the client’s estate plan. You can create a reusable library of schematic templates for clients using applications like PowerPoint®, SmartDraw®, Visio®, or similar applications. Some of your colleagues have posted their samples on the WealthCounsel Knowledge Base; feel free to review them and adapt them for use in your practice.

(d) Implementation – Executing the estate plan documents

You’ve met the clients and found that you had good chemistry. They perceived the need and importance of planning and you helped them design their plan. You have created the documents necessary to make their estate plan come to life and it’s now time to put pen to paper and finish the job. The document signing meeting is an important time to solidify your relationship with the client and make sure that they fully embrace the significance of their estate plan – not just today, but for years to come.
(1) **More than signing documents**

It is critical that the client understand the basic concepts underlying the plan. The amount of understanding will vary with each client; but every client is entitled to embrace the purposes and design of their plan. Many attorneys enjoy this time with clients and use the opportunity to discuss future planning needs that may arise as circumstances change, or to discuss possible friends or family members who might need similar planning. Other attorneys delegate the document signing meetings to an associate attorney, paralegal, or assistant. You will find the method that best suits your style.

(2) **To fund or not to fund?**

An unfunded trust-based plan doesn’t fully serve the client’s interests. For the trust to work best, it must hold title to property. The process of transferring property from the clients into their trusts is called “funding.”

(a) **Internal funding by the law firm**

Many law firms coordinate the trust funding process in whole or in part. Some attorneys accept full responsibility for funding and manage the entire funding process; other attorneys fund only certain assets. Still others hold periodic “funding seminars” for their existing clients to equip clients to fund their estate plans themselves.

Some attorneys include their funding services in the price of the quoted estate planning fee; others enter into a separate funding fee agreement.

(b) **Outside Resources**

There are many resources on the market that are available to help you manage the trust funding tasks of your practice. WealthCounsel has a product titled WDATS™ (WealthDocs Asset Transfer System™) which is made available to WealthCounsel members and is available for separate purchase by nonmembers. Other products and services include SettlementPro™ (by Advanced Planning Solutions, LLC), PBO Solutions, LLC (Professional Back Office) or local independent paralegals available on a contract basis in your area.

**Part III**

**Introduction to the WealthDocs™ Revocable Living Trust Agreement**

The remainder of the course assumes that the client has decided to use a revocable living trust (“RLT”), that you, as the drafting attorney, have all the necessary information, and you are prepared to draft the documents.
3.01 WealthCounsel’s drafting philosophy

WealthCounsel believes that legal documents should be easy for non-lawyers to read and understand.

(a) Comprehensible By Laymen

We draft legal documents so that non-lawyers can understand them. The only exception is a situation where technical language has a precise meaning that cannot be stated in non-technical language. In many cases the trust you draft must be administered by lay trustees, and should be as easy as possible for adult beneficiaries to understand.

(b) Logical Arrangement

Any written document is easier to understand if it is arranged in a logical, chronological sequence.

(c) Captions and Headings

WealthDocs™ uses captions and headings liberally throughout the document to help the reader understand the provisions in their proper context. Articles, sections, and important subsections, contain a descriptive heading. But each document also contains a provision stating that the headings and captions are included for the convenience of the reader; they have no legal consequence in construing the document.

(d) Table of Contents

A Table of Contents makes any complex legal document easier to use. To that end, the WealthDocs™ trust documents contain a Table of Contents keyed directly to each client’s document. The TOC can also easily be updated if the document is further edited after the TOC has been assembled.

(e) Coordinated “Ancillary” Documents

“Pour-over” wills and durable powers of attorney normally are used with the RLT in order to complete the client’s comprehensive estate plan. You must draft these documents carefully to make sure their provisions are entirely consistent since, under the most state’s laws, these documents will be construed together when they form part of the same estate plan. Cf. Schupbach v. Schupbach, 760 S.W.2d 918 (Mo. App. 1988).

(f) Clearly Expressed Intent

In construing an RLT, the courts generally ascertain the maker’s intent from the four corners of the document. Since the maker’s intent cannot generally be ascertained by parol evidence, you must use extreme care to make sure that every provision in your client’s plan is consistent with your client’s objectives.

• Although the WealthDocs™ templates are carefully drafted to cover many situations, you should review each document carefully to make sure the language adequately addresses your clients’ needs;
• Because WealthDocs™ assembles into Microsoft Word, your documents can easily be customized even beyond the options available within WealthDocs™;

• We recommend that a second person review custom-drafted provisions.

(g) First-Person Point of View

An RLT is usually created by a trust agreement or by a declaration of trust. A trust agreement is a two-party agreement between the grantor and the trustee, and is commonly drafted from a “third person” point of view. A declaration of trust is a written declaration by one or more persons – usually referred to as the grantor – that is accepted by the trustee. It is usually drafted from a “first person” point of view.

WealthDocs™ are written in first-person for the following reasons:

• Will language – also written in the first person – can be interchanged in a declaration of trust with little or no revision.

• Legal writing expert Bryan Garner (called the “Prosser of Legal Usage”) says that first person documents are easier for non-lawyers to understand and for judges to interpret.

• Use of first person pronouns – I, my, we, our – makes documents easy for clients to understand, improving client “buy-in” and promoting removing at least some of the veil of mystery that often shrouds clients’ estate plans.

3.02 Creating and using WealthDocs™ “Scenarios”

(a) What are Scenarios?

Scenarios, also referred to as “Overlay” answer files, enable you to create and reuse “pattern” answer files for estate planning methods you often implement in your practice. For example, if you often prepare estate plans for married couples with modest estates who want after-death planning flexibility and asset protection for the surviving spouse and other beneficiaries, you might create a scenario that funds the Marital and Non-Marital shares of the deceased spouse’s estate (see discussion, below) using Clayton election with a very restrictive QTIP and lifetime beneficiary trusts.

When you open a trust assembly with a new answer file and “Overlay” that scenario, those predetermined answers will automatically populate the new answer file, getting you well on your way to a finished document. You will simply need to add the client’s unique information, and then change any of the answers necessary for your client’s estate plan. It’s easy to see how much time you can save by creating and using your own scenarios!
For an excellent tutorial on the use of scenarios in WealthDocs™, see the presentations on the Recorded Events page of WealthCounsel’s members-only website.

(b) Existing WealthDocs™ Scenarios

The WealthDocs™ Library file also contains a “Scenarios” folder in the Living Trust System, which contains several different scenarios designed for clients with varying needs. You will find options to “Edit Scenarios,” “Assemble (Documents) Using Scenarios,” and view “Sample Documents” created using the scenarios.

You may wish to begin using these existing scenarios, or you may wish to simply review them to get some ideas of your own. To create an estate plan using one of the existing scenarios in WealthDocs™, simply open the folder titled “Assemble Using Scenarios,” select the scenario you wish to follow, and double-click to launch the WealthDocs™ interview.

When you launch an existing scenario in WealthDocs™, several things happen behind the scenes:
• First, the appropriate RLT master interview is opened with a NEW answer file. In the case illustrated in the previous screen shot, this would be the Individual RLT assembly.

• Then, WealthDocs™ automatically “overlays” a scenario answer file created in advance to accomplish the highlighted plan over the new answer file.

• In doing so, all of those plan-oriented answers are then populated into the new answer file.

• You then will proceed through the interview question-by-question to enter the client’s unique information, change any answers as necessary for the client’s unique plan, and then generate the document.

A few important reminders about existing scenarios in WealthDocs™:

• They were created in a vacuum – that is, they were created for purposes of illustrating the functionality within WealthDocs™ and may or may not be suitable for your clients’ needs. Furthermore, they may not reflect the type of plans you wish to recommend for your clients. You should absolutely NOT use an existing scenario without first reviewing each of the decisions made in the scenario’s interview, and ensuring that the decisions are right for your client.

• To that end, they are not a substitute for your knowledge and critical thinking; only YOU know what your clients need.

• They were created before WealthDocs™ was installed on your computer system. This means that your “Preferences” that you set when you first configured WealthDocs™ in your office will not be applied to the preexisting scenarios in WealthDocs™. (Note that any scenarios you create from scratch will contain your preferences.)

(c) Creating your own Scenarios with WealthDocs™

As mentioned above, the best way to learn about creating and using your own scenarios in your office is to first view the related recordings on the Recorded Events page of the WealthCounsel members’ website. Once you understand the basics, you will create scenarios using the following steps:

• From the Interviews – Data Input folder within WealthDocs™, select the type of scenario you wish to create and double-click to launch the interview. In the following screen shot, the user is creating a “Married Individual RLT” scenario.
• When prompted for an answer file, select (New Answer File) to create a new scenario. (You can also open existing scenario answer files to edit them, if necessary).

• This will begin the interview. You will quickly see that the interview is a little different than the standard RLT interview. For example, you will not be prompted to enter any names for the client, children, fiduciaries, etc.

• As you proceed through the interview, remember that you are creating a “generic” answer file of sorts; you are not creating a plan for a specific client. Rather, you are creating a “pattern” answer file that represents common plans that you implement with clients.

• Continue to build the scenario answer file and make it as complete as you wish. Any questions you answer will be answered when you overlay this scenario into another file; and questions you leave blank will also be left blank. This user is creating a scenario for a fractional marital deduction formula:
You will also note that the user is leaving some questions blank, to be completed on a client-by-client basis:

- Once you have completed the scenario interview to your satisfaction, close the interview. When prompted to save, give the file a name that will help you remember what the plan does, and save the scenario answer file to a unique location that you will remember.
Here, the user created a “My WDocs Scenarios” folder on the user’s computer desktop. If you use a file server, you will probably want to save your scenarios there. This was this user’s naming convention for an individual RLT for a married person using a fractional marital deduction formula and creating lifetime subtrusts for residuary beneficiaries.

- Remember that you can create as many different scenarios as you want; the trick is in keeping them straight!

**Using your scenarios for a client’s plan**

Now that you have created a scenario that represents your planning style, follow these simple steps to use your scenario for a specific client. Assume our WealthDocs™ user above now has a client who needs an individual RLT with a fractional marital deduction formula, and who wants to create lifetime trusts for remainder beneficiaries. After counseling the client and gathering all of the necessary information, the attorney will:

- Open the Revocable Trust Agreements folder in WealthDocs™ and launch the interview by double-clicking the interview.
- If this is a new client (one for whom no RLT-related data has already been entered into WealthDocs™), open a New Answer file. (If some data for the client’s RLT has already been entered, the attorney simply opens that existing answer file by navigating to the answer file on the attorney’s computer system.)
- Once the interview is open, the attorney will go to the “File” menu on the toolbar and select “Overlay Answers…”
The attorney then selects the scenario he or she designed and clicks “Open.”

And Voilà, the “new” client answer file is automatically populated with the attorney’s scenario answers.

The attorney simply completes the interview with the client’s unique data and altering the plan where needed. Soon the document is assembled and ready for final review and editing.

3.03 Joint Trusts for Married Couples

When planning for a married couple, what’s best: separate trusts for each spouse or a joint trust for the couple?

A “joint trust” is a revocable living trust in which both husband and wife are the grantors and generally also the initial Trustees. Joint trusts have been used for many years by married
couples in community property states. They are used less frequently in common law jurisdictions, but there is no longer any legal reason for this.

(a) Special WealthDocs™ Note: Joint Answer File

When you create a joint RLT with WealthDocs™, you will only create one answer file for both the husband and the wife. That one answer file will contain all of the answers necessary to create the clients’ RLT and all ancillary documents required to complete the clients’ estate plan. There is no need to perform a “spouse conversion” when using the joint trust assembly, as is done when planning with separate trusts. (See below.)

(b) Community Property Advantages of joint trusts

Joint trusts offer significant legal advantages in community property states. A joint trust permits the spouses to preserve community property ownership status while enjoying the benefits of owning property in a living trust. See Section 3.06 below for a more thorough discussion of the issues surrounding community property.

3.04 Joint Trusts for Unmarried Couples?

Many practitioners wonder whether it’s advisable to create joint trusts for couples who are not married. Non-traditional couples or aged siblings often wish to engage in estate planning for mutually-owned property, especially when they wish to provide for each other just as husbands and wives do. But these relationships bring a measure of added complexity that makes joint trusts inadvisable. There are federal gift and estate tax issues involved in two unmarried people funding a jointly beneficial and jointly revocable trust agreement between them. This is because there is no equivalent to the federal unlimited marital deduction for unmarried partners, even if their state legally recognizes their union.

(a) Gift Tax problems in joint trust

Unless the grantors contribute assets of precisely equal value to the trust, creating and funding a single joint trust by unmarried persons may result in taxable gifts between them unless assets are somehow carefully segregated into separate shares. This would, in effect, create two separate and distinct trusts within one trust agreement.

(b) Income Tax problems in joint trust

Because will be a "grantor trust" for income tax purposes, income tax will be reportable by the individual grantors on their separate returns (since unmarried persons can't file jointly). The individuals should report income from their separate respective share of the trust making reporting more complicated.

For these reasons we recommend that unmarried individuals use separate trusts only. To that end, WealthDocs™ allows the user to select “life partner” as a “Marital Status” option in the individual RLT interview.
3.05 Joint Trusts in Common Law Jurisdictions

The joint trust advantages in common law jurisdictions tend to be psychological rather than legal. In many longstanding marriages, the couple views their endeavors as a joint venture with the couple striving together to achieve financial success and prosperity. Often times, these couples believe the psychological cohesiveness of their “working together” is defeated when their property is separated into individual trusts for each spouse. Using a joint trust allows these couples to engage in proper planning and get the psychological comfort that comes from believing their joint venture will continue.

The joint trust, if properly drafted, can be an excellent tool if the husband and wife own all of their property jointly (except property that may pass to the trust by beneficiary designation). There are two approaches to joint trust planning and drafting.

(a) Separate, Yet Joint

Most planners draft and fund the joint trust so that one-half of the property is considered legally to be each spouse’s separate property. The trust is drafted to keep this property segregated while the spouses are alive. So, when a joint trust is funded with joint tenancy property, it is important to eliminate the “right-of-survivorship feature” so that the property passes under the terms of the trust on the first death. Merely transferring joint tenancy property into a trust severs the survivorship feature in many states; in other states, the joint tenancy property should be severed or changed to tenancy in common by written agreement between the spouses. (Hint: it’s important for you to know your state’s law.)

WealthDocs™ allows you to use this technique when drafting a joint trust in a common law jurisdiction.

Select one of the following options for transfers of separate property to the trust:
- Language for community property states
- Language for separate property states

Do you want to include signature lines for the parties on the separate schedules?
- Yes
- No

Do you want to provide that if the Grantors have entered into or in the future enter into a marital property agreement, the terms of that agreement shall control the characterization of property titled in the name the trust and that in the absence of a marital property agreement, property titled in the name of the trust shall be governed by the terms of this agreement?
- Yes
- No

This technique is discussed in two articles: Roy Adams and Thomas W. Abendroth, “The Joint Trust: Are You Saving Anything Other Than Paper?” Trusts and Estates 39 (August 1992) [an article that criticizes the approach while recognizing that it will work in a properly drafted trust] and Robert A. Esperi and Renno L. Peterson, “The Joint Revocable Living Trust: A Planning Tool for Married Couples,” Estate Planning 148 (May/June 1993) [an article that supports the approach and answers each objection in Adams’ article].
(b) Joint RLT with Lifetime General Power of Appointment

In Private Letter Ruling 2002210051 the Internal Revenue Service sanctioned a unique approach to joint trust planning and drafting. In that case, a joint trust was drafted to give each grantor, acting individually, a lifetime right to withdraw any or all of the trust property at any time. The Service approved many of the estate planning features of this joint trust, and made three significant holdings:

- First, the lifetime general power of appointment, coupled with formula language funding the Bypass trust with all of the joint trust property, resulted in the surviving grantor being treated as making a completed gift of his or her interest in the trust upon the death of the deceased grantor. Therefore, according to the Service, the deceased grantor’s gross estate will include the deceased spouse’s trust portion under IRC §2038, as well as the surviving grantor’s portion under IRC §2041. Accordingly, to the extent the Bypass Trust is funded, property passing to the Bypass Trust would be treated as passing from the deceased grantor, and not from the surviving grantor.

- Second, any future payments from the Bypass Trust to beneficiaries other than the surviving grantor would not constitute a gift from the surviving grantor to those beneficiaries. More importantly, the surviving spouse’s estate will include none of the assets held in the Bypass Trust.

- Finally, notwithstanding inclusion of the surviving grantor’s interest in the estate of the deceased grantor, there would be no step-up in basis for that portion of the Bypass Trust funded by operation of the deceased grantor’s power of appointment of the surviving grantor’s interest in the trust because of IRC §1014(e). (Many practitioners disagree with this conclusion.)

See also PLR 200101021.

***Special note for community property practitioners:*** This technique could result in the loss of the double step-up in basis otherwise available to community property held by a joint trust. Since the transfer to the deceased grantor is considered made at the instant before death, the property could be considered the individual property of the decedent, rather than community property, at the time of the decedent’s death. This would be consistent with the Service’s interpretation of IRC §1014(e) in PLR 2002210051.

But in Estate of Kwang Lee v. Commissioner, TC Memo 2007-371, the tax court disallowed the marital deduction where the decedent attempted to shift value into his predeceasing spouse’s estate using a formula lifetime GPOA. Perhaps illustrating the obvious, the court stated that “the term ‘surviving spouse’ requires that a spouse actually survive his or her spouse; i.e., the later-dying spouse must actually outlive his or her spouse.” As author and practitioner Charles A. Redd notes, “it is hard to imagine the Tax Court's concluding that a gift tax marital deduction would ever be available for a transfer to a spouse who is not a donee but a decedent.”

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2 For Mr. Redd’s complete analysis of the Lee case, see “Sharing Exemptions? Not So Fast…”, Trusts and Estates, April 2008. This article is reproduced in its entirety in the appendix.
WealthDocs™ contains this option in the joint RLT assembly, but practitioners are strongly cautioned to analyze the law and clients’ planning needs before implementing this strategy.

**3.06 Community property Issues**

There are special issues that arise when community property is used to fund a living trust.

(1) **What is Community Property?**

In community property states, community property is generally defined as any property acquired during marriage from the labor of either spouse, unless the parties agree otherwise. Each spouse is deemed to own an undivided one-half interest in community property. (Practitioners should consult state law for more precise definitions; California and Washington consider life insurance purchased with community funds to be community property, but Louisiana does not.) Commingling of separate property funds can change the separate property into community property. It is critical that separate property be clearly identified in the trust document.

Transfer of community property to a joint living trust will not change the character of the community property if each spouse retains the right to revoke the trust, the trust specifically provides that the property remains community property, and if the property withdrawn from the trust retains its character as community property.

(2) **Double Step-Up Advantage**

Community property receives a double step-up in tax basis upon the death of the first spouse. Upon the death of the first spouse, the decedent’s half of community property and the surviving spouse’s half of community property will receive a new basis equal to the fair market value at death, yet only the decedent’s half of the community property will be included in the decedent’s gross estate for estate tax purposes.

(3) **Use of Marital Agreement**

The grantors may convert separate property to community property, or convert community property to separate property with a marital property agreement, known in some states as a transmutation agreement.

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3 There are nine Community Property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. In addition, Alaska has some special statutory provisions that allow for the treatment of certain property as community property for tax purposes. This topic is beyond the scope of EP101.
(4) Community Property in Separate Property States

When a couple moves from a community property state and fails to maintain their property as community property, the step-up in basis is limited to the deceased spouse’s interest in the community property. Practitioners should identify community property and specifically preserve the community property nature of those assets. Several separate property states have adopted some form of the Uniform Disposition of Community Property Rights Act so that a couple moving from a community property state to a separate property state may retain the community property character in marital assets acquired as community property or traceable to community property. Several practitioners recommend a “yours, mine and ours” approach by drafting separate trusts for the separate property of each spouse and a joint trust for the community property.

To the frustration of some practitioners, WealthDocs™ contains at least some community property language in every RLT created for a married person. This is done out of an abundance of caution to ensure that, if clients in a common law property state ever acquired (or later acquire) community property that is not disclosed to the estate planning attorney, there will at least be some savings language to preserve community property treatment and hopefully saving the double step-up in basis at the death of the first spouse to die.

3.07 Selecting the Correct Trust Interview

Once the decision is made whether to prepare separate trusts or a joint trust select the appropriate WealthDocs™ interview and begin. For purposes of this outline, it is assumed that you have participated in WealthDocs™ Orientation or have viewed the recorded event on WealthCounsel’s website and understand the difference between selecting the interview-only option and selecting the document assembly option in WealthDocs™. The following images assume that you seek to actually prepare an assembled document, not to simply create an answer file for use at a later time.

(a) Creating Separate Trusts
(b) Creating a Joint Trust – Mutual Planning Objectives

If both Grantors have the same objectives for the selection of trustees, marital deduction planning, and dispositive provisions of the trust, then use this option:

(c) Creating a Joint Trust – Different Planning Objectives

If, on the other hand, the clients have different distribution schemes in mind (for example, the husband’s interest passing to his children of a prior marriage, and the wife’s interest passing to her children of a prior marriage), then consider this option:

This planning method creates a joint trust for the grantors’ joint lives, and then distributes to separate RLTs (one for each grantor) at the death of the first grantor to die. Although some critics (and clients) may perceive this as a more complicated strategy, proponents find it to be more reliable, understandable, and much easier to draft than a single joint RLT that contemplates various contingent distribution schemes.

As noted in the Template Properties tab, this template is also used to create an “Alaska Community Property Trust” designed to take advantage of Alaska’s tax-favored treatment of property at the death of the first grantor to die. Creation of an Alaska Community Property Trust requires an in-depth understanding of the nuances
of Alaska law. This strategy is beyond the scope of EP100, but is discussed at length in WealthCounsel’s “Thriving In Estate Planning” conference.

3.08 Choosing the “Full” or “Express” Interview

One of the first choices to be made in the WealthDocs™ RLT interview is whether to complete the “Full Interview” or the “Express Interview.” Choosing the Full Interview will reveal all of the various drafting options within the WealthDocs™ RLT assembly, and thus presents greater drafting flexibility. On the other hand, it generally takes more of the drafter’s time to complete the Full Interview.

By contrast, the Express Interview hides many of the more sophisticated options sometimes reserved only for more complicated estate plans. This allows more streamlined data entry and is designed to help users save time. It is largely used for simpler estate plans, but still provides a wide array of options. The Express Interview presents fewer drafting options and removes from view many options which are generally reserved for more sophisticated planning, such as the Distribution Trustee Dialog, GSTT Exempt and Nonexempt Trust planning, Stand-By SNT provisions, and others.

We recommend that newer users complete their first few WealthDocs™ interviews using the Full Interview to get a solid understanding of the options available in the system.

3.09 Family Information

Article two of the assembled WealthDocs™ RLT identifies the grantor’s family members. It also identifies those who will be provided for after the death of the grantor and those persons who have been important in the grantor’s life. This article also performs a secondary legal function: It provides evidence that the grantor was competent because he or she knew and could name his or her natural heirs.
(a) Citizenship

Whether or not the client is a U.S. citizen is critical for proper Marital Deduction planning. If either the client or the client’s spouse is not a U.S. citizen, you will later be prompted for Qualified Domestic Trust (QDOT) provisions (discussed below).

(b) Spouse and Children Information

Enter the spouse and children information, indicating whether or not the spouse is a U.S. citizen. The child dialogs are “repeating dialogs,” which continue to repeat so long as data is entered. Note that if a child is to be disinherited, you will enter that information in the child dialog. You will also be able to disinherit that child’s descendants, if applicable.

(c) Reference Afterborn Children

If you choose to include afterborn or adopted children in the definition of “children” in the trust agreement, that definition will include a reference that “children subsequently born to or adopted by the Grantor” will be considered as children for the purpose of the trust agreement. If you answer “No,” that reference will be excluded.
(d) Additional Family Information

Select appropriate options when the client wishes to identify additional individuals who impact the trust plan. If the trust will provide substantial benefits (other than specific distributions, which are addressed separately) to other family members or beneficiaries, that option should be selected. If the grantor wishes to acknowledge the death of one or more family members (such as a deceased spouse or child), you may select that option and complete the dialog that follows. Finally, if the grantor ceased family members; and/or (3) disinherited family members. If you select any of the following, the interview will prompt you to enter the individuals’ names.

<table>
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<tr>
<th>Additional Family Information</th>
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</thead>
<tbody>
<tr>
<td>Check the appropriate boxes to enter additional family information:</td>
</tr>
<tr>
<td>☐ List Other Family Members or Beneficiaries</td>
</tr>
<tr>
<td>☐ List Deceased Family Members</td>
</tr>
<tr>
<td>☐ List Disinherited Family Members</td>
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</tbody>
</table>

(e) Trust Identity

It is helpful to add a provision identifying the trust by name. Giving the trust a specific name is especially useful when funding (transferring property to) the trust. Often this Article will be attached to an Affidavit or Certificate of Trust, an ancillary document assembled as part of the client’s plan.

(f) State of Trust Administration

The selection of the State of Trust Administration determines the jurisdiction under which the trust will be construed. In some cases, this will also trigger state-specific provisions in the document.

(g) Survivorship Options

In a situation where a beneficiary is deceased and property is to be distributed to the beneficiary’s descendants, there are three alternatives as to how to divide the property among the beneficiary’s descendants.

- “Per Stirpes” – If a distribution is to be made to a person’s descendants per stirpes, the distribution is divided into as many shares as there are then-living
children of the person and deceased children of that person who left then-living descendants. Each living child receives one share and one share is allocated to each predeceased child who left living descendants. (The predeceased child’s descendants will divide that child’s share proportionately.) If a deceased child has no descendants, no share is allocated to that child.

For example, if the grantor has three children and two predecease leaving descendants, the distribution will be divided into three shares. The living child receives a 1/3 share, and each deceased child’s line of descendants, or “stirp” receives 1/3 share, to be distributed proportionately among each deceased child’s descendants.

In the example illustrated above, if Mary predeceased Tom Client and left no descendants of her own, Tom’s estate would be distributed in halves, with one half each to Peter’s stirp, and to Paul’s stirp. If Mary had two living children, each of her children would take half of her third, or 1/6 each.

- **“By Representation”** – If a distribution is to be made to a person’s descendants by representation, the distribution is divided into as many shares as there are descendants in the nearest degree of kinship and then-deceased descendants in the same degree who left then-living descendants. Each then-living descendant in the nearest degree receives one share and the share of each then-deceased descendant in the same degree is divided among his descendants in the same manner.

This option is similar to “per stirpes” except that, with “by representation”, one must look to the first generation below the trust maker where there are living descendants. So with the same facts as the above example, the result would be the same.
But, if all three children predecease the grantor, we must look to the first generation of the grantor’s living descendants to determine the number of shares. For example, if there are six grandchildren – three by Child 1, one by Child 2, and two by Child 3 – the estate is divided into six shares, with each grandchild receiving an equal 1/6 share.

In the example above, Tom Client has died and all three of his children predeceased him, leaving descendants. We then look to Tom’s grandchildren’s generation and count the number of grandchildren. This tells us the number of shares into which we will divide the estate. So if Tom had five grandchildren, the share is 1/5 to each; if her had seven grandchildren, the share is 1/7 to each, etc.

- “Per Capita at Each Generation” – If a distribution is to be made to a person’s descendants per capita at each generation, the distribution is divided into as many equal shares as there are descendants in the nearest degree of kinship to the designated ancestor and then-deceased descendants in the same degree who left then-living descendants, with each then-living descendant in the nearest degree receiving one equal share. The remaining shares, if any, are combined and then re-divided in the same manner among the then-living descendants of the deceased descendants as if the then-living descendants who received a share, and their descendants, had predeceased the date of distribution. (It sounds more complicated than it is.)
The following diagram illustrates distribution “per capita.”

In this example, Peter and Paul each predeceased Tom Client, and each had living descendants. Mary is living. Mary represents her “generation,” and each of her two siblings left descendants. So Tom’s estate is first divided into thirds, with Mary receiving a full 1/3 share. The remaining two-thirds then passes to the next generation where there are living descendants (Tom’s grandchildren), and re-divided equally. Each of Peter’s and Paul’s children will receive one-fourth of that two-thirds, or one-sixth each. \((1/4 \times 2/3 = 1/6)\).

On the other hand, if Mary also predeceased Tom Client, the first generation with living descendants is the grandchildren’s generation, so each grandchild receives a 1/6 share, yielding the same result as “by representation.”

### 3.10 UTC Provisions

The Uniform Trust Code is a body of trust law adapted from the Restatement of Trusts, Third, and is intended to provide consistency to the laws governing trust administration in the various states. Many states have adopted new trust states influenced at least in part by the UTC, while several states have wholly rejected the UTC\(^4\). Of those states that have enacted at least some form of the UTC, all of them have modified the UTC as originally drafted. The “Uniform” Trust Code may well be the least uniform of the “Uniform” Codes.

The UTC as enacted in many states changes the rights of beneficiaries, grantors, and creditors, and often adds new powers and responsibilities for the trustee. Many of the provisions of the various states’ versions of the UTC may be waived either by the grantor or by the beneficiaries, but some cannot. This course is not intended to serve as a primer on the UTC. It is each practitioner’s responsibility to know whether their state’s legislature has

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\(^4\) As of April 2008 the UTC has been enacted in some form or another in 20 jurisdictions: AL, AR, DC, FL, KS, ME, MO, NC, ND, NE, NH, NM, OH, OR, PA, SC, TN, UT, VA, and WY. It is pending in Oklahoma (SB 1825).
adopted some form of the UTC, and the extent to which that state law may affect the drafting and administration of trusts in the jurisdiction. There is some information on the WealthCounsel Knowledge Base on the UTC that may help practitioners begin to get an understanding of the scope of the UTC’s impact in each jurisdiction.

WealthDocs™ contains some provisions that are unique to UTC-“inspired” jurisdictions. If the UTC option is selected, the trust will contain additional language designed to comply with the requirements of most states’ UTC enactments:

- “Establishing My Trust” Article – Statement of grantor’s intent
- “Trust Administration” Article –
  - Waiving provisions of state law (inspired by the UTC) to the greatest degree possible
  - Modified Trust Accounting language
  - Inserted Section dealing with providing information to trust beneficiaries during grantor’s life and after death
- “General Provisions” Article – Inserting definitions for “Permissible Distributee” and “Qualified Beneficiary,” two terms used in the Uniform Trust Code as enacted by most states.

### 3.11 Initial Trustees

Specify who will serve as the Initial Trustees of the RLT. This will usually only be the client and the client’s spouse, if any. You will also be able to list other initial trustees, if applicable to your client’s situation.
3.12 Distribution Trustee

Using a “Distribution Trustee” is designed to bifurcate the role of the trustee, separating the managerial and investment aspects of the trustee’s responsibility from the distribution-making authority. Often, a beneficiary will be his or her own trustee as to administrative and investment matters, but will have a friend or other unrelated third party hold the power to render or withhold distributions. This method is intended to provide asset protection where the beneficiary is a trustee of his or her share (i.e., a “beneficiary-controlled” trust).

When a beneficiary holds distributive authority (such as when serving as trustee) of the beneficiary’s own share, the beneficiary’s ability to make distributions to himself or herself exposes the beneficiary’s trust share to potential attachment by creditors. In the worst-case scenario, a creditor may be able to step into the beneficiary’s shoes to force a distribution. But if the power to make distributions is vested solely in the discretion of an independent “Distribution Trustee,” the beneficiary can otherwise control all other aspects of his trust without exposing the beneficiary’s trust to creditors’ claims.

When Distribution Trustee Provisions are included, WealthDocs™ then requests information to design the means by which the Distribution Trustee is named for the trusts created in the document. Including Distribution Trustee Provisions also enables the drafting attorney to include provisions for each subtrust restricting the authority to make discretionary distributions from that particular subtrust to the Distribution Trustee alone. This allows the primary beneficiary to serve as the Trustee and a disinterested third party to serve as the Distribution Trustee, thus creating a “beneficiary-controlled” trust.

### Distribution Trustee Provisions

- Include provisions for naming, removing and appointing a Distribution Trustee?
  - Yes
  - No

In naming the Distribution Trustee to serve after the death of a Grantor, select from one of the following options:

- Name the Distribution Trustee once for all trusts.
- Name the Distribution Trustee separately for each trust created after the death of a Grantor.
- No Distribution Trustee is named in the agreement. Upon the funding of a trust containing provisions for a Distribution Trustee, a majority of the income beneficiaries shall appoint the Distribution Trustee for that trust.

3.13 Funding

Although it is unnecessary for the trust to recite the assets comprising the trust, many attorneys list these assets in an exhibit. In California, the Courts have held that this list is sufficient to fund the trust if the grantor and initial Trustee is the same person. See Estate of Heggstad, 16 CA4th 943, 948, 20 CR2d 433 (1993). But see Osswald v Anderson, 49 CA4th 812, 820, 57 CR2d 23 (1996) (transfer by list is insufficient to transfer title where a third party is Trustee).

**(a) Additions to the Trust**

The trust instrument should authorize the grantor to make additions both by *inter vivos* (lifetime) and by testamentary transfer. The trust instrument should also
authorize transfers by other persons, but only if the property is accepted by the Trustee.

(b) Magic Wand

In addition to allowing the listing of assets on a “Schedule A” attached to the trust, the “Magic Wand” adds language expressly assigning the grantor’s property to the trust, except for life insurance, qualified retirement accounts and certain other assets. Some practitioners believe that the Magic Wand funding language may be useful in some jurisdictions if the grantor dies before the trust is completely funded. Even if including this language may not completely eliminate the need to probate in the event the trust is not fully funded, it does provide a statement of the grantor’s intent to transfer property to the trust. The “Magic Wand” is intended only as a back-up if certain assets are not transferred to the trust using traditional funding methods, and the client dies or becomes incapacitated before funding is completed. It should NOT be considered a substitute for traditional funding methods.

<table>
<thead>
<tr>
<th>Initial Funding Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Which method do you want to use to initially fund the trust?</td>
</tr>
<tr>
<td>☐ Assets listed on Schedules</td>
</tr>
<tr>
<td>☐ Magic Wand</td>
</tr>
</tbody>
</table>

If you want to list items on a particular schedule check the appropriate box below. By default Schedule J lists “Ten Dollars Cash.”

☐ List Schedule "J" (Joint Property) Assets
☐ List Schedule "C" (Community Property) Assets
☐ List Schedule "W" (Wife’s Separate) Assets
☐ List Schedule "H" (Husband’s Separate) Assets

3.14 Agent’s Power to Amend

Whether or not the grantor should delegate the right to revoke or amend a revocable living trust to an agent under a durable power of attorney is a very difficult decision, as it bestows a great deal of authority on the agent. If such powers are to be granted, they should be included in both the trust agreement and the durable power of attorney. In fact, California imposes this requirement by statute.

There is concern that the agent could seriously distort the dispositive plan contained in the trust through exercise of these powers. So if you include this power, you should consider placing limitations on the agent’s power to amend. These limitations could include the power to amend to correct scrivener’s errors; alter the administrative and investment powers of the Trustee; or reflect tax or other legal changes that affect trust administration. And certainly don’t include the power without first counseling the client.
3.15 Exercise of Testamentary Power of Appointment

If either grantor is exercising a testamentary power of appointment upon his or her death, it is advisable to specify the terms under which that power is being exercised. This may only arise in a very limited number of cases but if it impacts your client, you will be prompted to specify the name of the person who granted that power to your client, what type of instrument granted the power, etc. You should also make sure you review the complete document purporting to grant the power to make sure it can be exercised by a trust, or to otherwise comply with the power’s requirements.

### Exercise of Testamentary Power of Appointment

- Check to insert a provision exercising a testamentary power of appointment held by the husband.
- Check to insert a provision exercising a testamentary power of appointment held by the wife.

#### 1: Exercise of Husband's Testamentary Power of Appointment

**First Testamentary Power of Appointment**

**Grantor/Donor of the Power of Appointment:** Kenneth F. Client

**Type of Instrument Granting the Power of Appointment:**

- Will
- Trust
- Other

**Specific Reference granting the power of appointment, i.e., "Article 7" or "Section 7.01"**

- Article 7

**Name of the Appointee/Donee (person to be benefited by the exercise of the power of appointment):**

- Trustee of the Thomas C. Client Irrevocable Trust, dated 9/10/2006

**The husband exercises the power of appointment for the benefit of the Appointee as follows:**

to be administered in accordance with the provisions of the trust agreement

### 3.16 Incapacity

It has been our experience that disability planning is one of the most neglected aspects of estate planning. In many cases a very rudimentary statement addressing the administration and distribution for the disabled grantor is the extent of disability planning. But studies routinely show that any individual is six times more likely to become disabled than they are to die in any given year. As a result, we believe proper estate planning will more fully address the grantor’s disability planning.
(a) Determination of Incapacity

A well-drafted living trust will spell out how the Trustee determines whether or not the grantor is disabled or incapacitated so that the provisions governing disability will become operative.

WealthDocs™ provides several options for making this determination.

**Determination of Incapacity**

- How will incapacity of the Grantor be determined?
  - Definition of Incapacity in the trust agreement
  - Disability Panel
  - Two Licensed Physicians
  - Attending Physician
  - Spouse and Attending Physician

- What type of decision is need by the disability panel?
  - Majority

- Will there be separate disability panels for Thomas C. Client and Cynthia M. Client
  - Yes
  - No

- Click to enter the husband’s disability panel members
- Click to enter the wife’s disability panel members

**Gift Tax Note:** Generally, property transferred to a revocable living trust is not a taxable gift for federal gift tax purposes because the grantor’s power to revoke makes the transfer incomplete. The subsequent termination of the power to revoke, however, completes the gift to the remainder beneficiaries at the time the power is terminated. *Burnet v. Guggenheim*, 288 U.S. 280 (1933). To avoid this result, WealthDocs™ provides that the power is only suspended temporarily in the event of the grantor’s incapacity and is restored when the disability or incapacity is removed, thus keeping the transfer to the RLT incomplete for gift tax purposes.

(b) Beneficiaries During Incapacity

Most boilerplate living trust provisions provide that only the grantor will be a beneficiary of the living trust if he or she becomes incapacitated; however, using WealthDocs™, you can create a trust that will also benefit the grantor, his spouse, and any of his or her dependents.

WealthDocs™ also allows the grantor to decide whether his or her needs should be have primary priority, or if the Trustee can provide for all of the beneficiaries’ needs without any priority among the beneficiaries.

**Distribution Guidelines During the Incapacity of a Grantor**

In making distributions from an incapacitated Grantor’s trust property, the Trustee shall give priority to:

- Needs of the incapacitated Grantor, then to needs of others.
- Needs of the incapacitated Grantor and the incapacitated Grantor’s spouse equally, and then to needs of others.
- Incapacitated Grantor’s needs and needs of others equally.
Gifting During Incapacity

It is often useful to include a provision in the trust permitting someone to make lifetime gifts for the grantor during any period he or she is incapacitated. This provision is useful for three reasons:

- In some instances, the grantor may have already established a lifetime giving program, and the Trustee will want to continue this program so that the grantor’s estate and tax planning can be carried out.

- It is possible that, during the grantor’s incapacity, the estate may grow or otherwise change so that unanticipated corrections are needed in the plan. In that case, it is convenient if someone can make gifts on the grantor’s behalf for tax planning purposes.

- People of faith and other charitably-minded people like knowing that gifts to their church, synagogue and other charities will continue even after they are disabled.

WealthDocs™ gives several drafting options that permit gifts for either a narrow or broad variety of purposes.

(1) Trustee Makes Gifts

The Trustee can be authorized to make gifts during any period of time the client is disabled.

(2) The Agent Under the Client’s Durable Power of Attorney Makes Gifts

Another option is to authorize the grantor’s agent to make gifts under his or her durable power of attorney, and authorize the trustee to make distributions to the agent for that purpose. (If this option is selected, it is obviously important to ensure that the client’s durable power of attorney bestows gifting powers to the agent to effectuate the gifting plan.)

Provisions for Gifting During a Grantor’s Incapacity

Include provisions authorizing the Trustee as follows:
- Distribute to an incapacitated Grantor’s agent to make gifts.
- Make gifts directly to an incapacitated Grantor’s beneficiaries.
- Don’t include provision for making gifts.

(To clear a selection, click it again)

Authorize the Trustee to make gifts for the following purposes:
- Prepay the cost of tuition.
- Gifts for payment of medical expenses pursuant to Section 2503(e).
- Initiate a gifting program limited in amount to the annual gift tax exclusion.
- Initiate a gifting program in amounts in excess of the annual gift tax exclusion.
3.17 Post Mortem Administration

Even a fully funded living trust requires work when the grantor dies. There are three truths to consider:

1. *Death ends your tax year.*
2. *Dead people have no assets.*
3. *Death will not be repealed.*

If you can’t take it with you, who owns it when you die? There are three choices: the Probate Estate, the Trust Estate, and individuals and charities outright.

*Remember: the Probate Estate and Trust Estate are subject to administration.* In most cases there will be income and expenses during administration. Expenditures during administration affect both taxes and beneficiary shares. Not only must you determine who gets the income (and when), you also must determine where to take the deduction for administration expenses.

(a) Payment of Expenses and Taxes

In Boatman’s Union National Bank v. Welton, 640 S.W.2d 497 (Mo. App. 1982), the Missouri Court of Appeals vented its frustration with tax clause cases:

“In view of the repeated litigation involving the basic issues herein, it is difficult to understand why those who concoct wills and trusts cannot simply ascertain the testator’s or grantor’s specific desires on the subject and then draw the instrument so that it is plainly stated that death taxes shall be borne only by either the residuary estate or by those who benefit by specific bequests, legacies and devises in wills or from trusts. Perhaps scriveners of such instruments bound for litigation simply ape forms whose authors are equally uninformed as the copier of the simple solution.”

Generally, the federal tax law does not determine who has the ultimate burden for the taxes. This determination is left to state law. And if a decedent’s will or trust is silent on the payment of taxes and expenses, state law provides default rules ordering payment. Most states are so-called “equitable apportionment” states, meaning the estate tax will be apportioned to the property that generated the taxes. But the decedent’s will or trust can be drafted to override the default apportionment rules. Consequently, every decedent has the ability to direct how taxes and expenses will be paid and apportioned. See Blattmachr and Hastings, “The Tax Apportionment Clause – Often the Most Important Provision in the Will,” *The Chase Review* (November 1987).

(b) Basic Principles

WealthDocs™ follows this basic philosophy on apportionment of taxes and expenses:

2. As a general rule, taxes are borne by the trust residue. “Except as otherwise provided in this Section or elsewhere in this agreement, my Trustee shall provide for payment of all death taxes from the Administrative Trust without apportionment and shall not seek contribution toward or recovery of any such payments from any individual.”

<table>
<thead>
<tr>
<th>Tax Apportionment Provisions - Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Select one of the following options for apportionment of death taxes:</td>
</tr>
<tr>
<td>☐ No apportionment, all from residue, except as otherwise provided.</td>
</tr>
<tr>
<td>☐ Equitable apportionment, except as otherwise provided.</td>
</tr>
<tr>
<td>☐ Apportioned as provided by state apportionment statute.</td>
</tr>
</tbody>
</table>

In addition to providing for payment of death taxes from residue, WealthDocs™ provides the ability to select equitable apportionment, causing the apportionment of tax liability against the property generating the tax, as discussed above. Alternatively, you may select apportionment as provided by your state’s state apportionment statute.

It is important to bear in mind that absent equitable apportionment, the residuary beneficiaries will be liable for death taxes otherwise attributable to beneficiaries of specific bequests. This can be quite problematic when different beneficiaries are involved. It is important to discuss this issue with clients and ensure that the trust reflects the client’s wishes.

3. Since RLTs are normally used in combination with a “pour-over” Will, it is important that the tax clauses in the documents be coordinated. You may otherwise find yourself in a situation where the personal representative and Trustee are looking to each other for payment of taxes not knowing which direction takes precedence over the other.

(c) Exceptions

WealthDocs™ carves out several exceptions to the second principle:

1. **Protection for Exempt Property** - If property otherwise exempt from estate tax is used to pay taxes, it will be unnecessarily includible in the estate. WealthDocs™ provisions protect exempt property from bearing the tax burden.

2. **Protection for Marital Deduction** - If marital deduction property bears a tax burden, this decreases the size of the marital deduction. WealthDocs™ provisions protect marital deduction property from bearing the burden of taxes and expenses.

3. **Protection of Charitable Deduction** - If charitable deduction property bears a tax burden, this decreases the size of the charitable deduction, resulting in a circular calculation. WealthDocs™ provisions protect charitable gift property from bearing the burden of taxes and expenses.

4. **Property Passing Outside Estate** – like life insurance or other property passing by beneficiary designation, POD, TOD, IRAs and other qualified
plans – is apportioned among the persons who receive this property in the same manner as equitable appointment.

5. **Specific Distributions** - WealthDocs™ provides the option of making these distributions share in the tax burden of the estate.

6. **Others:**
   a. Delayed taxes;
   b. Section 2031(c)(5)(C) – Qualified Easements;
   c. Section 2032A(c) – Farm Valuation;
   d. Section 2057(f) – Qualified Family Owned Business Interest
   e. GST taxable distributions and terminations.

**(d) Protection of Retirement Plan Assets**

Some practitioners have expressed concern that a clause requiring or permitting the payment of the decedent-grantor’s debts, expenses, and taxes from trust assets may cause the trust to lose its status as a see-through trust for IRA distribution purposes, resulting in the trust’s failure as a designated beneficiary. This concern is largely due to some Private Letter Rulings issued by the IRS that suggested that even indirectly allowing benefits to pass to the Participant’s estate (as through a trust provision which allows or directs the use of trust property to pay the Participant’s debts or probate expenses) may be treated as having named the estate as a beneficiary and may result in having no Designated Beneficiary.

As a response to this concern, WealthDocs™ includes an option to specifically state in the trust that death taxes cannot be apportioned to retirement accounts (as shown in the image below). However, retirement planning expert Natalie Choate opines that this concern is not well-founded. In fact, she points out that “[e]very letter ruling that does mention such a clause in a trust [requiring or permitting payment of the decedent’s debts, taxes, and expenses] finds some reason why the trust nevertheless qualifies as a see-through.”

The IRS’s reasoning for otherwise qualifying such trusts as see-through trusts was based on one or more of the following:

- The trust prohibits use of retirement benefits for this purpose;

To address this issue, WealthDocs™ provides language you can use to direct taxes and expenses away from any retirement plan assets paid into the trust, in much the same manner as charitable and marital distributions.

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6 Specifically, see PLR200453023 (referring favorably to trust language segregating retirement benefits from satisfaction of such expenses).
State law protects the benefits from creditors’ claims;

Benefits were not used for this purpose after the beneficiary finalization date (September 30 of the year following the Participant’s death);

No other assets were available for satisfaction of the expenses.

It is worth noting that the terms of the trust will not control as to assets that pass outside of it, so it’s debatable whether or not the language that prohibits apportionment of death taxes to retirement accounts passing outside the trust has any significant legal effect. But since the trustee and personal representative are often the same person, the language reinforces the notion that other assets would be used to satisfy the death tax liability. With this language included, the trustee is effectively on notice that other assets (potentially trust assets) must be used to satisfy the death tax liability that arises as a result of those retirement accounts.

In the end, it certainly doesn’t hurt to include the language, and many practitioners will do so out of an abundance of caution. However, the language does not appear to be necessary to qualify the trust as a see-through (conduit) trust.

(e) Payment of Charitable Bequests from IRD Assets

IRD assets receive no step-up in basis and are income-taxable assets in the hands of most beneficiaries. These assets, therefore, are excellent assets for transfer to charities. When IRD assets are transferred to charity, the organization will receive the asset without payment of income tax since it is a tax exempt organization. IRD assets are passive assets and thus generate no unrelated business taxable income. IRC §512. In addition, the transfer to a charity qualifies for an estate tax charitable deduction. IRC §2055(a).

WealthDocs™ allows you to direct that IRD assets be used to fund any charitable distributions.

Payment of Charitable Bequests from IRD Assets

Do you want to include a provision to the effect that all of a Grantor’s charitable gifts and bequests shall be made, to the extent possible, from property that constitutes “income in respect of a decedent”?

- Yes
- No

By answering “Yes” to this option the following provision will be included in the trust agreement:
“Payment of Charitable Bequests

I instruct my Trustee to satisfy all of my charitable gifts and bequests, to the extent possible, from property that constitutes income in respect of a decedent.”

Without this language the administrative trust will be able to claim an estate tax charitable deduction for its charitable gifts but not an income tax charitable deduction. Gifts to charity are deemed to come from principal at death, and not from income or from IRD assets. See Crestar Bank et al., Executors of the Estate of James Linen v. IRS 83 AFTR2d Par. 99-839; Van Buren v. Commissioner, 89 T.C. 1101(1987)

With this language, there is a good argument that if the administrative trust has any kind of IRD asset, then the administrative trust can claim an offsetting charitable income tax deduction for the payment that was made to charity or the total amount of IRD, whichever is less. (This language was suggested by Christopher R. Hoyt at the 36th Annual Heckerling Institute in Miami Beach, Florida, January 2002.)

In addition, practitioners should also be aware of a potentially troubling pronouncement by the IRS in CCA 200644020. There, the IRS determined that the satisfaction of a pecuniary charitable bequest from IRD assets constituted a sale or exchange, and that the payments were “transfers of the right to receive the IRD.” The trust was required to include the value of the IRD, and was not allowed to claim an offsetting charitable deduction. Many IRA experts, including Robert Keebler, Natalie Choate and others, express strong doubts as to the IRS’s position.

To avoid the result of CCA 200644020, Mr. Keebler suggests that EVERY will or trust should contain this language. Although the payment of the pecuniary bequest from IRD may still accelerate the income, Mr. Keebler believes that the inclusion of this language will preserve the trust’s ability to claim an offsetting charitable deduction under IRC §642(c).

3.18 Retirement Plans and Life Insurance

Qualified retirement plan assets (including IRAs) and life insurance policies have a separate article because these assets have special rules and issues that make them unlike other assets transferred to the RLT.

(a) Retirement Plans

In some instances, the grantor’s spouse or other individuals may lack the ability to handle large sums of money that could come their way through outright distributions from a retirement plan or IRA. In that case, the client may choose to make his or her RLT the beneficiary of the IRA or qualified plan, rather than a spouse or individual, so that the special provisions of the trust can handle those distributions. However, it is very important to make sure that the trust qualifies as a “Designated Beneficiary” (DB) under the Treasury Regulations for purposes of determining the Minimum Required Distributions (MRD) payable each year.
(1) Qualifying Trust

As a general rule, a DB must be an individual. A trust, however, can be treated as a DB under the Regulations (and the trust beneficiaries are treated as if they had been named directly) if the following four requirements are met:

1. The trust is valid under state law, or would be except that there is no corpus;
2. The trust is irrevocable or will, but its terms, become irrevocable upon the death of the participant;
3. The trust beneficiaries are identifiable from the trust document; and
4. A copy of the trust instrument is provided to the plan administrator along with an agreement that any amendments to the trust within a reasonable time; or a list of all of the beneficiaries and an agreement to make a copy of the trust document available upon request.

Note: The documentation requirements are satisfied in the case of MRDs before death when the spouse is the sole beneficiary of the trust if the participant either provides the plan administrator with a copy of the trust instrument and agrees to provide a copy of any future amendments, or provides the plan administrator with a list of all the beneficiaries of the trust (including contingent beneficiaries), certifies that this list is correct and complete and the other trust requirements are satisfied, agrees to provide corrected certifications if the trust is amended, and agrees to provide a copy of the trust instrument on demand. In the case of minimum distributions after the death of the participant (or a surviving spouse), the requirements are satisfied if the Trustee, no later than October 31 of the calendar year immediately following the calendar year in which the participant died, either provides the plan administrator with a copy of the trust instrument or a final list of beneficiaries as of the date on which the beneficiary is determined. If this list is provided, the Trustee must certify that this list is correct and complete and that the trust requirements are met, to the best of the Trustee’s knowledge, and agree to provide a copy of the trust instrument to the plan administrator or the IRA Trustee or custodian on demand. Treas. Reg. §1.401(a)(9)-5 Q&A 6.

A fifth rule is that all of the beneficiaries of the trust must be individuals. Treasury Regulations Section 1.401(a)(9)-5 Q&A 7(a) states that as a general rule if more than one beneficiary is named, then the oldest beneficiary will be used as the measuring life for MRD purposes.

(2) QTIP Trust

The QTIP Trust is a very useful tool when the participant is reluctant to name the spouse as beneficiary, either because the spouse is unable to handle money or because the participant wants to assure that the remaining retirement plan assets pass to his or her children.
You can draft the QTIP so that it is a qualified trust for DB purposes. The discussion, however, does not end there. The trust must also qualify for marital deduction purposes. To accomplish this, the trust instrument must give the surviving spouse the power, exercisable annually, to withdraw from the plan or IRA all income earned on plan or IRA. The trust instrument must also require that, if the surviving spouse exercises this power, the Trustee of the QTIP trust must withdraw from the plan or IRA the greater of (1) the income earned on the IRA assets during the year, or (2) the annual MRD. If the surviving spouse does not exercise the power, the Trustee need only withdraw the MRD amount and distribute that amount to the surviving spouse. Rev. Rul. 2000-2, 2000-31, I.R.B. 305.

**Note:** A QTIP trust also creates vested rights in beneficiaries other than the surviving spouse. If, therefore, the QTIP is named as beneficiary, the plan proceeds cannot be treated as owned by the surviving spouse for roll-over purposes.

(3) **The Unresolved Issue: Which Trust Beneficiaries Must Be Counted?**

The problem with a trust as a DB centers in the fifth requirement: That all of the trust beneficiaries must be individuals who would qualify as DBs if named outside the trust. If any of the trust beneficiaries fail to meet the definition of a DB, then the trust will not be considered a DB for purposes of the MRD rules. The problem expresses itself primarily in two situations:

**(a) Successor Trust Beneficiaries**

Under the Final Regulations, some beneficiaries may be disregarded: Section 1.401(a)(9)-5 Q&A 7 says at A(c): “Successor beneficiary—(1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy under paragraph(a) of this A-7, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee’s beneficiaries after that beneficiary’s death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee’s benefit beyond being a mere potential successor to the interest of one of the employee’s beneficiaries upon that beneficiary’s death. Thus, for example, if the first beneficiary has a right to all income with respect to an employee’s individual account during that beneficiary’s life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary’s death), both beneficiaries must taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.” (Emphasis added.)
A-7 is troublesome when a trust is named as a beneficiary because the Regulations do not clarify what is meant by a “mere potential successor.”

(b) Trusts with Powers of Appointment

Giving the trust beneficiary a power of appointment is another area of concern. Unless the trust provides for an outright distribution of the retirement plan or conduit trust language (discussed below), when a trust beneficiary of a trust has a power to appoint the retirement plan assets, the “class of appointees” must be counted. If the class of possible appointee’s includes an “unidentifiable” beneficiary (i.e. a beneficiary without a measuring life) or a person with a shorter life expectancy, then the life expectancy of the primary beneficiary will not control. In the event an “unidentifiable” beneficiary (charities, creditors, estate, etc) is counted, the trust will not qualify as a DB.

The IRS recognizes two types of trusts for purposes of determining Designated Beneficiary status.

1. “Conduit” Trusts

In a conduit trust, the trustee is required to distribute all qualified retirement plan distributions outright to the trust’s beneficiary. For purposes of identifying the Designated Beneficiary under the plan, the conduit trust beneficiary is the sole beneficiary of the conduit trust, and is thus able to use his own life expectancy as the Applicable Distribution Period (the period of time under which the retirement plan must be completely distributed) under the retirement plan. All beneficiaries other than the conduit trust beneficiary will be deemed mere potential successors, and they will subsequently be disregarded.

A conduit trust is guaranteed to pass the IRS trust rules.  

WealthDocs™ gives you an option to apply the conduit trust rules to living trusts that you create:

<table>
<thead>
<tr>
<th>Conduit Trust Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Include provisions to create conduit trusts for any retirement plans payable to any trust created under this agreement?</td>
</tr>
<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
</tbody>
</table>

2. “Accumulation” Trusts

By definition, any trust that is not a conduit trust is an accumulation trust. In an accumulation trust, the trustee has the ability to hold property for the benefit of the beneficiary, and is not required to make distributions. In an accumulation trust, all beneficiaries must be

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7 Choate, at 313
counted for purposes of identifying the measuring life for the Applicable Distribution Period.

An accumulation trust may or may not pass the IRS trust rules.\textsuperscript{8}

WealthDocs™ contains a Standalone Retirement Trust module that can be used to create various kinds of conduit or accumulation trusts. For more information on this strategy, consider attending the EP205 course, \textit{Understanding & Drafting Retirement Plan Beneficiary Designations & Trusts}.

\textbf{Bibliographical Note:} The best in-depth discussion of the estate planning issues for retirement plans and IRAs is Natalie Choate’s, \textit{Life and Death Planning for Retirement Benefits: The Essential Handbook for Estate Planners} (6th ed. 2006). Ms. Choate keeps her book well up-to-date. The latest edition of her book can be purchased through her website: \texttt{www.ataxplan.com}. She also quickly posts supplements to her book on the website when there are changes to this rapidly evolving area of law.

\textbf{(b) Life Insurance Policies}

A well-drafted revocable living trust should contain these provisions dealing with life insurance:

\begin{itemize}
  \item[(1)] \textbf{Control During the Grantor’s Life}
  
  Because the proceeds of the life insurance policy are included in the grantor’s estate, even if the policy is owned by the trust (since the trust is revocable), most grantors will want to have full control over the policy, and access to any cash value. WealthDocs™, therefore, gives the grantor full access to the life insurance policy even if owned by the trust, and to exercise all options available on the policy.

  \item[(2)] \textbf{Payment of Premiums}
  
  If the trust is named as policy owner or as death beneficiary, the trust should provide that the Trustee may, but is not obligated to, pay premiums on the policy.

  \item[(3)] \textbf{Settlement Options}
  
  The Trustee should be authorized to accept any payments due the trust after the grantor’s death under any settlement arrangement, and should be authorized to exercise any rights available to under the arrangement.

  \item[(4)] \textbf{Collection Efforts}
  
  Upon proof that the insured has died, the Trustee should be obligated to collect all sums payable to the trust under the policy contract, and should be authorized to take any action necessary to collect those sums.
\end{itemize}

\textsuperscript{8} Id.
The Trustee should also be authorized to compromise, arbitrate or otherwise adjust claims on policies payable to the trust, but should not be required to exercise any settlement options available under the policies.

(5) Release of Payor’s Liability

The Trustee’s receipt to the insurance company is a full discharge of the insurance company, and the company is not obligated to see to the application of the proceeds.

3.19 Definition of the Internal Revenue Code

Certain provisions in the trust agreement are defined by reference to an Internal Revenue Code section. If the section is later repealed, what will be the effect on the provision in the document?

The answer to this question will depend upon how the provision is drafted, how terms are defined in the instrument, and how the “Internal Revenue Code” is defined. WealthDocs™ provides two options:

(a) Standard Definition:

“References to the “Internal Revenue Code” or to its provisions are to the Internal Revenue Code of 1986, as amended from time to time, and the corresponding Treasury Regulations, if any. References to the “Treasury Regulations,” are to the Treasury Regulations under the Internal Revenue Code in effect from time to time. If a particular provision of the Internal Revenue Code is renumbered, or the Internal Revenue Code is superseded by a subsequent federal tax law, any reference shall be deemed to be made to the renumbered provision or to the corresponding provision of the subsequent law, unless to do so would clearly be contrary to our intent as expressed in this agreement. The same rule shall apply to references to the Treasury Regulations.”

(b) Phase Out Definition:

“References to the “Internal Revenue Code” shall refer to the Internal Revenue Code of 1986, as amended. References to the “Regulations” are to the Treasury Regulations under the Internal Revenue Code.

Reference to any provision or section of that Code shall be deemed to refer to the provision or section of the federal tax law in effect on the date of a Grantor’s death that corresponds to the provision or section referred to that was in effect at the time of the execution of this agreement.

If there is no provision or section at the date of a Grantor’s death that corresponds to such provision or section and if the estate tax has been repealed, the reference to a provision or section of the federal tax law shall nevertheless be deemed to refer to the provision or section that was in effect at the time of the execution of this instrument or the provision that was in effect immediately before the tax law was repealed, solely for the purpose of determining the amount of property that passes under a provision of this
instrument if our Trustee, in its sole and absolute discretion, determines that such result is more consistent with our intention.

In no event shall our Trustee under the powers granted under preceding paragraph take any action it would cause any property passing under this agreement that would otherwise qualify for a marital deduction, charitable deduction, special use valuation or QFOBI deduction to fail to qualify.

Our Trustee shall bear no liability for any decision made in good faith pursuant to the power granted under the terms of this section defining the term ‘Internal Revenue Code.”

3.20 Specific Distributions and Distributions of Personal Property

(a) Specific Distributions

WealthDocs™ provides a variety of options for specific distributions to individuals (charitable options are discussed below). You can make distributions upon the death of either spouse or upon the death of both spouses, from the residue.

<table>
<thead>
<tr>
<th>Specific Distributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Include a specific gift of residence to the surviving spouse?</td>
</tr>
<tr>
<td>☐ Yes, outright to surviving spouse</td>
</tr>
<tr>
<td>☐ Yes, to Survivor’s Trust</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
</tbody>
</table>

Include pre-residual specific distributions . . .
☐ Upon death of Thomas C. Client to individuals
☐ Upon death of Cynthia M. Client to individuals
☐ Upon death of Thomas C. Client to charities
☐ Upon death of Cynthia M. Client to charities

Include residual specific distributions . . .
☐ Upon death of survivor to individuals or charities
### (1) Distributions to a Class

You can choose whether to make distributions to specific individuals or to all members of a class.

#### 1: Thomas C. Client’s Specific Distributions to Individuals

- **This specific distribution is:**
  - [ ] to a named individual.
  - [x] a dollar amount to each member of a class of individuals.

**Distribution to Class of Individuals**

**Amount of gift to each member of the class:**

$10,000

For this class gift, the Trustee is instructed to distribute $10,000 to each of:

- [ ] my grandchildren living at the time of my death
- (e.g. "[Client name]'s grandchildren" or "the children of Bob Jones")

**Specific Distribution Section Heading for correct capitalization**

**Specific Distribution to My Grandchildren**

- **Distribution to be made upon death of the Grantor:**
  - [ ] even if wife is alive
  - [ ] only if wife is deceased

- **Shall death taxes be apportioned to the recipient of this distribution?**
  - [ ] Yes
  - [ ] No

[Select]
(2) Distributions in Trust

Specific distributions to individuals can be made in trust or outright.
(3) Specific Distributions from Residue

If you choose to make a specific distribution from the residue, an article will be added before the residuary distributions article:

<table>
<thead>
<tr>
<th>1: Residual Specific Distributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>This specific distribution is:</td>
</tr>
<tr>
<td>☐ to a named individual or charity.</td>
</tr>
<tr>
<td>☐ a dollar amount to each member of a class of individuals.</td>
</tr>
</tbody>
</table>

Name of Individual or Charity (e.g. "Red Cross")  Gender  
June Client  Female

- Type of gift:  
  ☐ Monetary Gift - Outright  
  ☐ Monetary Gift - Trust  
  ☐ Specific Property  
  ☐ Pour-over to existing trust

- If the individual is deceased, the distribution shall:  
  ☐ To the individual’s descendants  
  ☐ Lapse

- Shall death taxes be apportioned to the recipient of this distribution?  
  ☐ Yes  
  ☐ No

Select

(b) Specific Gift of Residence to Surviving Spouse

WealthDocs™ provides the option to include a provision instructing the Trustee to make a specific distribution of the Grantor’s residence to the surviving spouse. This provision is intended to keep the residence from ending up in the Family Trust.

If the surviving spouse desires to fund the Family Trust or the Marital Trust with the residence, the surviving spouse can exercise a qualified disclaimer, in which case the residence will end up being allocated pursuant to the formula clause.

Specific Distributions

- Include a specific gift of residence to the surviving spouse?  
  ☐ Yes, outright to surviving spouse  
  ☐ Yes, to Survivor’s Trust  
  ☐ No

(c) Testamentary CRT for Retirement Plans

Because of the tax-exempt character of charitable remainder trusts, many planners believe these trusts should be named as beneficiary for retirement plan assets. Typically, the spouse will be named as the initial beneficiary of the retirement plan (so as to not waste the benefits of the spousal roll-over) and the CRT named as contingent beneficiary if the spouse predeceases the grantor.

Some states require that a trust be “in existence” if retirement plans are to be beneficiaries. Therefore, nominal funding provisions are used to make sure that the trust has corpus (and thus is “in existence”) when retirement plan assets are transferred to it.

The other option is to create a credit shelter CRUT. Christopher Hoyt advocates the use of a credit shelter CRUT for the surviving spouse and children for estates in which the estate is less than their combined applicable credit amount. Hoyt has written, “The most intriguing aspect of this strategy is that a CRUT could be used as a credit shelter trust for a retirement account. Such a trust typically pays income to the surviving spouse and then distributes assets to the children in such a way that the assets are not included in the surviving spouse’s taxable estate. A common problem for physicians, professors and other professionals is that they would like to have a credit shelter trust for some of their retirement plans assets but the stretch IRA regulations discourage it. They have been searching for a solution. It turns out that the best solution may be a testamentary CRUT that pays amounts first to the surviving spouse, then to the children, and then to a charity.

### Testamentary Charitable Remainder Trusts for Specific Purposes

- **Specific Testamentary CRT Designated as Beneficiary**
  - □ Check if you want to create a testamentary charitable remainder trust to hold retirement plan assets of the husband.
  - □ Check if you want to create a testamentary charitable remainder trust to hold retirement plan assets of the wife.

  [Note: On the above, the Grantor must designate the testamentary CRT as the specific death beneficiary of the retirement plan. See Help Screen for suggested beneficiary designations.]

- **Living Trust Named as Beneficiary - Formula Funding**
  - □ Check if you want to create a testamentary charitable remainder trust for the benefit of the wife to be funded by husband's retirement plan benefits up to the amount of the exemption credit amount.
  - □ Check if you want to create a testamentary charitable remainder trust for the benefit of the wife to be funded by wife's retirement plan benefits up to the amount of the exemption credit amount.

### (d) Tangible Personal Property

In addition to listing specific items of tangible personal property as a specific distribution, WealthDocs™ provides an option directing the Trustee to distribute items of personal property in accordance with a personal property memorandum.
Using a list or memorandum for distributing tangible personal property is allowed in some states for transfers by Will, and is a statutory authorization. Some practitioners are concerned that these statutes do not extend to trusts and, therefore, a list is ineffective to transfer tangible personal property held by the trust. WealthDocs™ solves this problem by treating the list as an amendment to the living trust.

### 3.21 Estate Tax

The federal estate tax is levied against the decedent’s estate as a tax on the decedent’s ability to transfer property. Federal estate taxes are imposed on a decedent’s taxable estate to the extent the size of the taxable estate exceeds the estate tax applicable exclusion amount. The value of a decedent’s taxable estate is computed by adding the value of all of the property interests owned by the decedent, and then subtracting all allowable deductions (including the unlimited marital deduction).

Before the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the lifetime gift tax exemption was equal to the estate tax exclusion amount. After EGTRRA took effect, the exemptions diverged. The law established a graduated timeline under which the estate and generation-skipping transfer taxes would be repealed, but with an important hitch: there would be no estate or GSTT only for decedents dying in 2010.

Under existing law, the repeal of the estate and GST tax is only temporary. Unless Congress acts to make the repeal permanent before January 1, 2011, the repeal established under EGTRRA will “sunset” and the tax laws will revert to prior law. This means that the gift and estate tax exclusions will once again be unified, the GSTT exemption will revert to its inflation-indexed pre-EGTRRA value, and the former tax rates (up to a confiscatory 55%)!

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⁹ To the extent the applicable exclusion amount has been used against taxable gifts on lifetime gifts, it is not available against the estate tax.
will return. Until Congress takes action, the exemptions from gift, estate, and generation-skipping transfer taxes track the following schedule:

<table>
<thead>
<tr>
<th>Decedents dying in calendar year</th>
<th>Applicable Exclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2003</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2004</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2005</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2006</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2007</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>2010</td>
<td>n/a (repealed)</td>
</tr>
<tr>
<td>2011</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

To the extent the decedent’s taxable estate exceeds the applicable exclusion amount shown in the preceding table, federal law imposes tax at the rates indicated below:

<table>
<thead>
<tr>
<th>Decedents dying in calendar year</th>
<th>Maximum Estate Tax/GSTT Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>50%</td>
</tr>
<tr>
<td>2003</td>
<td>49%</td>
</tr>
<tr>
<td>2004</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>46%</td>
</tr>
<tr>
<td>2007</td>
<td>45%</td>
</tr>
<tr>
<td>2008</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>0%</td>
</tr>
<tr>
<td>2011</td>
<td>55%</td>
</tr>
</tbody>
</table>

3.22 Introduction to the Marital Deduction

Generally speaking, the federal government favors transfers of property from a decedent to a surviving spouse. But what has become an *unlimited* marital deduction did not start out that way.
Before the Economic Recovery Tax Act (ERTA) was enacted in 1981, the maximum value that a decedent could pass to a surviving spouse without incurring estate tax was limited to the greater of $250,000 or one-half of the decedent’s adjusted gross estate.

When ERTA became law in 1981, it removed all but a few limitations on the amount of the marital deduction. Death transfers from a spouse to a surviving spouse are entirely removed from the estate of the deceased spouse, provided that the transfer meets the requirements of the Internal Revenue Code. Generally, Section 2056 establishes the requirements for transfers at death to a spouse who is a U.S. citizen; Section 2056A controls gifts to a spouse who is not a U.S. citizen. Gifts structured under Section 2056 pass free of the deceased spouse's estate for later inclusion in the surviving spouse's gross estate. By contrast, gifts to a non-citizen spouse do not pass into the survivor's gross estate. Later distributions of principal are taxed in the deceased spouse's estate, subject to that deceased spouse's applicable exclusion amount and estate tax rate.

Because the marital deduction generally allows estate tax liability to be deferred until the second spouse’s death (except in the case of non-citizen survivors, discussed above), a “marital deduction formula clause” is often used to pass part of the estate of a deceased spouse to the surviving spouse in a manner that qualifies for the marital deduction, and pass the rest of the deceased spouse's property to a trust that does not qualify for the marital deduction. The value of the trust that does not qualify for the marital deduction will be applied against the deceased spouse's estate tax applicable exclusion amount, ensuring efficient use of the couple's estate tax planning opportunities.

For most estates, the “optimum” marital deduction is the smallest amount needed to completely eliminate estate taxes in the estate of the first spouse to die. (Because there may be taxable specific gifts made or significant assets not controlled by the trust, sometimes the estate tax cannot be completely eliminated. In those cases the goal is to reduce the taxes to the lowest possible amount.) Thus, the value of the gift qualifying for the unlimited marital deduction should be reduced by the estate tax applicable exclusion amount available at the death of the first spouse to die.

3.23 Estate “Equalization”

In very large estates, it may be desirable to further reduce the marital deduction to trigger estate tax liability at the death of the first spouse to die in order to take advantage of a lower estate tax rate. For example, assume an elderly couple has a very large estate, and that Husband dies during an estate tax regime of escalating estate tax rates (like the existing structure under EGTRRA 2001). An equalization clause exposes a portion of the estate to

10 IRC § 2044 applies to QTIP property under §2056(b)(7); other Code sections apply based on the ownership features attributable to the surviving spouse (§§2036, 2038, 2041).

11 Generally speaking, property passing to a non-citizen surviving spouse does not qualify for a marital deduction unless there is an estate tax treaty in place between the U.S. and the surviving spouse’s country of citizenship (Treas. Reg. §20.2056A-1(c)). However, IRC § 2056A allows a marital deduction for property held and administered for the surviving spouse in a Qualified Domestic Trust (QDOT). Interestingly, unlike normal marital deduction transfers, which result in the transferred property being includible in the estate of the surviving spouse, the deduction merely results in the postponement of the imposition of estate tax on the QDOT property as a part of the estate of the transferor spouse.
taxation at the Husband's tax rate, resulting in less property taxed in Wife's later estate under a potentially higher estate tax rate.\textsuperscript{12}

(a) Why don't more people use equalization clauses?

Even if using an estate equalization clause seems sensible from an overall estate tax perspective, the strategy is rarely used in practice, because:

- Clients generally prefer to defer paying taxes as long as possible. Even if the tax rate arbitrage saves some money, paying some tax liability at the death of the first spouse obviously reduces the amount of money available to the surviving spouse;
- Depending on the surviving spouse's longevity and the rate of asset growth, the future value of the money otherwise used to pay taxes may far exceed the additional tax liability incurred if the payment of tax liability is deferred to the second estate;
- Triggering estate tax liability with an equalization clause may completely backfire. Paying estate tax at the first estate only makes sense if it results in overall tax savings for the clients. But if the federal estate tax is repealed or the applicable exclusion amount is substantially increased between the death of the first spouse and the death of the second spouse, the strategy is a complete failure and a financial disaster for the clients;
- The surviving spouse may end up spending much of the property in the surviving spouse's estate, dramatically lowering or eliminating the surviving spouse's estate tax liability.

Because of these significant pitfalls, estate equalization clauses generally are not (and should not be) used for clients' estate plans.

(b) What if it DOES make sense to trigger liability at the first death?

If it does make sense to trigger estate tax liability in the estate of the first spouse to die, it is often most efficiently done with the use of qualified disclaimers\textsuperscript{13}, partial QTIP elections, or "Clayton election" planning.\textsuperscript{14} These "second-look" options provide far greater flexibility than a mandatory equalization clause.

3.24 The goal of Marital Deduction Planning

A well-designed estate plan efficiently uses the marital deduction to eliminate estate tax liability, while using as much of the applicable exclusion amount as possible when the first spouse dies. If the combined value of the clients' estates is greater than the applicable exclusion amount, transferring all of the property to the surviving spouse under the marital deduction is inefficient and costly. Doing so wastes the applicable exclusion amount of the

\textsuperscript{12} Under EGTRRA 2001, the maximum estate tax rate for decedents dying in 2007, 2008, and 2009 is 45%. In 2010, there would be no estate tax imposed at all. However, for decedents dying in 2011 or thereafter, the maximum estate tax rate will be 55% and will be applied on all taxable estates in excess of $1,000,000.

\textsuperscript{13} For a general discussion on the use of disclaimers, see the discussion at 4.03, below.

\textsuperscript{14} See 4.04, below for a discussion of the Clayton election.
first spouse to die, and the entire estate value is later included in the estate of the second-to-die. The couple ends of paying estate tax that they wouldn't otherwise owe. As illustrated in the pages below, there are many different ways to structure the estate tax elements of clients' estate plans. The skilled practitioner guides the clients to selecting the marital deduction planning method that best suits the clients' needs.

3.25 Dividing the Estate in Marital and Non-Marital Shares

Effective marital deduction planning requires that the deceased spouse's estate is divided into separate shares: a “Marital share,” designed to qualify for the marital deduction, and a “Non-Marital share,” which does not. Although both shares may provide benefit to the surviving spouse, the Marital share will ultimately be included in the surviving spouse's estate at the spouse's later death. The Non-Marital share is charged against the deceased spouse's estate tax applicable exclusion amount and is intended to escape estate taxation when the surviving spouse dies.

The method used to divide the deceased spouse's estate into Marital and Non-Marital shares depends entirely on the provisions of the clients' estate plan, and should be driven by the unique circumstances and needs of the clients. If the clients' jurisdiction of residence imposes a separate estate tax, the clients may choose marital deduction calculation language that minimizes only federal estate tax, or language that minimizes both federal and state-imposed estate tax.

To most effectively eliminate both federal and state estate tax, the clients' estate plan may subdivide the Marital share. Using this approach, the Marital share is first calculated to minimize both federal estate tax and state death taxes. The Marital share is then divided into two separate QTIP trusts. The first QTIP trust equals the amount necessary to minimize federal estate tax. The second QTIP equals any additional amount necessary to reduce all remaining state death taxes.

In states that allow separate QTIP elections for state and federal purposes, the first QTIP trust is funded with property elected for QTIP treatment for both federal and state death tax purposes. The second QTIP trust is funded with property elected for QTIP treatment for state purposes only.

In states that do not allow separate QTIP elections for state and federal purposes, the first QTIP is funded with property elected for QTIP treatment sufficient to minimize federal estate taxes only. The second QTIP is funded with property elected for QTIP treatment for state purposes only. The second QTIP, unnecessary for federal estate tax purposes, is potentially then disregarded by the Treasury Department15.

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15 This strategy takes advantage of the IRS's position stated in Rev. Proc. 2001-38, which provides that qualified terminable interest property election will be treated as null and void for purposes of Code Sec. 2044(a); Code Sec. 2056(b)(7); Code Sec. 2519(a); and Code Sec. 2652, in situations in which election wasn't necessary to reduce estate tax. But some practitioners question the validity of this strategy, citing concern over the following language in the Revenue Procedure: “This revenue procedure does not apply in situations where a partial QTIP election was required with respect to a trust to reduce the estate tax liability and the executor made the election with respect to more trust property than was necessary to reduce the estate tax liability to zero.”
Part IV
Marital Deduction Planning Methods

4.01 Introduction

WealthCounsel’s drafting system WealthDocs™ offers many options for dividing the property of the first-to-die into Marital and Non-Marital Shares. These options are generally referred to as “formula clauses,” though only three are actual formulas. Some of these options are estate tax driven and others are not. Each has advantages and disadvantages, and the best method for your clients will depend entirely on the clients’ financial situation and planning objectives.

The following discussion examines the most common strategies for dividing a deceased spouse’s estate into Marital and Non-Marital shares, and the circumstances under which each of the methods may be most appropriate for clients.

As we will see, there is often no “right” marital deduction planning option. Like many (if not all) of the significant issues that must be addressed in clients’ estate planning, the best method for dividing, administering, and distributing the estate of the first spouse to die depends on many factors. The value and composition of the clients’ assets, the degree of inheritance and asset preservation they seek, and the relationship between the surviving spouse and the remainder beneficiaries all greatly influence the marital funding decision.

The first three options discussed below are intended primarily for nontaxable estates. They each leave open the possibility for estate tax planning after the first spouse dies, without creating a mandatory allocation of property between Marital and Non-Marital shares.

The next three options discussed provide a specific method for calculating the value necessary to most effectively fund Marital and Non-Marital shares, ensuring sufficient estate tax planning after the first spouse dies. These options are often (but not always) reserved for clients with taxable estates, or who want to provide the greatest degree of protection and asset preservation for the deceased spouse’s property after death.

The final options discussed below are generally fact-based, not driven by estate tax considerations. They will typically be used when the clients’ estate planning objectives provide for specific allocations to the surviving spouse, like when the clients’ prenuptial agreement waives or reserves specific rights to the spouses’ estates.

WealthDocs™ includes the following marital deduction planning options. (Please note that the discussion below does not follow the order in which the options appear in the dialog.)
4.02 All to surviving spouse

The simplest approach? – No built-in estate tax planning

Sometimes clients want to “just keep things simple.” These clients will usually have a very modest estate, or simply do not understand the value of building in basic estate tax flexibility. Clients who opt for this approach want only to distribute everything to the surviving spouse, and may be considering trust planning as a mere probate-avoidance tool.

Under this approach, the deceased spouse’s estate is not divided into Marital and Non-Marital shares at all; everything is distributed to the Marital share and passes under the unlimited marital deduction. There is no mechanism to facilitate the use of the deceased spouse’s estate tax applicable exemption amount. To accommodate any effective estate tax planning, the surviving spouse must rely on operation of the laws governing disclaimers to shift property to other beneficiaries and trigger the use of the deceased spouse’s estate tax exemption. This generally forecloses the spouse’s ability to later receive any benefit from the disclaimed property, so the survivor should only disclaim property that is not needed at all.16

Although the “all to marital” option has no moving parts and is easy to understand and administer, the fact that there is no built-in accommodation for estate tax planning should make it fairly unattractive. It should be reserved for only those clients with the simplest and most modest estates, and often when the clients are fairly old, where the inherited assets are not likely to appreciate significantly in the time between the deaths of the spouses.

4.03 Disclaimer funding method

The survivor’s “Second-look” for estate tax planning

The most basic option with built-in estate tax planning is the Marital/Disclaimer option. Under this approach, all of the deceased spouse’s property is distributed to the Marital share. To the extent the surviving spouse exercises a qualified disclaimer as provided under IRC§2518, the disclaimed property is distributed to the Non-Marital share. The Non-Marital share is then held either in a bypass trust or to the residuary beneficiaries.

The disclaimer method offers the maximum discretion and flexibility to the surviving spouse for post-mortem estate planning. The spouse can choose to fund the Non-Marital share in any appropriate amount depending on the estate tax law then in effect, composition and value of the deceased spouse’s estate, and the surviving spouse’s financial needs and comfort level at the first spouse’s death.

16 A person who exercises a “qualified disclaimer” cannot direct the disposition of the property subject to the disclaimer, and the disclaimer must be irrevocable and complete. (See generally, IRC§2518.) In an interesting turn of phrase, the Code states that a “qualified disclaimer…” must be “…irrevocable and unqualified.” Is there any surprise that the Code might provide less than perfect clarity? The gist is that the disclaimant cannot retain any interest or control over the disclaimed property. An important exception to this rule is found at IRC§2518(b)(4), which allows the disclaimed interest to pass to the spouse of the decedent. The effect of this rule is discussed in greater detail in this chapter as an optional means of creating a bypass (Non-Marital share) trust to benefit the surviving spouse by operation of that surviving spouse’s disclaimer.
(a) Requirements for an effective disclaimer

To effectively disclaim property from the Marital share to the Non-Marital share, the spouse’s disclaimer must be “qualified” by meeting several essential requirements set forth under the Code:

- The disclaimer must be irrevocable and unqualified, or without exception; it must be in writing;
- It must be received by the deceased spouse’s legal representative or the legal holder of title of the property disclaimed (perhaps the trustee of the deceased spouse’s trust) within nine months of the date on which the transfer was made (generally the date of death)\(^\text{17}\);
- The “disclaimant” (that is, the person disclaiming the interest in property; here, the surviving spouse) must not have accepted any benefit from the disclaimed interest\(^\text{18}\);
- The interest must pass without any direction from the disclaimant, and
- The disclaimer must be valid under applicable state law.

Generally speaking, to be a qualified disclaim er the disclaimed interest must pass to someone other than the disclaimant. But an exception in the Code allows the disclaimed property to pass to the surviving spouse, even though the spouse exercised the disclaimer\(^\text{19}\). To satisfy this requirement the disclaimed interest need not pass outright to the surviving spouse, but may pass into a bypass (Non-Marital) trust providing benefits to the surviving spouse\(^\text{20}\).

(b) Why should the disclaimer method be used?

Because the surviving spouse holds the power to disclaim property into the Non-Marital share, the disclaimer method provides the greatest amount of discretion and control to the survivor. This approach allows the spouse to rely on competent counsel to decide to what extent the marital deduction will be used and how much property, if any, will fund a bypass trust.

(c) Why should the disclaimer method NOT be used?

This flexible option is not without its disadvantages, however. The structural simplicity and the rules imposed on disclaimers combine to create several specific obstacles that must be considered:

- The surviving spouse cannot hold a power of appointment (either limited or general) over the disclaimed assets in the bypass trust. As a result, this option may not be appropriate where the clients want to allow the survivor to make gifts from the bypass trust to children or others.

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\(^\text{17}\) The nine-month time frame is not negotiable; extending the estate tax return does not extend the period of time in which a disclaimer may be filed.

\(^\text{18}\) See generally, Reg §25.2518-2(d)(1); PLR 8225096, and PLR 9017026

\(^\text{19}\) IRC §2518(b)(4)(A)

\(^\text{20}\) See PLR 9646010, PLR 200442047
• The surviving spouse may not understand the estate tax implications of the power to disclaim, or may fail to properly execute a qualified disclaimer;
• The surviving spouse may not be emotionally prepared to disclaim assets over which he or she would otherwise have total control;
• If the deceased spouse and the surviving spouse have children from prior relationships, the survivor may not be willing to disclaim assets into a bypass trust that may ultimately benefit the decedent’s children. The survivor may prefer to keep control over the property in the Marital share, and later distribute those assets to the survivor’s own children.21

As mentioned above, the disclaimer method provides a built-in mechanism to accommodate estate-tax planning after the death of the first spouse to die. The next option to be considered provides similar flexibility, but a different means of operation.

4.04 The “Clayton” Election

Another flexible option

Like the disclaimer method, the so-called “Clayton” election provides a means of determining the amount of the marital deduction after the death of the first spouse to die, in order to facilitate tax planning with a measure of hindsight. Named after the Fifth Circuit Court of Appeals case on which the strategy is based22, the Clayton election operates to distribute all of the deceased spouse’s property to the Marital share in a QTIP trust23. Any property elected out of QTIP treatment on the decedent’s federal estate tax return is allocated to the Non-Marital share.24

Although the Clayton election and the disclaimer method both allow “second-look” marital deduction planning, there are some important aspects of the Clayton election that distinguish it from the disclaimer method.

First, the allocation of property to the Non-Marital share is made by an election made on the deceased spouse’s federal estate tax return, not by a spouse’s disclaimer. This feature has advantages and disadvantages. Because a disclaimer is not required, the requirements of IRC§2518 do not apply. This means that the surviving spouse can retain a limited power of appointment over the Non-Marital share, allowing greater administrative flexibility than a disclaimer-funded trust.

Because the election is made on the estate tax return, the decision to create and fund a Non-Marital share can be made up to 15 months after the death of the first spouse25. In addition, the spouse is not usually the person who makes the election to allocate property to the Non-

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21 This is an excellent reason to structure the Marital share as a “QTIP” trust, discussed below.
22 Estate of Clayton, Jr. v. Commissioner, 70 AFTR 2d 92-6292 (976 F.2d 1486)
23 A “QTIP” trust is one accepted structure for a trust that will qualify for the marital deduction under IRC§2056(b)(7). For a greater discussion, see the text at 5.07
24 Schedule M of IRS form 706 provides instructions on electing (and opting out of) QTIP treatment for property that meets the qualifications of IRC2056(b)(7).
25 Although the estate tax return is originally due nine months after death, the IRS will automatically allow a one-time six-month extension if requested.
Marital share, so the risks of emotion-driven decision making are overcome. This objectivity may also be necessary to avoid adverse tax consequences.

The Regulations governing this strategy do not specifically approve of the surviving spouse making the decision to elect property out of QTIP treatment and causing allocation to the Non-Marital share. Although as the personal representative the surviving spouse is bound to a fiduciary standard, the surviving spouse may be deemed to have made a completed gift of any property for which the QTIP election is not made. Furthermore, if the election is made by any fiduciary who has an interest in the property, that fiduciary should not participate in the QTIP election decision making process. An interested fiduciary may be deemed to have made a gift of property for which the QTIP election is not made, and may also breach a fiduciary duty to the beneficiaries of the various trusts by acting in the fiduciary’s own best interests. To avoid these pitfalls the will or trust containing a Clayton election option should designate (or provide a means of designating) an independent personal representative or trustee for the purpose of making the election.  

The flexibility of the Clayton election allows the grantor to design flexible estate tax-oriented decision making while preserving third-party objectivity and the control and protection of a QTIP trust for the Marital share. These benefits seem to make the Clayton election slightly more beneficial than disclaimer-based planning, even though the decision to not elect QTIP treatment on some of the decedent’s property requires the preparation and filing of a federal estate tax return.

Both the disclaimer option and the Clayton election are designed to provide a flexible estate-tax planning mechanism after the first spouse dies, by giving someone other than the grantor the ability to divide and administer the deceased spouse’s estate in Marital and Non-Marital shares. They balance after-death flexibility with reliable tax-planning methods. But because they require assertive action to use the estate tax exemption of the first spouse to die, the disclaimer and Clayton options should generally be used only for clients without taxable estates.

### 4.05 Pecuniary Marital Deduction Formula

Unlike the options discussed above, the pecuniary marital deduction provides a mechanism for the mandatory division of the deceased spouse’s estate into Marital and Non-Marital shares. As a “mandatory formula,” it is designed to ensure optimum use of the marital...

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26 See Regs.§20.2056(b)-7(d)(3); Regs.§20.2056(b)-7(h), Ex.6  
27 The rationale of TAM 8943004 suggests that property for which the QTIP election is not made would be considered to be a gift from the deceased spouse, not the surviving spouse making the election. But for strong commentary against allowing the spouse to exercise the “Clayton” election, see Blattmachr & Zaritsky, “Coping with the New Clayton QTIP Regulations,” 136 Tr. & Est. 41 (May 1997)  
28 Blattmachr and Zaritsky note that Regs.§20.6018-2 does not provide an option to allow a fiduciary to sign the federal estate tax return in a limited capacity. Rather, all fiduciaries must sign the return under penalty of perjury. When an interested fiduciary is serving, but an independent trustee is appointed to make the QTIP election, it seems that language in the will or trust prohibiting the interested fiduciary from participating in the Clayton election should suffice to defeat an argument that the interested fiduciary made a taxable transfer by merely signing the return. Id. When the Clayton election option is chosen in WealthDocs, the system inserts language in the “Administration Upon Death” article requiring the appointment of an Independent Trustee for the purpose of making QTIP elections.
deduction in the estate of the first spouse to die, minimizing the impact of estate tax and most effectively using the deceased spouse’s estate tax exemption amount.

The approach relies on a formula to determine the smallest fixed dollar amount necessary to reduce estate taxes to the lowest possible amount. Assets from the deceased spouse’s estate equal to that amount are then allocated to the Marital share. The balance of the deceased spouse’s estate is allocated to the Non-Marital share. A sample pecuniary marital formula clause might read:

“I give the smallest pecuniary amount that, if allowed as a federal estate tax marital deduction, would result in the least possible federal estate tax being paid as a result of my death.”

Once the pecuniary amount is computed under the marital deduction formula, we must determine how to allocate assets to the trust shares to satisfy the marital gift, how and when to value the property allocated, and the tax considerations of each of these options. Because the pecuniary marital formula solves for the minimum amount necessary to fund the Marital share (and conversely, the maximum amount to the Non-Marital share), it is generally designed for use in estates where the Non-Marital share will be larger than the Marital share. The will or trust should specify whether the pecuniary gift must be satisfied in cash, or whether a gift in kind will suffice. To the extent the gift can be satisfied by existing cash, it should be. If there is not enough cash in the estate to satisfy the gift and the trustee must either satisfy the gift in kind or sell assets to raise cash, the in-kind transfer or asset sale may constitute a taxable sale, causing the estate to incur capital gains tax liability.

Although the pecuniary amount necessary to satisfy the marital gift and the value of the decedent’s assets are both calculated at the decedent’s date of death, there is often a considerable amount of time between the date of death and the date that assets are actually transferred to the Marital share. How then, does the fiduciary account for value fluctuations between the decedent’s date of death and the actual transfer date? In satisfying the marital gift, the fiduciary will apply one of the following three valuation methods, each identified by the IRS as “safe harbor” methods.

(a) “True Worth” pecuniary funding method

Under the True Worth method, the marital gift is satisfied with assets based on the assets’ value on the date of funding, not the decedent’s date of death. Consider the following example:

Tom dies June 1, 2008 and his estate is worth $4 million. The pecuniary marital formula gift is valued at $2 million to most effectively use the marital deduction in Tom’s estate. The estate’s assets are valued as follows:

---

29 By default WealthDocs contains language authorizing the decedent’s trustee to satisfy the marital pecuniary gift in cash or in kind, or partially in cash and partially in kind.
30 See generally, IRC§1014(a); Suisman v. Hartford Conn Co, 83 F.2d 1019 (C.C.A. 2d Cir. 1936)
31 The safe harbor pecuniary formula funding methods were authorized by the IRS in Rev.Proc. 64-19, 1964-1 CB 682; IRC§5741
32 Rev.Proc. 64-19 §4.01(3)(c)
<table>
<thead>
<tr>
<th></th>
<th>Value for estate tax purposes</th>
<th>Value at date of funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset A</td>
<td>$1,750,000</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Asset B</td>
<td>$650,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>Asset C</td>
<td>$750,000</td>
<td>$900,000</td>
</tr>
<tr>
<td>Asset D</td>
<td>$400,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Asset E</td>
<td>$300,000</td>
<td>$325,000</td>
</tr>
<tr>
<td>Asset F</td>
<td>$150,000</td>
<td>$175,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$4,000,000</strong></td>
<td><strong>$4,500,000</strong></td>
</tr>
</tbody>
</table>

Because the funding date value of the assets is used to satisfy the marital gift, Tom’s marital gift can be satisfied with Asset A, or with assets B, C, and D.

**1) Why should the True Worth method be used?**

The True Worth funding method gives the fiduciary a lot of flexibility, because the marital gift can be satisfied with specific assets selected by the fiduciary. In addition, the Marital share is protected from the impact of asset depreciation that may occur between the date of death and the funding date; all risk of depreciation is borne by the residuary estate. This is good news to the surviving spouse who is concerned about having enough in the Marital share to provide adequate financial support.

At the same time, because the pecuniary value of the marital gift is fixed at the decedent’s date of death, all appreciation in asset value inures to the benefit of the residuary estate. This certainly pleases residuary beneficiaries!

Finally, because assets are valued at the date they are distributed to the Marital share, and because the trustee has the ability to “pick and choose” assets to satisfy the marital gift, the True Worth formula is generally considered the easiest to administer. As a result, the True Worth method is a very popular pecuniary funding method.

**2) Why should the True Worth method NOT be used?**

Although some aspects make the True Worth method attractive, it has its limitations. First, as indicated above, if the estate does not have adequate cash to satisfy the marital gift, assets may need to be sold to generate liquidity. If assets have appreciated in value after the decedent’s death, the fiduciary will incur capital gains tax liability at the time of the sale.

Even if assets are not sold but are transferred in kind, the transfer in satisfaction of a pecuniary gift is treated as a sale or exchange, also potentially triggering capital gains tax liability. If the pecuniary gift is satisfied with assets that constitute income in respect of a decedent (“IRD”), like a
retirement account, the tax consequences are worse: the transfer in satisfaction of a pecuniary gift is treated as a sale or exchange of the IRD asset, triggering ordinary income tax liability on the balance of the IRD.

Finally, because the assets must be valued at the date of funding, the assets transferred to the Marital share must be reappraised at the time of transfer, causing administrative delay and expense.

(b) “Fairly Representative” pecuniary funding method

The “Fairly Representative” funding method approaches asset valuation a little differently. This method is designed to accommodate (and equitably allocate) increases or decreases in estate value between the decedent’s date of death and the date the marital gift is funded.

For example, if there is a 10% net decrease in estate value between the date of death and the funding date, the amount funded to the Marital share is also decreased by that percentage. If there is a 10% net increase in estate value, the amount funded to the Marital share is increased by that same percentage.33

(1) Why should the Fairly Representative method be used?

The Fairly Representative approach avoids recognition of gain or loss when the marital gift is funded because satisfaction of the pecuniary gift is based on the adjusted value of the assets. (This eliminates the primary disadvantage of the “true worth” funding method.)

(2) Why should the Fairly Representative method NOT be used?

Even though it avoids the gain/loss issue raised by the “True Worth” method, the Fairly Representative method has limitations.

First, because of the likelihood of change in asset value between the decedent’s date of death and the date the marital gift is funded, the Marital share is likely to be over-funded or under-funded, potentially disappointing beneficiaries.

Also, because fluctuation in asset value is applied ratably between the Marital and Non-Marital shares, the fiduciary must revalue every asset available for funding to make sure appreciation and depreciation was properly apportioned. This makes administration more burdensome than the True Worth method, which requires only revaluation of those assets actually distributed in satisfaction of the marital gift.

Finally, because the Trustee must make an effort to select assets that generally represent overall appreciation and depreciation of the pool of assets available for distribution, the ability to “pick and choose” specific assets is substantially diminished.

33 Rev.Proc. 64-19 §2.02
(c) “Minimum Worth” pecuniary funding method

Under this final “safe harbor” pecuniary funding method the Marital share is funded in an amount at least equal to the amount determined based on the original asset value determined on the decedent’s date of death.34

For example, if there is a 10% net increase in the estate value between the decedent’s date of death and the funding date, the amount transferred to the Marital share is increased by 10%. But if there is a net decrease, the value of the marital gift would remain the same as computed at the date of death.

(1) Why should the Minimum Worth funding method be used?

A Minimum Worth pecuniary formula generally favors the funding of the Marital share. Because the marital gift is funded in an amount at least equal to the amount computed at the decedent’s date of death, the value of the marital gift can only be increased by post-death asset appreciation; all risk of depreciation is borne by the Non-Marital share.

In addition, because date of distribution value is relevant only for assets transferred in satisfaction of the marital gift, only those assets actually transferred to the Marital share must be revalued after the decedent’s date of death. And the value is only relevant to the extent that the assets transferred to the Marital share decreased in value from the decedent’s date of death.

(2) Why should the Minimum Worth funding method NOT be used?

The greatest advantage of the Minimum Worth funding method is also its greatest disadvantage when viewed from a different perspective. As mentioned above, the Marital share can only be benefited from asset appreciation; it is immune from depreciation. This leaves open the possibility for overfunding of the Marital share. While this may be preferred by the surviving spouse by creating greater value in the Marital share, it also increases the surviving spouse’s taxable estate.35

Overfunding the Marital share also means underfunding of the Non-Marital share. As a result the Minimum Worth method fails to take optimum advantage of the decedent’s estate tax exclusion, since the impact of post-death asset depreciation is borne entirely by the Non-Marital share.

4.06 Credit Shelter Pecuniary Formula

Recall that the pecuniary formula discussed in 4.05 uses a formula to calculate the smallest dollar amount necessary to fund the Marital share in a way that avoids estate tax at the deceased spouse’s death. The pecuniary Credit Shelter formula works just the opposite: it

35 Under IRC§2044 a decedent’s estate includes the value of property for which a QTIP election was previously made; Other Code sections (§§2036, 2038, 2041) apply based on the survivor’s ownership and control.
solves for the largest fixed dollar amount that can be distributed to the Non-Marital Share without triggering estate tax liability. The balance of the deceased spouse’s estate is allocated to the Marital Share. A sample pecuniary credit shelter formula clause might read:

“The Marital Share will consist of an amount equal to the maximum marital deduction allowable in my estate for federal estate tax purposes, reduced by the final federal estate tax values of all other property interests passing to my spouse and which qualify for the marital deduction. My trustee must not allocate any greater amount to the Marital Share than is necessary to completely eliminate the federal estate tax in my estate.”\textsuperscript{36}

This approach is designed to simply stuff the Non-Marital share with enough value to fully use the deceased spouse’s estate tax applicable exclusion amount, leaving the larger residue to qualify for the marital deduction. As a result, the pecuniary credit shelter method is best designed for estates in which the Marital share will be larger (often much larger) than the Non-Marital share. Like the pecuniary marital formula, the credit shelter pecuniary formula relies on either a “True Worth” or “Fairly Representative” valuation and funding method to fund the Non-Marital share. To that end, the same advantages and limitations on the efficacy of the pecuniary marital formula apply.

The most significant disadvantage of any pecuniary formula, whether a marital deduction or credit shelter formula, is the so-called “IRD problem” alluded to above. If any pecuniary gift is funded with assets that constitute income in respect of a decedent, the transfer of the IRD assets in satisfaction of a pecuniary distribution will accelerate income recognition to the estate, triggering income tax liability.\textsuperscript{37}

\textbf{4.07 Fractional Marital Formula}

\textit{A way around pecuniary formula weaknesses}

Unlike the pecuniary funding approach, the fractional marital formula cannot be reduced to a specific dollar amount. Rather, the fractional formula solves for the smallest fraction of the residuary estate necessary to eliminate estate tax at the death of the first spouse to die. After the fraction is calculated it is applied to the decedent’s estate to determine which assets will be distributed to the Marital share. The balance of the deceased spouse’s estate is allocated to the Non-Marital share. The numerator of the fraction is the value of the marital deduction needed to eliminate estate taxes, and the denominator is the total value of the remaining assets in the decedent’s estate.

A sample fractional marital formula might read:

“My Trustee shall allocate to the Marital Share a fractional share of the remaining trust property calculated as follows:

\textsuperscript{36} Language adapted from HAROLD WEINSTOCK AND MARTIN NEUMANN, PLANNING AN ESTATE §4.33 (4th Ed. 2002)

\textsuperscript{37} IRC § 691(a)(2); Treas. Reg. § 1.691(a)-4(b)(2). If the transfer of the IRD asset is treated as a sale or exchange, there is a disposition of the IRD asset that results in realization of income by the distributing entity. Since retirement plan and IRA assets are IRD property, if allocated under a pecuniary formula, the entire date-of-death value (less basis, if any) of those assets will be recognized as ordinary income in the year of the transfer, even if the account is distributed over a number of years as an annuity.
The numerator of the fraction shall equal the minimum value, assuming the value qualifies for the federal estate tax marital deduction, sufficient to reduce the federal estate tax to the lowest possible amount. In computing the numerator, my Trustee shall take into account my gifts (including gifts treated as made by me) and all deductions, exclusions, credits and reductions in value allowed in computing such tax; provided, however, that any state death tax credit shall be taken into account for this purpose only to the extent that it does not increase the amount of state death taxes payable.

The denominator shall consist of the value of the remaining trust property as finally determined for federal estate tax purposes."

Under a strict fractional formula, the fraction is applied pro rata to every asset regardless of the asset type. This means that assets will be allocated and distributed to the Marital and Non-Marital shares in undivided interests, which may be cumbersome and disadvantageous. For example, control of a closely-held business interest might be significantly compromised if fragmented by a fractional marital deduction formula.

But the terms under which the fractional formula is applied may be drafted to give the fiduciary broader discretion, allowing the fiduciary to “pick and choose” specific assets to satisfy the marital gift. With power to pick and choose, the fiduciary is able to distribute assets in kind to the Marital share rather than to distribute undivided interests in each and every asset. To satisfy the requirements of Revenue Procedure 64-19, this non pro rata asset distribution must be based on the values of the assets at the date of distribution, not the decedent’s date of death.

Even though revaluation is required at the date of distribution, when the fiduciary is empowered to satisfy the marital gift on a non pro rata basis, there is no recognition of gain for the estate or the beneficiaries. The beneficiaries do not receive a new “date of distribution” basis; rather they receive the date of death basis received by the decedent’s estate.

(a) Why should the “Fractional Share” formula be used?

Under a fractional share formula, if the value of the assets increases in value between the decedent’s date of death and the date of distribution, there is no realization of gain when the Marital and Non-Marital shares are funded. This is because the fractional shares of the trust assets are treated as if owned by their respective beneficiaries at the deceased spouse’s date of death. When assets are distributed to the Marital and Non-Marital shares, those distributions are treated as allocations of what the beneficiaries already own. Because the distribution of assets is not treated as a sale or exchange, there is no acceleration of income tax liability on IRD assets.

Under a strict fractional formula where the calculated fraction is applied pro rata to all of the assets at the funding date, the special rule of Rev. Proc. 64-19 (revaluation of assets at the distribution date) does not apply. So not only is gain not recognized, the administrative burden and expense of asset revaluation is avoided. (This is not the case with “pick and choose” funding; see below.)

38 See Rev.Rul. 55-117, 1955-1 C.B. 233; Ltr. Ruls. 7929054, 8029054, 8119040, and 9324015
39 Reg §1.1014-4(a)(3)
(b) Why should the “Fractional Share” formula NOT be used?

With a strict fractional share formula the fiduciary does not have the ability to choose which assets to fund the marital gift. Each asset is fractionalized into undivided interests as they are transferred to the Marital and Non-Marital shares. This limitation can cause considerable problems with certain types of assets.

If the fiduciary is empowered to pick and choose assets to satisfy the fractional marital gift, the assets transferred in satisfaction of the marital gift must be revalued at the date of distribution. Even though this revaluation does not trigger taxable gain, it is an administrative hassle and expense that the fiduciary may rather avoid.

4.08 Fact-based methods – not estate tax-driven

Although many clients are concerned about estate tax planning, some clients have other planning priorities to consider. Clients in second marriages, with widely disparate ages or separate asset values, or with children or other important beneficiaries from previous relationships have unique planning issues that are often best addressed by distributing the deceased spouse’s estate on a non tax-driven basis.

The options below certainly have estate tax implications, but here estate taxes are of secondary concern. The propriety of each strategy for a particular client is driven by the unique facts of the clients’ situation, often guided by clients’ prenuptial or postnuptial agreement.

(a) Statutory Minimum to the Marital Share

This method distributes an amount equal to the surviving spouse’s statutory “elective share” to the Marital share. The balance is distributed to the Non-Marital share. The elective share is the amount the surviving spouse would be entitled to receive under state law if the spouse were to elect against the deceased spouse’s will in a probate proceeding. In other words, it is the legal minimum a decedent must leave the surviving spouse under applicable law.

(b) Stated fraction to the Marital Share; balance to the Non-Marital Share

Here a specific fraction or percentage of the deceased spouse’s property is distributed to the Marital share. The fraction or percentage is generally determined by the provisions of the clients’ prenuptial or postnuptial agreement.

(c) None; surviving spouse is specifically disinherited

The most extreme approach distributes all of the deceased spouse’s property to the residuary beneficiaries, creating no Marital share. (Even under this approach it is conceivable that the surviving spouse is a preressiduary or residuary specific beneficiary.) This method is typically reserved for planning under the terms of a prenuptial or postnuptial agreement.
4.09 Selecting the right marital deduction method for clients

Deciding on the right formula clause requires careful consideration of the interaction of four factors:

First, it requires a solid understanding of the estate and income tax consequences of the different formula clauses;
Second, it requires a complete understanding of the clients’ financial situation;
Third, it requires a complete understanding of the clients’ relationship, on both legal and personal terms; and
Fourth, it requires a full understanding of the clients’ estate planning objectives, ensuring that they understand and are willing to comply with the strategies implemented in their estate plan.

After determining the amount to distribute as a marital deduction gift for the surviving spouse, the client must decide how the property will be administered and distributed. As we will see, the surviving spouse may benefit from distributions from the Marital share, Non-Marital share, or both. Whether the property distributed to or for the benefit of the surviving spouse actually qualifies for the marital deduction depends entirely on the manner in which the property is held and distributed.

The following chart, adapted from an article by Sebastian V. Grassi, Jr., may help guide the grantor client (and the client's counsel) into selecting an appropriate marital deduction funding method. But remember that there is no "hard and fast" rule, and the best marital deduction method for clients is generally only determined after balancing all of their planning concerns against the value and asset composition of the clients' estates.

<table>
<thead>
<tr>
<th>Primary planning concern…</th>
<th>Consider:</th>
<th>Avoid:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contentious family; separate descendants from prior relationships</td>
<td>• Fractional pro-rata</td>
<td>• Minimum Worth marital, or pick &amp; choose</td>
</tr>
<tr>
<td>Avoiding/minimizing realization of capital gain upon funding</td>
<td>• Minimum Worth marital pecuniary</td>
<td>• True Worth marital pecuniary</td>
</tr>
<tr>
<td></td>
<td>• Fairly Representative marital pecuniary</td>
<td>• True Worth credit shelter pecuniary</td>
</tr>
<tr>
<td></td>
<td>• Fairly Representative credit shelter pecuniary</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Any fractional marital formula</td>
<td></td>
</tr>
<tr>
<td>Avoiding realization of income on IRD assets</td>
<td>• Any fractional marital formula</td>
<td>• Any pecuniary formula</td>
</tr>
</tbody>
</table>

40 The concept and content of this table was greatly influenced by the excellent article, Choosing the Appropriate Marital Deduction Formula.; Sebastian V. Grassi, Jr., WG&L Estate Planning Journal (2006)
<table>
<thead>
<tr>
<th>Primary planning concern...</th>
<th>Consider:</th>
<th>Avoid:</th>
</tr>
</thead>
</table>
| GSTT planning               | • Any fractional marital formula  
• True Worth marital pecuniary  
• Fairly Representative marital pecuniary  
• True Worth credit shelter pecuniary  
• Fairly Representative credit shelter pecuniary | • Minimum Worth formula |
| "Pick & choose" funding flexibility (easier administration) | • True Worth marital pecuniary  
• True Worth credit shelter pecuniary  
• Minimum Worth formula  
• Fractional pick & choose\(^{41}\) | • Fractional pro-rata |
| Avoiding revaluation of funded assets; assets difficult to value | • Fractional pro-rata  
• True Worth marital pecuniary  
• True Worth credit shelter pecuniary  
• Minimum Worth formula | • Fractional pick & choose  
• Fairly Representative marital pecuniary  
• Fairly Representative credit shelter pecuniary |
| Minimizing administrative expenses | • True Worth marital pecuniary  
• True Worth credit shelter pecuniary | • Either Fractional formula  
• Fairly Representative marital pecuniary  
• Fairly Representative credit shelter pecuniary |
| Maximizing the Marital share | Best: Minimum Worth marital pecuniary  
Next: True Worth marital pecuniary | • Either Fractional formula  
• Fairly Representative marital pecuniary  
• Fairly Representative credit shelter pecuniary |
| Ensuring a fixed amount is funded and unaffected by interim depreciation | • True Worth marital pecuniary  
• True Worth credit shelter pecuniary  
• Minimum Worth marital pecuniary | • Either Fractional formula  
• Fairly Representative marital pecuniary  
• Fairly Representative credit shelter pecuniary |
| Maximum marital deduction planning, maximum flexibility in modest estates, flexibility for decoupling | • Clayton election  
• All to Marital, disclaimer to Non-Marital | • Any pecuniary marital formula  
• Any pecuniary credit shelter formula  
• Fractional formula without two-QTIP option |

\(^{41}\) The default WealthDocs fractional marital deduction language includes "pick and choose" authority. WealthDocs does not contain a strict fractional pro-rata funding option.
4.10 Generation-Skipping Transfer Tax (GSTT, or GST Tax) Provisions

Chapter 13 of the Internal Revenue Code imposes a transfer tax on generation-skipping transfers. The tax is computed at the maximum federal estate tax rate. For 2001 and earlier years, the maximum federal estate tax rate for 2001 and earlier years is generally 55%. For the estates of decedents dying, and generation-skipping transfers, after December 31, 2001, however, the maximum federal estate tax rate decreases gradually until 2009 (and is eliminated entirely for the estates of decedents dying, and for generation-skipping transfers, after December 31, 2009), as shown below:

<table>
<thead>
<tr>
<th>Generation-Skipping Transfers in Calendar Year</th>
<th>Rate of Tax Imposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001 &amp; earlier</td>
<td>55%</td>
</tr>
<tr>
<td>2002</td>
<td>50%</td>
</tr>
<tr>
<td>2003</td>
<td>49%</td>
</tr>
<tr>
<td>2004</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>46%</td>
</tr>
<tr>
<td>2007 – 2009</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>N/A – Repealed</td>
</tr>
<tr>
<td>2011 &amp; thereafter</td>
<td>55%</td>
</tr>
</tbody>
</table>

IRC §2001(c). Under the 2001 Act, this provision does not apply to generation-skipping transfers beginning after December 31, 2010.

The tax applies to:

- **Direct Skips.** A direct skip is a transfer of an interest in property to a skip person where the transfer is subject to either federal estate tax or gift tax. IRC §2612(c)(1). “Skip Persons” are natural people – individuals – assigned to a generation more than one generation below the generation of the transferor. IRC §2613(a)(1). A trust can also be a skip person.

- **Taxable Distributions.** Taxable distributions are defined in IRC §2612(b) as being any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

- **Taxable Terminations.** IRC §2612(a)(1) provides that a taxable termination means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust. This rule has two statutory exceptions: There will be a taxable termination unless (1) immediately afterwards a non-skip person has an interest in the property; or (2) at no time thereafter may a distribution (including distributions on termination) be made from the trust to a skip person. IRC §2612(a)(1)(A)&(B).
(a) The GSTT Exemption

Every individual is entitled to an inflation-adjusted lifetime GSTT exemption. Because a married couple may make split-gifts, husbands and wives are effectively given a double GSTT exemption. IRC §2652(a)(2).

Through 2003, aggregate transfers of up to $1 million (adjusted for inflation after 1998) per transferor were exempt from the GST tax. IRC §2631(a). For calendar year 2003, the amount was $1,120,000. Rev. Proc. 2002-70, 2002-46 I.R.B. 845. Starting in 2004, the GSTT exemption is tied to the Applicable Exclusion Amount for estate and gift tax purposes, which increases periodically through 2009, as shown below:

<table>
<thead>
<tr>
<th>Decedents dying in calendar year:</th>
<th>Generation-Skipping Transfer Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2005</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2006</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2007</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>2010</td>
<td>n/a (repealed)</td>
</tr>
<tr>
<td>2011</td>
<td>$1,000,000 (indexed for inflation)</td>
</tr>
</tbody>
</table>

(b) Allocating the GSTT Exemption

For transfers by gift, the GSTT exemption is allocated on a timely filed gift tax return. In the case of testamentary transfers, the allocation is made on the estate tax return. Automatic allocation rules may apply to generation-skipping transfers made by gift. There is no automatic allocation for testamentary transfers. For a more detailed discussion of the automatic allocation rules, see Section 3.11 of the ILIT Outline, beginning at p.23.

(1) How the Allocation Works

The GST tax applies to direct skips, distributions and terminations, and taxes these at the “applicable rate.” This rate is the product of: (a) the maximum federal estate tax rate, multiplied by (b) the inclusion ratio with respect to the transfer. IRC §2641(a).

The purpose of the inclusion ratio is to allocate to the GST tax determination that portion of a transferor’s GSTT exemption amount that may have been (or may be) allocated to a given transfer. In its simplest terms, if no GSTT exemption is allocated to a transfer, the inclusion ratio will always be 100 percent, or 1; and thus the GST tax rate will always be the maximum federal
estate tax rate. But, of course, the inclusion ratio is not always 1. IRC §2642(a)(1) defines the inclusion ratio as 1 minus the “applicable fraction.” The applicable fraction is a fraction, the numerator of which is the GSTT exemption amount allocated to the trust (or to the property transferred in a direct skip). IRC §2642(a)(2)(A).

(2) Allocation Planning

The exemption should be allocated efficiently to insure the largest possible transfer to skip persons free of the GST Tax. In other words, the careful planner will allocate enough GSTT exemption to ensure an inclusion ratio of “zero.”

Planning for the GSTT exemption resembles planning for efficient use of the applicable exemption amount for both spouses. While it is usually appropriate to plan for the use of the applicable exemption amount on the death of the first spouse so that it is not wasted, similar planning is necessary for the GSTT exemption on the first death so it is not wasted either.

(c) Tax Apportionment Clause

The tax apportionment clause in the RLT that determines which trust property bears the burden for estate taxes should normally exempt GST taxes from its provisions.

(d) Reverse Q-TIP Election

The GSTT rules apply to gifts or testamentary transfers made by a “transferor.” A transferor is the individual with respect to whom property was most recently subject to federal estate or gift tax. Treas. Reg. §26.2652-1(a)(1). Under IRC §2056(b)(7), when a qualified terminable interest property (QTIP) election is made for marital property, the effect is that all such property is subject to estate tax in the surviving spouse’s estate. At the surviving spouse’s death, he or she is treated as the transferor for GSTT purposes. To ensure that QTIP property (for which a marital deduction was previously allowed) is subject to estate taxation at least once in a generation, property that has qualified for a marital deduction to the decedent is subject to estate tax under IRC §2044 if the spouse dies holding property for which a QTIP election was made.

By making a “reverse QTIP” election under IRC §2652(a)(3), the transferor decedent’s estate is permitted to treat the property transfer as if no QTIP election had been made for purposes of the GST tax. Under this election the decedent, not the surviving spouse, will be considered as the transferor for GSTT purposes and can thereby utilize his or her GST tax exemption with regard to the marital deduction trust property. Treas. Reg. §26.2652-1(a)(3).

Essentially, the result of a reverse QTIP election is that the decedent who established the QTIP trust (the first spouse to die) remains the transferor of the QTIP trust with respect to which the election is made, thereby his or her GSTT exemption may be allocated to that QTIP trust, enabling the full use of the first spouse’s GSTT exemption.
(1) Partial Elections Disallowed

Partial reverse QTIP elections are not permitted. Section 26.2652-2(a) of the Treasury Regulations says that the reverse QTIP election is irrevocable and must be made with respect to all of the property in the trust to which the QTIP election applies. In general, the personal representative can make the reverse QTIP election for the same property in the QTIP trust that was elected in the original QTIP election. The trust instrument should therefore provide for the marital trust to be divided into two separate trusts – one for the balance of the GSTT exemption and the other for the remainder of the marital share. The reverse QTIP election can then be made with respect to one trust.

(2) Formula Clauses

This division of the QTIP trust into separate trusts can be accomplished as part of the marital deduction formula clause.

<table>
<thead>
<tr>
<th>GSTT Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you want to include provisions maximizing use of the Grantor’s GST Exemption by creating generation-skipping transfer tax exempt and nonexempt shares?</td>
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<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
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</table>

Part V
Distributing the Marital Share

5.01 Introduction

By its definition, the “Marital share” is that portion of the deceased spouse’s estate that will qualify for the marital deduction. But as we will see, the way the Marital share is structured, and not the amount of the gift, is what determines if the gift qualifies for the marital deduction. There are several options for structuring the marital gift, each of which may be designed with varying degrees of access and flexibility, and each with its unique strengths and weaknesses.

The marital deduction works to avoid estate taxation when the first spouse dies because the Treasury Department knows it will get paid sooner or later. Any property for which a marital deduction is claimed is includable in the gross estate of the surviving when he or she dies. The gift structured for the surviving spouse will qualify for the marital deduction when it takes the form of an outright gift, or a qualifying interest in trust. Generally speaking, to be a qualifying interest in trust, the gift to the spouse must be structured in a way that causes the property to be included in the surviving spouse’s estate when he or she later dies.

In structuring the marital gift, it is important to avoid running afoul of the “terminable interest rule.” This rule provides that a marital gift will not qualify for the marital deduction

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42 The marital deduction is governed by IRC§2056 and 2056A
43 IRC§2044 applies to QTIP property; Other Code sections (§§2036, 2038, 2041) apply based on the surviving spouse’s ownership and control.
if the gift terminates or fails in the event of the occurrence of an event or a contingency, or upon the failure of an event or contingency, causing the interest to pass to a beneficiary other than the surviving spouse. For example, if the marital gift is structured in a way that causes the surviving spouse’s beneficial interest to terminate upon the spouse’s remarriage, the interest is “terminable” and will not qualify for the marital deduction. But as we will see, not all terminable interests cause the marital gift to fail. In fact, creating the marital gift in a way that qualifies for the marital deduction but still constitutes a terminable interest may provide the very best strategy for administering, distributing, and ultimately controlling the disposition of the Marital share.

5.02 Outright gift to surviving spouse

Qualifying the marital gift for the marital deduction does not get any more straightforward than an outright gift of property to the surviving spouse. This approach is a “no strings attached” distribution to the surviving spouse outright, free of trust. Assuming that the spouse is a U.S. citizen, the outright gift qualifies for the marital deduction.

An outright gift to spouse requires the property to be transferred from the name of the deceased spouse into the individual name of the surviving spouse in order to accomplish outright ownership. Administratively this appears to be the easiest option, as no continuing administration of a marital trust share is necessary, and there are no limitations imposed on the survivor’s ability to administer or dispose of the property.

These apparent advantages carry attendant disadvantages. Without the mechanism of a trust in place to administer the assets, if the surviving spouse later becomes incapacitated the assets will become part of the spouse’s guardianship or conservatorship estate, subject to administration by the court. When the spouse later dies, the assets are included in the spouse’s probate estate and subject to disposition by the spouse’s will or by the jurisdiction’s intestacy statutes as overseen by the probate court.

Assets distributed to the spouse outright also lose any benefit of creditor protection that the deceased spouse might have otherwise put in place for the surviving spouse. Once the property has been distributed to the surviving spouse, the spouse has full dominion and control; a judgment creditor can generally attach its claim to the spouse’s interest.

Finally, an outright marital gift cedes complete control over the property; the decedent spouse can do nothing to prevent the survivor from distributing the property to beneficiaries the decedent might not have approved of. If the surviving spouse had children of a prior

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44 IRC§2056(a)(1)
45 Example from HAROLD WEINSTOCK AND MARTIN NEUMANN, PLANNING AN ESTATE §4.11 (4th Ed. 2002)
46 IRC§2056(d) generally denies the marital deduction for transfers at death to a noncitizen spouse. The most commonly-known exception is the Qualified Domestic Trust, or QDOT, discussed later in this chapter.
relationship, or if the surviving spouse remarries in the future, the deceased spouse’s property may very well be distributed to new beneficiaries never before contemplated by the deceased spouse.

5.03 Life estate with power of appointment

Another marital gift option that does not include trust provisions creates a legal life estate in the surviving spouse, and couples that life estate with either a lifetime or a testamentary general power of appointment. Although this gift structure qualifies for the marital deduction, it contains most of the same limitations as an outright gift. WealthDocs™ does not contain this option, as it is used very infrequently.

5.04 “Estate” trust

The marital estate trust option provides some structure to prevent the intervention of the guardianship court upon the surviving spouse’s incapacity, but it contains significant limitations that preclude it from rendering very effective planning. This option for the marital deduction transfers the marital gift to a trust that vests all beneficial interest in the surviving spouse, and upon the spouse’s death, to the spouse’s estate.

One interesting feature of the estate trust is that the trustee is not required to distribute all of the income to the spouse on an annual basis. Rather, the trustee may accumulate the income, provided that it is distributable to the spouse’s probate estate at death. As a result, the spouse need not be given the authority to compel the trustee to convert non income-producing property to income-producing property. This makes the estate trust a better candidate for “heritage-type” assets like vacation homes and other non-productive property with sentimental value. But the requirement that the estate trust assets be distributable to the spouse’s probate estate (and thus subject to disposition by will or intestate succession and court supervision) make it a fairly undesirable alternative for the Marital share. That is why it is not included as an option in WealthDocs™.

5.05 Six-month survivorship condition

As mentioned above, the terminable interest rule generally intervenes to prevent a marital gift conditioned on the lapse of time from qualifying for the marital deduction. But the Internal Revenue Code provides an exception for a marital gift predicated on the surviving spouse outliving the deceased spouse by six months or less. If the terms of the gift require the surviving spouse to survive the deceased spouse by more than six months, the gift will not qualify for the marital deduction even if the surviving spouse does indeed die within six months. The terms of the gift determine whether the gift qualifies; the facts are irrelevant. To this end, the cautious estate planner should consider the interplay between the mandatory

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47 IRC§2056(b)(5)
48 For a good, general discussion on estate trusts and other marital deduction options, see Weinstock and Neumann, Planning an Estate §4.19 (4th Ed. 2002)
49 Reg.§20.2056(c)-2(b)(iii)
50 IRC§2056(b)(3)
51 Reg §20.2056(b)-3
survivorship provision (requiring a beneficiary, including the surviving spouse, to survive for a specified number of days for the beneficiary’s interest to vest) and the six-month survivorship exception under the terminable interest rule and make sure that the survivorship requirement does not cause the marital gift to fail. Because this option is extremely limited in its appeal and applicability, it is not included as an option in WealthDocs™.

5.06 General appointment trust

The general appointment trust overcomes some, but not all, of the perceived limitations of an outright gift. It does provide the structure of a trust (potentially avoiding the guardianship and probate exposure of an outright gift), but the fact that the trust must provide the surviving spouse with a general power of appointment provides little if any creditor protection, and no assurances that the surviving spouse will maintain the deceased spouse’s intended scheme of distribution.

To qualify for the marital deduction, a general appointment trust must provide that all of trust income is payable to the surviving spouse at least annually. If the trust holds assets that are not income-producing, the surviving spouse must have the power to compel the trustee to convert those assets to income-producing assets.52

In addition, the trustee cannot appoint any property from the general appointment trust to any person other than the surviving spouse during the spouse’s life. Finally, the surviving spouse must have the unlimited power to appoint the trust property to anyone during the spouse’s life or at death.53 As with an outright marital gift, the deceased spouse cannot prevent the surviving spouse from distributing property to otherwise unintended beneficiaries. As a result, the general appointment trust may not be the best option, especially when planning for spouses with children of prior relationships or where the spouses otherwise have differing distribution schemes in mind.

When clients create separate, or individual, living trusts as the foundation of their estate plan, the assets in the marital general appointment trust will often be appointed by the surviving spouse into the survivor’s separate living trust, eliminating the administrative necessity of maintaining a separate marital general appointment trust under the deceased spouse’s trust. When clients create a single, joint living trust, the general appointment trust is typically combined with the survivor’s trust.54

<table>
<thead>
<tr>
<th>Marital Share Funding Options</th>
<th>Distribution of the Marital Share</th>
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<td>Minimum Amount to Marital Share</td>
<td>The Marital Share shall be held or distributed:</td>
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<td>Marital Deduction Formula</td>
<td>○ In a General Appointment Trust</td>
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<tr>
<td>GSTT Provisions</td>
<td>○ In a QTP Trust.</td>
</tr>
<tr>
<td>Distribution of the Marital Share</td>
<td>○ Outright to the surviving spouse.</td>
</tr>
<tr>
<td>Estate Tax Repeal Provision for Section 1022 Basis St.</td>
<td></td>
</tr>
</tbody>
</table>

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52 Reg.§20.2056(b)-5(f)(8). This power to compel the trustee to convert non income-producing property to income producing can not only cause administrative headaches, it can require the trustee to dispose of property that may otherwise be desirable to maintain. For example, if the marital trust contains a vacation property, a partnership, LLC, other closely-held business interest, the surviving spouse can generally require the trustee to sell the asset and reinvest the proceeds in income-producing property. When possible, these assets may be better distributed under the Non-Marital share where the income-producing requirement does not exist.

53 IRC§2056(b)(5)

54 For our purposes the “survivor’s trust” is that portion of a joint living trust which is attributable to the contribution of the surviving spouse; i.e., the survivor’s “contributive share.”
5.07 Qualified Terminable Interest Property (QTIP) trust

The QTIP trust seems to be the most protective and most flexible structure for the Marital share. This exception to the terminable interest rule allows the grantor spouse to establish a trust for the benefit of the surviving spouse, build in creditor protection for the spouse, and retain control over the ultimate disposition of the deceased grantor spouse’s assets at the surviving spouse’s later death.\(^\text{55}\)

Like the general appointment trust, discussed above, the surviving spouse must be entitled to receive all of the income from the QTIP trust at least annually.\(^\text{56}\) If the spouse dies during a time that the QTIP trust contained undistributed income ("stub” income), it was believed that the accumulated and undistributed income must be distributed to the spouse’s estate, or that the spouse must otherwise be given a general power of appointment over that stub income. But a 2003 amendment to the regulations have made it clear that the spouse’s income interest will not fail to qualify for this reason alone.\(^\text{57}\) And even in the absence of the spouse’s general power of appointment over stub income the value of that income will be included in the spouse’s gross estate.\(^\text{58}\) For practitioners who are concerned about this stub income issue, WealthDocs™ does contain an option to grant the surviving spouse a GPOA over stub income in the QTIP trust:

The QTIP trust must also prohibit anyone from distributing any QTIP property to any beneficiary other than the surviving spouse during the spouse’s life.\(^\text{59}\) This limitation, imposed even on the surviving spouse\(^\text{60}\), helps protect the QTIP property from alienation. The surviving spouse enjoys a measure of creditor protection as a result of this limitation, and the deceased spouse can “rest” assured that the property in the QTIP trust is not given to unintended beneficiaries during the spouse’s life. This limitation prohibits the surviving spouse from holding a lifetime power of appointment over the QTIP trust. But depending on the amount of access the surviving spouse has to the principal of the trust, the surviving spouse may take distributions from the QTIP trust and then distribute that property to others once the property is free of the trust.\(^\text{61}\)

Unlike the other trust options that qualify as exceptions to the terminable interest rule, discussed above, there is no requirement that the surviving spouse be granted any testamentary power of appointment, either limited or general. If the decedent and the surviving spouse have the same beneficiaries, it often makes sense to give the surviving spouse at least a limited power of appointment over the QTIP trust to accommodate any

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\(^\text{55}\) For an excellent discussion on QTIP trusts in general, see Sebastian V. Grassi, Jr., Estate Planning with QTIP Trusts After the 2001 Tax Act, 30 ACTEC Journal 111 (2004)

\(^\text{56}\) IRC§2056(b)(7)(B)(ii)

\(^\text{57}\) Reg §20.2056(b)-7(d)(4)

\(^\text{58}\) IRC§20.2044-1(d)(2)

\(^\text{59}\) IRC§2056(b)(7)(B)(ii)(II)

\(^\text{60}\) Reg §20.2056(b)-7(b)(d)(1)

\(^\text{61}\) Reg §20.2056(b)-7(d)(6)
significant changes in circumstances after the deceased spouse’s death. But the class of permissible appointees can be as restrictive as the grantor (deceased) spouse wants. This can be structured in a way that prevents the QTIP property from ultimately being distributed to a new spouse, children of subsequent relationships, or other unintended beneficiaries.

It is worth noting that there is no great harm in giving the surviving spouse a general testamentary power of appointment over any property that qualifies for the marital deduction (other than the possible elimination of creditor protection and alienation of inheritance from intended beneficiaries) because as indicated above, the Marital share property is already includable in the surviving spouse’s gross estate for federal estate tax purposes. The inclusion of a testamentary general power of appointment (which causes estate inclusion IRC§2041) does no greater tax harm.

The planning flexibility offered by the QTIP trust makes it a very attractive choice for marital deduction planning. But it is not without drawbacks. For example, the QTIP trust must file a fiduciary’s income tax return (form 1041) each year after the deceased spouse’s death. In addition, the surviving spouse has limited control over the trust’s assets, and is prohibited from distributing the trust to others, like the spouses’ mutual descendants.

But perhaps the final mark in favor of the QTIP trust is that it is the only form of marital deduction-qualifying trust that also qualifies for the modified carryover basis provisions scheduled to come into effect in 2010 under EGTRRA 2001.62

5.08 Qualified Domestic Trust – Providing for a non-citizen spouse

As mentioned earlier in this chapter, the unlimited marital deduction does not generally apply to property passing to a surviving spouse who is not a citizen of the United States.63 But marital transfers to a special “qualified domestic trust” or QDOT64 enable a decedent spouse to set aside property for the surviving non-citizen spouse without incurring immediate estate tax liability.65

The general purpose for not allowing the marital deduction for transfers to non-citizen spouses is to prevent the surviving spouse from receiving assets free of the federal estate tax

62 IRC§1022(c)(2)(B)
63 IRC§2056(d)
64 IRC§2056(d)(2), 2056A.
65 For a general discussion on QDOT requirements and administration, see Stephens, Maxfield, Lind, Calfee & Smith - WG&L Estate Planning Treatises Federal Estate and Gift Taxation - Part II The Estate Tax Chapter 5: The Taxable Estate ¶5.07. Section 2056A. Qualified Domestic Trusts
regime and then expatriating those inherited assets to a jurisdiction that does not have an estate tax treaty with the United States. Rather than allow for a distribution to or for the surviving spouse free of estate tax, the QDOT provides a structure that merely defers the estate tax otherwise due at the decedent spouse’s date of death (and at the decedent spouse’s applicable estate tax rate) until the property is actually distributed free of the trust.66

In order to qualify as a QDOT, the trust must meet several strict requirements. Failure of any of these will cause the trust to fail and the entire balance of the QDOT will be immediately subject to estate taxation in the decedent spouse’s estate if steps are not taken to reform the trust before the filing deadline for the deceased spouse’s federal estate tax return.

First, the QDOT must require that at least one of the trustees of the QDOT be a citizen of the United States or a domestic corporation as the “U.S. Trustee”;67

No principal may be distributed from the QDOT unless the U.S. Trustee is empowered to withhold the estate tax attributable to the principal distribution;68

The deceased spouse’s fiduciary must irrevocably elect to treat the property as marital deduction property on the deceased spouse’s federal estate tax return;69 and

If the fair market value of the assets distributed to the QDOT exceed $2 million (a fixed value, not adjusted for inflation), the trust must meet additional requirements designed to provide adequate security to ensure payment of the estate tax liability imposed on the transferred property.70

In addition to these special requirements, the structure of the QDOT must otherwise meet the requirements of a trust that will qualify for the marital deduction.71 In order to create a QDOT in WealthDocs™, you must first identify the beneficiary spouse as a non-U.S. citizen:

66 IRC§2056A(b)
67 IRC§2056A(a)(1)(A), Reg.§20.2056A-2(c)
69 IRC§2056A(a)(3)
70 Reg.§ 20.2056A-2(d)(1)
71 Reg.§20.2056A-2(b)(1) . Although this requirement is not apparent in the text of IRC§2056A, it is contained in the legislative history (HR Rep. No. 101-247, 101st Cong., 1st Sess. 1431 (1989)). It is also a logical extension in the context of IRC§§2056(d)(2)(A) and 2056(a)
Then, as you design the marital trust, you will be given the option of creating the QDOT:

### 5.09 Structuring the Marital Share Trust

Each of the options for designing the Marital share trust have some common elements. To qualify for the marital deduction the trust must state that the spouse is entitled to receive all of the income from the trust at least annually. In addition, the spouse must be able to compel the trustee to convert any non income-producing property to income-producing property. Whether the spouse will have the ability to appoint the Marital trust property in favor of other beneficiaries is a function of the particular design of the trust. Recall that a "general appointment trust" requires that the surviving spouse hold either a lifetime or testamentary power of appointment; the QTIP trust or QDOT trust may or may not grant a power of appointment. (And remember that the spouse cannot hold any lifetime power of appointment over a QTIP trust. 72) Aside from these requirements, the Marital trust may have other features that limit or expand the surviving spouse's access to the Marital property.

#### (a) Augmenting the income interest with access to principal

The surviving spouse need not have access to trust principal for the trust to qualify for the marital deduction. But depending on the clients' objectives, it may be desirable to allow for distributions of principal to the surviving spouse to augment the spouse's income interest. Because the value of the Marital trust is already included in the surviving spouse's gross estate, allowing distributions of principal from the Marital trust to the surviving spouse is estate tax neutral. But granting access to principal can have other significant consequences that must be explored with the clients during the counseling and estate plan design process.

#### (b) Creditor protection issues

If the beneficiary of any trust (including the surviving spouse as beneficiary of the Marital trust) has unfettered access to principal, the beneficiary is deemed to hold a general power of appointment under Section 2041 of the Internal Revenue Code. While we know that a general power of appointment causes the value of the property subject to the power to be included in the gross estate of the power holder, that general power of appointment also eliminates any creditor protection otherwise afforded by the design of the trust. A beneficiary's judgment creditor will "step into the shoes" of the beneficiary, and can then demand distribution of the trust principal in satisfaction of the creditor's claim. But to the extent that the beneficiary's access to principal is limited to a so-called "ascertainable standard," the beneficiary is not

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72 Remember that no one can be permitted to distribute property to anyone other than the surviving spouse in a QTIP trust. See the discussion at 5.07, above.
considered to hold a general power of appointment, and the risk of creditor attachment is significantly reduced.  

Because the trustee holds the authority to distribute property to or for the benefit of the beneficiary, the relationship between the trustee and the beneficiary also greatly impacts the degree of creditor protection available. If the beneficiary also serves as trustee, the beneficiary's power to make distributions to himself or herself absolutely must be limited to an ascertainable standard to avoid having the beneficiary's interest treated as a general power of appointment and opening the trust to the beneficiary's creditors. Similarly, if the trustee is related or subordinate to the beneficiary (i.e., an "Interested Trustee") the trustee's distributive authority should be limited to ascertainable standards.  

If the trustee is not related or subordinate to the beneficiary (in other words, an "Independent Trustee," ) the trustee's distributive authority need not be limited to an ascertainable standard. The trustee may be given completely broad authority to make any distributions (and when necessary, withhold distributions) for beneficiaries as determined to be appropriate by the trustee. Because the trustee's authority is not "ascertainable," it tends to enjoy substantially greater creditor protection for the beneficiary, because there is no objective standard to which a creditor can attach its claim.

Just like other trust assemblies in WealthDocs™, the Marital trust may (but need not) allow distributions of principal to the surviving spouse. If principal distributions are allowed, there are several options available to define the circumstances under which the distributions are made:

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73 An ascertainable standard is generally a power limited to distributions for the beneficiary's "health, education, maintenance, and support." IRC§2041(b)(1)(A), Reg.§20-2041-1(c)(2). In order to sustain a claim against an interest limited to an ascertainable standard, a judgment creditor must establish that its claim is substantially related to one or more of the elements of that ascertainable standard. The degree of creditor protection available to the interest of a beneficiary who is entitled to receive distributions subject to an ascertainable standard depends entirely on state law.

74 IRC§672(c) establishes the definition of a "related or subordinate" party. Because the powers of the trustee are deemed to be held by the beneficiary, if the trustee is related or subordinate to the beneficiary, or if the trustee may be removed and replaced by the beneficiary with someone else who is related or subordinate to the beneficiary, then the scope of the trustee's distributive authority will be imputed to the beneficiary. If the distributive authority is not limited to an ascertainable standard, the beneficiary will be deemed to hold a general power of appointment over the property subject to the trustee's authority, as discussed in the preceding footnote.
(1) **Discretionary distributions by a "Distribution Trustee"; no other distributions permitted**

This option is only available when the trust grantor bifurcates the trustee's role into that of a "distribution" trustee and an "administrative" trustee. The distribution trustee must be an independent trustee; the "administrative" trustee is typically either the beneficiary or someone who is related or subordinate to the beneficiary. In the case of a Marital trust, the distribution trustee might be someone the surviving spouse trusts and knows well, and the spouse may serve as trustee for all administrative purposes. This way, the spouse controls the investment and management of the trust's assets, and enjoys the creditor protection afforded by having an independent trustee oversee trust distributions.

(2) **Principal distributions limited to ascertainable standards**

This option establishes only one standard for distribution and applies it to all trustees. It may make sense when the clients insist that family members or other related or subordinate parties will serve as trustees. It is simple and certainly prevents the trustee's authority from ever constituting a general power of appointment, but in states that tend to allow judgment creditors to attach to a beneficiary's support standard, an "ascertainable standards-only" distribution standard provides slightly less creditor protection than having an independent trustee with a purely discretionary distribution standard.

(3) **Independent trustee may make discretionary distributions; interested trustee subject to ascertainable standards**

This flexible option allows the identity of the trustee to determine the applicable distribution standard. If the trustee is independent, then the trustee will hold a purely discretionary distribution power. But if the trustee is an interested trustee, the trustee discretion is limited to ascertainable standards.

(4) **Independent trustee may make discretionary distributions; interested trustee may not distribute principal**

This option provides greatest protection, but requires that an independent trustee be serving if any principal distributions will be made. If the spouse or some other interested trustee is serving, the trustee may not make any principal distributions at all.

(5) **No principal distributions**

When the grantor spouse wants to significantly limit the surviving spouse's access to the trust, the grantor may simply prohibit principal distributions, allowing the spouse to receive only the income interest required to qualify for the marital deduction.

**c Controlling the distribution scheme**

Clients who seek greater control over the ultimate disposition of the Marital trust assets after the death of the surviving spouse will tend to limit or prohibit distribution of principal from the trust. Just as a power of appointment allows the power holder to
redirect the property subject to the power, once property is distributed from the trust and is held individually by the beneficiary spouse, the spouse can give that property away.

In longstanding relationships with common goals and common beneficiaries, allowing the surviving spouse to receive principal from the trust poses little risk, because the spouse is not likely to gift property in a way inconsistent with the couple's original distribution scheme. When spouses have significantly different planning objectives, or when the grantor spouse is concerned that the surviving spouse may not properly manage distributed property, the grantor spouse may want to more strictly limit or prohibit distributions of principal.

**(d) Building remarriage protection**

If a grantor spouse is concerned about protecting the assets in the Marital trust from the subsequent remarriage of the surviving spouse, the grantor may include provisions that limit, suspend, or terminate principal distributions from the Marital trust if the spouse remarries. It is important for the attorney to ensure that these restrictions do not violate public policy in the trust's jurisdiction. In addition, it is important to understand that no provision may limit the surviving spouse's right to receive income from the trust.

**5.10 Survivor’s Trust – Joint Trust**

In the context of a joint trust, the surviving spouse’s own property continues in the Survivor’s Trust. The Survivor’s Trust is designed to continue the provisions of the living trust during the survivor’s lifetime, subject to the surviving spouse’s continuing power to amend or revoke it.

If you select any funding formula except the Clayton Election (which must use a QTIP trust for the decedent’s Marital Share), the survivor’s trust may also receive the Marital Share of the deceased spouse’s portion of the joint trust:

**NOTE:** If the Survivor’s Trust option is selected, WealthDocs™ creates a subaccount in the Survivor’s Trust for the deceased spouse’s property. This subaccount is irrevocable at death to qualify as a designated beneficiary for retirement plan distribution purposes and to avoid the possible disqualification of the Survivor’s Trust as a nonqualified terminable interest.
(1) **Section 1022 Basis Step-Up**

IRC §1022 provides that for property acquired from a decedent dying after December 31, 2009, shall be treated for purposes of this subtitle as transferred by gift, and that the basis of the person acquiring property from such a decedent shall be the lesser of—

(A) the adjusted basis of the decedent, or

(B) the fair market value of the property at the date of the decedent’s death.

Section 1022(c) provides for a basis increase of up to an additional $3,000,000 for qualified spousal property. Qualified spousal property is property passing to a surviving spouse outright or in a QTIP.

Thus, upon selection of the Survivor’s Trust Marital Share option, WealthDocs™ provides an option to include language authorizing the Trustee to distribute that amount to the spouse outright. The Trustee is given discretion if there is good reason not to make the transfer to the surviving spouse.

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**Estate Tax Repeal Provision for Section 1022 Basis Step-Up**

Do you want to include provision that if the federal estate tax is not in existence, the Trustee should allocate an amount sufficient to use the basis increase provisions of Section 1022(b) to the Non-Marital Share and then an amount sufficient to use the basis increase provisions of Section 1022(c) to the QTIP trust with any remaining property allocated to the Non-Marital Share?

- [ ] Yes
- [ ] No

Include a provision limiting the amount of property that may be transferred to the Non-Marital Share to that amount that may pass without increasing state death taxes?

- [ ] Yes
- [ ] No

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(2) **Distributions of Income**

How frequently will distributions of income be made from the Survivor’s trust?

**Survivor’s Trust - Distributions of Income**

The Trustee shall be required to distribute the net income of the Survivor’s Trust to the surviving spouse at least:

- [ ] monthly
- [ ] quarter-annually
- [ ] semi-annually
- [ ] annually

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(3) **Distributions from Survivor’s Trust During Incapacity**

The trustee may also be authorized to make distributions to other individuals deemed by the trustee to be dependent upon the surviving spouse during any time the spouse is incapacitated.
Some practitioners have expressed concern that the IRS might take the position that such a power held by the Trustee would disqualify the Survivor’s Trust for the federal estate tax marital deduction. We believe that such a position would not be correct because of the surviving spouse’s unrestricted right to amend the Survivor’s Trust and the unrestricted right to remove any Trustee.

However, to avoid this argument altogether, any property transferred to the Survivor’s Trust from the deceased spouse is segregated into a separate subaccount. The resulting language that merges with this option provides that distributions made by the trustee from the Survivor’s Trust to any person other than the surviving spouse will be made the surviving spouse’s “other” property in the Survivor’s Trust; that is, from assets other than those in the segregated subaccount.

Further, the surviving spouse is given the right to direct that the Trustee transfer any property held in the subaccount to the main account of the Survivor’s Trust.

### Distributions from Survivor’s Trust During Incapacity

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<thead>
<tr>
<th>Include provisions for distributions from the Survivor’s Trust during surviving spouse’s incapacity to those dependent on the surviving spouse?</th>
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<tbody>
<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
</tbody>
</table>

### (b) The General Appointment Trust (Separate Trusts).

A “General Power of Appointment” Trust qualifies for the marital deduction if it meets these rules:

1. All trust accounting income is payable to the surviving spouse at least annually. IRC §2056(b)(5)
2. The surviving spouse has a general power of appointment either during lifetime, by Will or other testamentary disposition, or both, over trust assets. IRC §2056(b)(5).
3. Generally, the trust may hold unproductive assets only if the trust document requires, or permits the surviving spouse to require, the current Trustee to either make the property productive or convert it to productive property within a reasonable time. Treas. Reg. §20.2056(b)-(5)(f)(4).

#### (1) Advantages

A perceived advantage of the General Power of Appointment Trust is that it allows the surviving spouse additional time to determine who will ultimately receive the remainder interest in the decedent’s property when more facts and circumstances are known.

#### (2) Disadvantages

The General Power of Appointment Trust generally has two perceived disadvantages:
• The General Power of Appointment Trust gives the surviving spouse ultimate control over disposition of the trust property. The spouse may pass the trust assets to a beneficiary that the decedent does not approve of – such as a “replacement” spouse!

• The trust must produce income. The Trustee may be forced (either by the surviving spouse or the trust document) to dispose of a nonproductive assets that the decedent may have wanted to remain in the family (such as a closely held business or undivided real estate.)

In some states, a third disadvantage is that the law may permit the surviving spouse’s or the estate’s creditors to reach trust assets.

(3) Drafting the General Power of Appointment Trust

For you, as drafting attorney, the only decision to make on the General Power of Appointment Trust is frequency of income (which must be at least annually).

(c) The “QTIP” Trust

A QTIP Trust provides an income interest to the surviving spouse for life, and it allows the decedent – not the surviving spouse – to decide who will receive the remainder interest when the surviving spouse dies. The decedent’s ability to name the ultimate beneficiary of the QTIP Trust property is a primary consideration in choosing a QTIP trust. The fair market value of the trust property, however, is included in the surviving spouse’s estate at his or her death, and does not escape estate taxation. A QTIP must meet the following requirements:

1. All trust accounting income is payable to the surviving spouse at least annually. IRC §2056(b)(7);

2. No one, including the surviving spouse, has a power to appoint or distribute the assets of the trust during the life of the surviving spouse to any person other than the surviving spouse. IRC §2056(b)(7).

The surviving spouse, however, can be permitted to appoint the property at death by power of appointment. This, however, defeats the reason for using a QTIP. But the surviving spouse may be given a limited power of appointment exercisable at death to change the allocation of assets among – for example – the first spouse’s children and specifically-named charities; and

3. Generally, the trust may hold unproductive assets only if the trust document requires, or permits the surviving spouse to require, the current Trustee to either make the property productive or convert it to productive property within a reasonable time. Treas. Reg. §20.2056(b)-(5)(f)(4).
(1) Advantages
The QTIP provides greater creditor protection for the surviving spouse and the QTIP assets, and more effectively prevents the surviving spouse from disinheriting the grantor spouse’s intended beneficiaries (depending on the scope of any power of appointment). It is also the only form of marital deduction-qualifying trust that expressly qualifies for the modified carryover basis provisions scheduled to take effect in 2010.\(^75\)

(2) Disadvantages
As mentioned above, the trustee of a QTIP trust must file a form 1041 Fiduciary’s Income Tax Return each year, adding a bit of an accounting nuisance and potential expense. And for clients who want to provide the surviving spouse with unfettered power over the marital trust, a QTIP will prove too restrictive.

(3) Drafting the QTIP Trust
There are several options available for the QTIP provisions under the WealthDocs™ system.

(a) Income Distributions
All that is required under the QTIP rules is that the net income be paid at least annually. WealthDocs™ permits the drafting attorney to decide the frequency with which the income must be paid.

A popular option is to create a so-called “total return” Marital Trust. This option has become especially popular in recent years with the decline in interest rates, and tries to give the surviving spouse an adequate income stream without hurting the remainder beneficiaries’ interest in the trust.

WealthDocs™ provides the option to include a provision that the surviving spouse shall receive the greater of all of the income or a unitrust amount. The unitrust amount is a percentage – selected by the drafter – of the value of the trust at the beginning of the trust’s taxable year. A Marital Trust with this provision is referred to as a “total return” trust, because it allows the Trustee to invest for a total return rather than an income stream.

The “greater of” language is required to make sure that the Marital Trust does not run afoul of the QTIP rules by distributing an amount less than the net income earned by the trust.

\(^75\) IRC§1022(c)(2)(B)
(b) Discretionary Distributions of Principal

While there is no requirement of distributions of principal from the QTIP trust, the grantor may wish to give the surviving spouse discretion over distributions of principal.

WealthDocs™ includes an option for discretionary distributions of principal to be made only by a Distribution Trustee. This permits a beneficiary to control his or her trust to a great extent while also preserving asset protection, assuming the beneficiary does not have a withdrawal right.

The trust document may name the initial Distribution Trustee, or it may simply provide the means by which the Distribution Trustee is later appointed by the trust beneficiaries. The beneficiary of any trust with a Distribution Trustee holds the authority to remove and replace the Distribution Trustee with an individual or corporate fiduciary that is not related or subordinate to the beneficiary.

(c) Spouse’s Right to Demand Principal

A WealthDocs™ Marital Trust may be drafted to authorize distributions of principal by the Trustee to the surviving spouse. It
may also be drafted to give the surviving spouse the right withdraw principal limited to the so-called “5 and 5” power. Finally, WealthDocs™ also permits the trust to be designed so that the Trustee’s ability to make distributions to the surviving spouse is limited to distributions for the spouse’s health, education, maintenance and support. (These are called “ascertainable standards.”)

These restrictions to “ascertainable standards” and “5 and 5” power are discussed below. These limitations are intended to prevent inclusion in the surviving spouse’s estate as a general power of appointment under IRC §2041. If, however, the Marital Trust is included in the surviving spouse’s estate anyway, why would you, as drafting attorney, be concerned with these limitations? Primarily because, if the Trustee makes a partial QTIP election, you may want to include these limitations to make sure that portion of the trust not subject to the QTIP election isn’t included in the surviving spouse’s estate.

One of the perceived disadvantages of using a QTIP trust for tax planning purposes is the limit on the surviving spouse’s ability to access principal. To counter this concern, WealthDocs™ provides the option to give the surviving spouse an unlimited demand right if he or she survives the grantor by 16 months. This right only applies to property elected to qualify for the unlimited federal estate tax deduction. The reason for the 16 month survival provision is to provide adequate time for making the QTIP election. The advantage of this option is to provide the flexibility provided by a QTIP while giving the surviving spouse access to trust principal in the event a QTIP election is not made.

(d) Remarriage Restrictions

Some clients want to provide that a surviving spouse’s right to principal terminates in the event of the surviving spouse’s remarriage. The trust agreement can restrict the surviving spouse’s access to the trust principal if the spouse remarries.
The surviving spouse’s access to the *income* from the trust **cannot be limited**, or the trust will not qualify as a QTIP Trust.

CAVEAT: Some practitioners have expressed concern that this provision may be invalid under the laws of some jurisdictions. Others fear that the marital deduction may be lost if this provision is included. So - *Use with care.*

### The QTIP Trust - Remarriage Provision

<table>
<thead>
<tr>
<th>Effect of Remarriage on Principal Distributions from the QTIP Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Remarriage does not affect the surviving spouse’s right to principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of principal. However, if spouse subsequently becomes unmarried, either because of death or divorce, spouse shall again have the rights to distributions of principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of principal, unless the spouse and the new spouse execute a valid prenuptial agreement protecting the rights of the spouse and descendants in case of divorce or death.</td>
</tr>
</tbody>
</table>

### (e) Testamentary Limited Power of Appointment

One of the primary purposes of creating a QTIP Trust is to permit the decedent – not the surviving spouse – to decide who receives the remainder interest when the surviving spouse dies. However, if the Grantor wants the spouse to take a ‘second look’ at the residuary beneficiary provisions for the principal of the QTIP Trust remaining at the spouse’s death (*i.e.*, to take into account events occurring after the Grantor’s death), the surviving spouse can be given a special testamentary power to appoint trust principal among the Grantor’s descendants.

If the spouse doesn’t exercise the special power, the residuary beneficiary provisions of the trust agreement will control.

### The QTIP - Testamentary Limited Power of Appointment

- Do you want to include provisions granting the surviving spouse a limited testamentary power of appointment?
  - Yes
  - No

- Permissible appointees under the Marital Trust limited power of appointment:
  - Descendants only
  - Descendants and charities
  - Descendants and spouses
  - Descendants, spouses and charities
  - Any person or entity
  - Other

### (f) That Pesky “Stub Income” Problem

Shortly after the enactment of the 1981 Act, several writers raised the issue of the accrued but undistributed income (“stub income”) in the Marital Trust at the date of the surviving spouse’s death. These
writers argued that, under a literal reading, the Trustee must be required to distribute this stub income to the surviving spouse’s estate. The Service attempted to lay the issue to rest in Treas. Reg. §20.2056(b)-7(d)(4), which states that “[a]n income interest does not fail to constitute a qualifying income interest for life solely because income between the last distribution date and the date of the surviving spouse’s death is not required to be distributed to the surviving spouse or to the estate of the surviving spouse.”

Yet in an unusual case where the taxpayer argued that the marital deduction could not be taken where the instrument did not require the stub income to be distributed to the surviving spouse’s estate, the Tax Court agreed with the taxpayer and held that the trust instrument was not a “qualifying income interest for life” for that reason. Howard Estate v. Commissioner, 91 T.C. 329 (1988), rev’d 910 F.2d 633 (9th Cir. 1990). Notwithstanding the fact that the Ninth Circuit upheld the Regulation, the Tax Court held again that failure to pay the stub income to the surviving spouse’s estate meant the marital trust failed to meet the QTIP requirements. Shelfer Estate v. Commissioner, 103 T.C. 10 (1994).

Some practitioners avoid this potential pitfall by granting the surviving spouse a general power of appointment over this income. This general power of appointment will cause the stub income to be included in the surviving spouse’s estate under IRC §2041.

Because the Service is bound to follow the Regulations, other practitioners believe that Marital Trusts need not address the stub income issue.

WealthDocs™ provides an option to include a general power of appointment over stub income:

<table>
<thead>
<tr>
<th>General Power of Appointment over Stub Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you want to include a general power of appointment over any accrued but undistributed income remaining in the Marital Trust?</td>
</tr>
<tr>
<td>○ Yes</td>
</tr>
<tr>
<td>○ No</td>
</tr>
</tbody>
</table>

**General Power of Appointment over Stub Income**

(d) **Outright to the Survivor**

WealthDocs™ also gives you the option to give the marital share outright to the surviving spouse.

<table>
<thead>
<tr>
<th>Distribution of the Marital Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Marital Share shall be held or distributed:</td>
</tr>
<tr>
<td>○ In a General Appointment Trust.</td>
</tr>
<tr>
<td>○ In a QTIP Trust.</td>
</tr>
<tr>
<td>○ Outright to the surviving spouse.</td>
</tr>
</tbody>
</table>
Part VI
Distribution of Non-Marital Share

As discussed above, the Non-Marital share is comprised of a portion of the deceased spouse's estate that because of the way it is structured and administered, does not qualify for the marital deduction. As a result, the Non-Marital share is charged against the estate tax applicable exclusion amount of the deceased spouse.

6.01 Spouse Not a Beneficiary of Non-Marital Share

The spouse does not have to be a beneficiary of the Non-Marital Share. If the spouse is not a beneficiary, no “Bypass” trust will be created and the non-marital trust property will be distributed to the residuary beneficiaries.

This might be appropriate where the grantor has children or other intended beneficiaries from a prior relationship, or where the survivor has ample assets of his or her own. It might also be appropriate in circumstances where the survivor has a disability or other medical condition that might qualify them to receive needs-based assistance.

6.02 Bypass Trust to Benefit Spouse

If the Non-Marital Share is used for the benefit of the surviving spouse, it is normally held in a Bypass Trust (so called because the property and all appreciation in the trust bypasses the surviving spouse’s estate for federal estate tax purposes). Other terms you will see periodically include:

- Credit Shelter Trust (“sheltering” the estate tax “credit” of the deceased spouse);
- “B” Trust (created with property of the spouse “below” ground);
- Decedent’s Trust (created with the decedent’s property);
- Exemption Trust (funded with property equal to the decedent’s estate tax “exemption”);
- Family Trust (created to provide for the decedent’s family)

Although children, other descendants or even non-relatives can benefit from the Bypass Trust, the trust is generally created to give primary benefit to the surviving spouse and then to others. WealthDocs™ contains the following options for designating the Bypass Trust’s beneficiaries:
6.03 Income and Principal Distributions

Giving the surviving spouse a mandatory income interest for life will not cause the Bypass Trust to be included in the surviving spouse’s gross estate. The trustee can also distribute the income and principal to the surviving spouse at the discretion of the trustee or it can “spray” the income or principal among the surviving spouse and the other beneficiaries. Distributions can also be made in the form of a “total return” trust. See Section 5.10(c)(1), above.

6.04 Discretionary Distributions

The Family Trust can also be drafted to give the Trustee the ability to make principal distributions to the beneficiaries. However, this presents a problem if a trust beneficiary is also serving as a trustee. (WealthDocs™ calls a beneficiary-Trustee an “Interested Trustee.”) Under the Code, a person treated as having a general power of appointment for estate and gift tax purposes if that person can pay the property to himself, his creditors, his estate or creditors of his estate. IRC §§2041(b)(1) and 2514(c). Additionally, a person who can pay property to someone other than himself, in discharge of his legal obligation, is regarded as being able to pay the property to himself. So, if the Bypass Trust beneficiary-Trustee can pay trust principal to himself or herself at his or her absolute discretion, that right creates a general power of appointment which results in the Bypass Trust being included in the beneficiary-Trustee’s estate when the Trustee dies.

An important exception to the general power of appointment definition is that a power holder’s power to pay property to himself or herself is not a general power of appointment if the power is limited by an “ascertainable standard” that relates to the power holder’s own health, education, maintenance or support. (IRC §§ 2041(b)(1)(A) and 2514(c)(1)) Therefore, if a beneficiary-Trustee’s power to make distributions to himself is limited to an “ascertainable standard,” the beneficiary-Trustee will not have a general power of appointment. Id.
WealthDocs™ provides three options (a fourth, if “Distribution Trustee” provisions are included in the trust) designed to ensure that the power to make principal distributions to the Bypass Trust beneficiaries does not result in a general power of appointment:

<table>
<thead>
<tr>
<th>The Bypass Trust - Discretionary Distributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Trustee shall make distributions of income and principal to the beneficiaries of the Bypass Trust as follows:</td>
</tr>
<tr>
<td>○ The Distribution Trustee may make distributions for any purpose. No other Discretionary distributions are permitted.</td>
</tr>
<tr>
<td>○ The Trustee shall make distributions pursuant to ascertainable standards.</td>
</tr>
<tr>
<td>○ An Independent Trustee may distribute for any purpose and an interested Trustee shall make distributions pursuant to ascertainable standards.</td>
</tr>
<tr>
<td>○ An Independent Trustee may make distributions for any purpose. If there is no Independent Trustee there will be no Discretionary distributions.</td>
</tr>
</tbody>
</table>

**6.05 Withdrawal Right – 5 and 5 Power**

IRC §2041(b)(2) states that the lapse of a power of appointment during the life of the individual holding the power is considered a release of that power. A failure to exercise a general power of appointment within a specified period of time, so that the power expires, constitutes a lapse. Treas. Reg. §20.2041-3(d)(3). A lapse, however, will only be considered to be a taxable release to the extent that the value of the property (that could have been appointed) exceeds the greater of: (1) $5,000; or (2) 5 percent of the total value, at the time of the lapse, of the assets out of which (or the proceeds of which) the exercise of the lapsed power could have been satisfied.

When properly structured in a trust instrument, a “5 and 5” provision will not be treated as a release and will not cause the entire trust property to be included in the holder’s gross estate. In the year the holder of the power of appointment dies, only the property subject to the “5 and 5” power will be included in the gross estate. Treas. Reg. §20.2041-3(d)(3).

You can create Bypass Trust provisions that give the surviving spouse a “5 and 5” withdrawal right using WealthDocs™. The amount subject to this right of withdrawal, however, will be included in the surviving spouse’s gross estate, and this amount could be substantial. 76 But the WealthDocs™ provision allows the surviving spouse to exercise the right to withdraw 5 percent of the trust principal only on the last day of the year. The odds of this amount being included in the surviving spouse’s gross estate are thus diminished considerably.

<table>
<thead>
<tr>
<th>The Bypass Trust - 5 and 5 Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant the surviving spouse an annual noncumulative right to the greater of $5,000 or 5% of the principal?</td>
</tr>
<tr>
<td>○ Yes</td>
</tr>
<tr>
<td>○ No</td>
</tr>
</tbody>
</table>

76Consider a Bypass Trust that hold assets valued at $2,000,000. Five percent of that amount, which would be available under the “5 and 5” power is $100,000.
6.06 Remarriage Provisions

As with the Marital Trust, some clients want to provide that a surviving spouse’s right to principal is eliminated by the surviving spouse’s remarriage. WealthDocs™ permits the trust agreement to restrict the surviving spouse’s access to the trust principal if the spouse remarries. However, because the Bypass Trust is not intended to qualify for the marital deduction, the restriction is extended to the income from the trust as well.

<table>
<thead>
<tr>
<th>The Bypass Trust - Remarriage Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effect of Remarriage on Principal Distributions from the Bypass Trust</td>
</tr>
<tr>
<td>☐ Remarriage does not affect the surviving spouse’s right to income or principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of income and principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of income and principal. However, if spouse subsequently becomes unmarried, either because of death or divorce, spouse shall again have the rights to distributions of principal.</td>
</tr>
<tr>
<td>☐ Remarriage terminates the surviving spouse’s right to distributions of income and principal, unless the spouse and the new spouse execute a valid prenuptial agreement protecting the rights of the spouse and descendants in case of divorce or death.</td>
</tr>
</tbody>
</table>

6.07 Lifetime Limited Power of Appointment

WealthDocs™ also contains an option to give the surviving spouse a lifetime limited power of appointment. Because it is a limited power of appointment, such a provision will not result in estate tax inclusion.

For some couples, designing the Credit Shelter Trust with the spouse as the only current beneficiary with mandatory income distributions to the spouse and discretionary principal distributions coupled with the lifetime limited power of appointment for descendants is more acceptable than having the descendants as current beneficiaries of the Credit Shelter Trust.

However, if the spouse exercises this power, the IRS will likely seek to treat the exercise of the power as a taxable gift by the surviving spouse. (TAM 9419007, PLR 9451049, PLR 8535020)

<table>
<thead>
<tr>
<th>The Bypass Trust - Lifetime Power of Appointment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you want to include provisions granting the surviving spouse a lifetime limited power of appointment?</td>
</tr>
<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
</tbody>
</table>

NOTE: Surviving spouse’s exercise of a lifetime limited power of appointment is considered to be a taxable gift by the surviving spouse. See TAM 9419007, PLR 9451049 and PLR 8535020.

6.08 Testamentary Limited Power of Appointment

The surviving spouse may be given a testamentary limited power of appointment allowing him or her to appoint the trust assets to third parties. The class of permissible appointees may be very narrow or it may be broad enough to literally encompass appointment to anyone other than the spouse, the spouse’s creditors, the spouse’s estate or the creditors of the spouse’s estate. (IRC §2041(b)(1)) The latter gives the surviving spouse maximum flexibility over the trust without causing estate tax inclusion.
The options under are the same as those for the marital trust limited power of appointment, discussed above.

## Part VII
### Planning for Residuary Beneficiaries

WealthDocs™ gives a wide variety of distribution options for family members after the grantor’s death (and the grantor’s spouse, if married).

<table>
<thead>
<tr>
<th>Residuary Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>After the death of the Grantor and the Grantor’s spouse, the residuary beneficiaries are:</td>
</tr>
<tr>
<td>○ All individuals.</td>
</tr>
<tr>
<td>○ All charities.</td>
</tr>
<tr>
<td>○ Divide remaining property into charitable and non-charitable shares.</td>
</tr>
</tbody>
</table>

**Note:** While beyond the scope of this course, to create testamentary charitable planning for part of the residuary share, you must select “Divide remaining property into charitable and non-charitable shares” on the Residuary Beneficiaries options screen. This will, among other things, give you the option to create a Testamentary Charitable Lead Trust or Testamentary Charitable Foundation to “zero out” the estate tax.

<table>
<thead>
<tr>
<th>Distribution to Residuary Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Following the death of Thomas C. Client and Cynthia M. Client the remaining trust property shall be:</td>
</tr>
<tr>
<td>○ Distributed outright to descendants, per survivorship option.</td>
</tr>
<tr>
<td>○ Divided into shares for descendants, per stripes to be distributed outright to descendants over a stated age and held in trusts for any descendants under a stated age.</td>
</tr>
<tr>
<td>○ Divided into equal shares for living children and descendants of deceased children, each share held in trust. State the terms of the trust once and apply to all descendant’s trusts.</td>
</tr>
<tr>
<td>○ Divided into equal shares for living children and descendants of deceased children. Separately state terms of administration and distribution for each child.</td>
</tr>
<tr>
<td>○ Divided into shares for named beneficiaries. Separately state terms of administration and distribution for each beneficiary.</td>
</tr>
</tbody>
</table>

### 7.01 Planning for Minor Children

If the grantor has minor children, one popular planning option is to create a “Common trust” or “Pot Trust” for the children’s benefit. The philosophy behind the “Common Trust” is that, while at least one of the children is underage, the trustee should make distributions to children in the same manner as the parents would if alive, and this typically means that distributions will be made based on “need” or “equity,” not necessarily “equality.”

**(a) Common Trust Provisions**

A properly designed and drafted Common Trust will typically contain these provisions:

- The Trustee is authorized and directed to “sprinkle” distributions among children (and their descendants); satisfying the needs of the children is more important than making equal distributions.
• Many minor children will live with a guardian, who may incur out-of-pocket expenses in caring for the minor children; accordingly, the trustee can reimburse the guardian or pay directly for these expenses; and

• Some expenses do not easily fit into the categories of health, education, maintenance and support. These expenses – for child’s first wedding, investment in personal business opportunities, the purchase of a child’s first home – should be treated as advancements. When the Common Trust terminates, there should be an adjustment to each child’s share for these advancements.

(b) Terminating the Common Trust

The Common Trust should terminate at some point after the youngest children attains a stated age. WealthDocs™ gives two termination options:

<table>
<thead>
<tr>
<th>Common Trust Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Include provisions for a common trust for Grantor’s children?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>The Common Trust shall terminate when:</td>
</tr>
<tr>
<td>The youngest child attains a stated age.</td>
</tr>
</tbody>
</table>

Termination age: 

Distributions from the common trust are to be made only by the Distribution Trustee? 

| Yes | No |

7.02 Distribution for Beneficiaries

WealthDocs™ provides a variety of distribution patterns for the grantor’s beneficiaries to family members, non-relatives or charities. Once the beneficiaries are identified, WealthDocs™ provides many options for administering and distributing the trust property. The appropriate distribution method depends completely on your clients’ objectives: the degree of flexibility, and the degree of protection they want to provide for their beneficiaries.

WealthDocs™ gives four options for distributions to individuals following the grantor’s death or upon termination of the Common Trust:

<table>
<thead>
<tr>
<th>Distribution Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1: Distribution Details</td>
</tr>
<tr>
<td>Distribution of Peter A. Client’s Share</td>
</tr>
<tr>
<td>The share shall be distributed:</td>
</tr>
<tr>
<td>Outright</td>
</tr>
</tbody>
</table>
7.03 Outright Distribution

As the name indicates, an outright distribution causes a beneficiary’s share to be distributed as soon as is practicable after the post-mortem administration is complete. There are no restrictions or protections placed on outright gifts.

7.04 General Needs Trust

A general needs trust is any trust that continues for any period of time for the general beneficial interest of a beneficiary. General needs trusts are not specifically designed to qualify a beneficiary for needs-based assistance due to a health condition. (See “Special Needs” trust, below.)

General needs trusts may terminate at a point in the future, or they can span generations (depending on GSTT exemption allocations). WealthDocs™ allows general needs trusts to grant staged withdrawal rights, or to continue indefinitely.

(a) Beneficiary’s Descendants as Current Beneficiaries

Decide whether the named beneficiary’s descendants will also be beneficiaries of that named beneficiary’s trust. If the beneficiary’s trust is not exempt from GST tax, any distribution to a skip person (as to the grantor) will constitute a GST taxable distribution.

(b) Beneficiary’s access to trust income

WealthDocs™ contains three options for determining the terms under which income will be distributed to the beneficiary.

(1) All income to the beneficiary

If the beneficiary receives all income annually from the trust, the trust will be a “simple” trust for tax reporting purposes, passing all income out to the beneficiary each tax year and incurring no income tax at the trust rates. But remember that property distributed to the beneficiary is in the beneficiary’s estate for tax and creditor protection purposes.
(2) Discretionary distribution of income and principal

The trustee holds the authority to make or withhold distributions based on the trustee’s discretion. The standard of that discretion is addressed later in the interview and will be discussed in greater detail below. Generally speaking, this option affords the greatest degree of asset protection, because the beneficiary does not have a guaranteed distribution each year to which a creditor can attach its claim.

(3) “Unitrust” Amount to the beneficiary

As discussed above in similar options under the design of the marital and non-marital trusts, WealthDocs™ provides the option to include a provision that the beneficiary receive the greater of all of the income or a unitrust amount – a percentage specified in the trust agreement based on the value of the trust at the beginning of the trust’s taxable year. This provision creates a “total return” trust, because it allows the Trustee to invest for a total return rather than simply for an income stream.

7.05 General Needs Trust – Discretionary Distribution of Income/Principal

If the trustee is given the discretion to distribute income and principal to the beneficiary, you must specify how that discretion is exercised.

General Needs Trust - Discretionary Distributions

Select one of the following options for discretionary distributions of income and principal:

- The Distribution Trustee may make distributions for any purpose. No other discretionary distributions are permitted.
- The Trustee shall make distributions pursuant to ascertainable standards.
- An Independent Trustee may make distributions for any purpose and an Interested Trustee shall make distributions pursuant to ascertainable standards.
- The Trustee, except for an interested Trustee, may make distributions for any purpose. If there is no Independent Trustee no discretionary distributions are permitted.

(a) Discretionary distributions by a "Distribution Trustee"; no other distributions permitted

This option is only available when the trust grantor bifurcates the trustee's role into that of a "distribution" trustee and an "administrative" trustee. The distribution trustee must be an independent trustee; the "administrative" trustee is typically either the beneficiary or someone who is related or subordinate to the beneficiary. The distribution trustee might be someone the beneficiary trusts and knows well, and the beneficiary may serve as trustee for all administrative purposes. This way, the beneficiary controls the investment and management of the trust's assets, and enjoys the creditor protection afforded by having an independent trustee oversee trust distributions.

(b) Principal distributions limited to ascertainable standards

This option establishes only one standard for distribution and applies it to all trustees. It may make sense when the clients insist that family members or other related or
subordinate parties will serve as trustees. It is simple and certainly prevents the trustee's authority from ever constituting a general power of appointment, but in states that tend to allow judgment creditors to attach to a beneficiary's support standard, an "ascertainable standards-only" distribution standard provides slightly less creditor protection than having an independent trustee with a purely discretionary distribution standard.

(c) Independent trustee may make discretionary distributions; interested trustee subject to ascertainable standards

This flexible option allows the identity of the trustee to determine the applicable distribution standard. If the trustee is independent, then the trustee will hold a purely discretionary distribution power. But if the trustee is an interested trustee, the trustee discretion is limited to ascertainable standards. This is generally a good selection for purposes of creditor protection, while affording a lot of flexibility in the succession of trustees.

(d) Independent trustee may make discretionary distributions; interested trustee may not distribute principal

This option provides greatest protection, but requires that an independent trustee be serving if any principal distributions will be made. If the beneficiary or some other interested trustee is serving, the trustee may not make any principal distributions at all.

7.06 Precatory guidelines for discretionary distributions

If the trustee is given discretion in deciding when and to what extent distributions will be made to beneficiaries, it is a good idea to provide guidance to help the trustee understand the grantor’s intent. WealthDocs™ contains some options to get you started on the design of these precatory guidelines, but you should make it a point to ensure that your client’s trust captures their true intent. The WealthDocs™ options are:

<table>
<thead>
<tr>
<th>General Needs Trust - Precatory Guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Options for precatory guidelines of discretionary distributions:</td>
</tr>
<tr>
<td>☐ Liberal</td>
</tr>
<tr>
<td>☐ Conservative</td>
</tr>
<tr>
<td>☐ None</td>
</tr>
</tbody>
</table>

(a) The “Liberal” Distribution Standard:

In making discretionary distributions to Peter A. Client, it is my desire to provide for his well-being and happiness. Although I request that my Trustee consider the other known resources available to Peter A. Client before making distributions, I also request that my Trustee be liberal in making any distributions to, or for his benefit. I acknowledge that the principal of the trust established for Peter A. Client may be exhausted in making such distributions.
(b) The “Conservative” Distribution Standard:

In making discretionary distributions to Peter A. Client, it is my desire that Peter A. Client develops a strong work ethic, be a productive and contributing member of society, and provide for those who are dependent on him for care and support. Accordingly, my Trustee shall be mindful of, and always consider, the other known resources available to Peter A. Client before making discretionary distributions. It is my desire that preservation of principal be a priority for purposes of this trust share and that genuine need be shown by Peter A. Client before my Trustee makes any discretionary distribution.

Several of your WealthCounsel colleagues have shared expanded distribution guidelines that they have used for clients by posting their sample language to the Knowledge Base. Feel free to explore that site and use that language to get you started on custom-tailoring your client’s estate plan to suit their unique needs.

7.07 Granting Withdrawal Rights

Rather than create trusts that mandate distributions to beneficiaries at specified ages or intervals, WealthDocs™ provides for the granting of structured withdrawal rights. This is intended to prevent forced distributions to beneficiaries who, for any number of reasons, may not wish to be forced to receive their distribution at a specified time.

**Withdrawal Rights - Trust Termination**

Rather than terminate the trust, Peter A. Client may be given a right to withdraw all or a portion of the trust principal.

- What type of withdrawal right?
  - Unlimited
  - At Ages
  - At Intervals
  - None

If withdrawal rights will vest at certain ages, then complete the repeating dialogs to structure the rights:

**New: Withdrawal Rights - Ages**

Peter A. Client’s First Withdrawal Right

Age for first withdrawal:

Percentage or fraction subject to withdrawal right:

Enter ALL for the amount if Peter A. Client will be entitled to withdraw the entire balance of the trust at the stated age.

If withdrawal rights will vest at specified intervals (after the funding of the beneficiary’s trust), complete the repeating dialogs accordingly:
7.08 Granting Powers of Appointment

Deciding whether, and to what extent, a beneficiary will hold a power of appointment over the property in the beneficiary’s trust is an essential fact- and tax-sensitive issue. A beneficiary holding a power of appointment can, within the scope of the power, redirect the distribution of the beneficiary’s trust share either during their lifetime or upon their death. Beneficiaries often desire this control, but the grantors may or may not willingly grant it. But when GST tax is issue, it may be very advisable to give sufficient power to the beneficiary to trigger estate inclusion for that beneficiary and avoid a generation-skipping transfer.

Powers of appointment may be exercisable during the power holder’s lifetime (a “lifetime” power of appointment), or they may be exercisable only at death (a “testamentary” power). The person who grants the power will dictate that. The person granting the power also defines the scope of the power by doing so, dictates the tax implications of the power in the hands of the power holder.

(a) Limited Powers of Appointment

A limited power of appointment does not result in estate inclusion for the beneficiary. If the beneficiary dies while holding a limited power, the value over which the beneficiary holds the power is not included in the beneficiary’s gross estate. Limited powers of appointment are also generally beyond the reach of the beneficiary’s creditors, because those creditors are not “permissible appointees.”
But if the beneficiary exercises that power of appointment in favor of a non-charitable appointee during the beneficiary’s lifetime, the exercise of that power will likely be treated as a taxable gift.

If the beneficiary dies while holding the power of appointment – regardless whether the beneficiary actually exercises the power – the value of the property subject to the power is not included in the beneficiary’s gross estate. As a result, the beneficiary does not become the “transferor” for GSTT purposes. If the property subject to the limited power then passes to a person who is a skip person in relation to the original transferor (the person who granted the beneficiary that limited power of appointment), there will be a GST taxable termination if the property transferred is not covered by the original transferor’s GSTT exemption.

By definition, a limited power of appointment is anything that is not a general power of appointment.

(b) General Powers of Appointment

A general power of appointment does result in estate inclusion for the beneficiary. If the beneficiary dies while holding a general power, the value of which the beneficiary holds the power is included in the beneficiary’s gross estate. General powers of appointment are generally subject to attachment by the power holder’s creditors.

A general power is a power that is exercisable by the power holder in favor of:

- The power holder himself or herself;
- The power holder’s estate;
- His or her creditors; or
- The creditors of his or her estate.77

Any one of these as permissible appointees will cause the power to be a general power of appointment.

Like the limited power, if the beneficiary exercises a general power of appointment in favor of a non-charitable appointee during the beneficiary’s lifetime, the exercise of that power will likely be treated as a taxable gift (subject to the Regulations regarding lifetime gifting).

If the beneficiary dies while holding a general power of appointment – regardless whether the beneficiary actually exercises the power – the value of the property subject to the power is included in the beneficiary’s gross estate. Because of the estate inclusion, the beneficiary holding the general power becomes the new “transferor” for GSTT purposes. If the property subject to a general power then passes to a person who is a skip person in relation to the original transferor (the person who granted the beneficiary that limited power of appointment), there is no GSTT event in the original transferor’s estate. (Of course, if the power holder appoints the property in favor of a skip person in relation to the beneficiary, we must analyze the GSTT implications for the power holder and allocate that power holder’s GSTT exemption to the transfer.)

77 Treas.Reg. §20-2041(c)(1)
(c) “Hybrid” Powers of Appointment

WealthDocs™ provides a third option in granting powers of appointment: the so-called “hybrid” power of appointment. The hybrid power provides that the scope of the power will depend on the GST tax status of the property subject to the power.

Generally speaking, the power will be a general power of appointment. But if the property subject to the power has an inclusion ratio of zero for GSTT purposes (in other words, it is completely covered by the original transferor’s GSTT exemption), then the power will be a limited power.

The following screen shots illustrate the dialogs for granting powers of appointment in WealthDocs™:

Granting a lifetime limited power of appointment:

General Needs Trust - Lifetime Power of Appointment

Do you want to include provisions granting the beneficiary a limited lifetime power of appointment?

- Yes  
- No

Permissible appointees under the Lifetime Power of Appointment:

- Descendants only
- Descendants and charities
- Descendants and spouses
- Descendants, spouses and charities
- Any person, corporation or entity
- Other

NOTE: The beneficiary’s exercise of a lifetime limited power of appointment is considered to be a taxable gift by the beneficiary. See TAM 9419007, PLR 9451049 and PLR 8535020.

Granting a testamentary power of appointment:

General Need’s Trust - Power of Appointment Options

What type of power of appointment should Peter A. Client have?

- A general power of appointment
- A limited power of appointment
- A general power of appointment, however any share of the trust not subject to a generation-skipping transfer tax shall have a limited power or appointment.
- None.

Permissible appointees:

- Descendants only
- Descendants and charities
- Descendants and spouses
- Descendants, spouses and charities
- Any person or entity
- Other
7.09 Lapse Options

Determine how the beneficiary’s trust will be distributed if the beneficiary dies before the beneficiary’s trust is distributed:

<table>
<thead>
<tr>
<th>Distribution Upon Death</th>
</tr>
</thead>
<tbody>
<tr>
<td>If Peter A. Client should die before the complete distribution of his trust, without exercising a power of appointment or if none is granted, the balance of the trust property shall be distributed:</td>
</tr>
<tr>
<td>o to the beneficiary's descendants, and if none to the descendants of the beneficiary's nearest lineal ancestor who is a descendant of Thomas C. Client and if none, to Thomas C. Client's descendants. If Thomas C. Client has no descendants to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to the beneficiary's descendants, and if none to Thomas C. Client's descendants and if none to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to the beneficiary's descendants in (cascading) trusts, and if none to the descendants of the beneficiary's nearest lineal ancestor who is a descendant of Thomas C. Client in trusts, and if none to Thomas C. Client's descendants in trusts. If Thomas C. Client has no descendants to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to the beneficiary's descendants in (cascading trusts), and if none to Thomas C. Client's descendants in trusts and if none to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to Thomas C. Client's descendants and if none to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to Thomas C. Client's descendants in (cascading) trusts and if none to the Remote Beneficiaries.</td>
</tr>
<tr>
<td>o to named individuals.</td>
</tr>
<tr>
<td>o to named charities.</td>
</tr>
</tbody>
</table>

7.10 Special Needs Trust

A Special Needs Trust is sometimes used when one of the children or other individual beneficiaries suffers from a medical or psychological condition that allows them to get state aid for their support. In many states a “general needs trust” will create an entitlement that could cause the beneficiary to lose his or her aid. A “special needs trust” is designed as a wholly discretionary trust that does not create an entitlement to the beneficiary; accordingly, the beneficiary’s aid and benefits are not lost. Note: These Special Needs Trusts may or may not work in any given jurisdiction; they are extremely state-specific. The standard WealthDocs™ language should be reviewed to make sure it complies with the law of your state.
Note: The Power of Appointment and Distribution upon Death options are the same as for the General Needs Trust option.

7.11 Trust Provisions for Afterborn or Adopted Children

If a child is born or adopted after the client executes the estate plan, it is usually desirable to specify what trust terms will apply to manage any distribution for that afterborn or adopted child. If practicable, your clients should restate or amend their trust if the birth or adoption of other beneficiaries makes a significant impact on the planning or administration of their estate.
7.12 Options for Descendants of a Deceased Child

The options are the same as for afterborn or adopted children.

<table>
<thead>
<tr>
<th>Provisions for any Descendants of a Deceased Child</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any trust share set-aside for a descendant of a deceased child shall be:</td>
</tr>
<tr>
<td>□ Distributed outright</td>
</tr>
<tr>
<td>□ Held in trust similar to another child's trust</td>
</tr>
</tbody>
</table>

7.13 Remote Contingent Beneficiaries

A well-drafted living trust will contain a provision for distribution of trust assets if all named beneficiaries fail to take. The provision is especially important for small families with minor children. WealthDocs™ offers three options:

<table>
<thead>
<tr>
<th>Remote Contingent Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case of a failure of beneficiaries, property is to be distributed to:</td>
</tr>
<tr>
<td>□ One-half to each Grantor's Heirs; or</td>
</tr>
<tr>
<td>□ Each Grantor's share to his or her Heirs; or</td>
</tr>
<tr>
<td>□ To named individuals or charities</td>
</tr>
</tbody>
</table>

Part VIII

Trust Protectors and Trustees

8.01 Introduction to Trust Protectors

For many years practitioners in the United Kingdom and other English common law jurisdictions, as well as practitioners in “tax haven” jurisdictions, have used the concept of a “trust protector” to add flexibility to a trust once it becomes irrevocable.

WealthDocs™ allows you to make provisions for a trust protector.

(a) Typical Powers of the Trust Protector

Powers frequently reserved to the trust protector include:

- The power to remove and replace Trustees;
- The power to monitor the investment performance of a Trustee;
- The power to approve or veto distributions from the trust;
- The power to approve more aggressive investment strategies that might otherwise make a Trustee fear exposure to liability; and
- The power to amend or restate the trust to carry out the grantor’s intent, to address tax law changes, to correct scrivener’s errors, or to make other modifications to the trust that might otherwise require court adjudication and reformation.
The trust protector’s powers of amendment are limited, and cannot be exercised in such a way as would result in a reduction in the estate tax marital deduction under IRC §2056 or the estate tax charitable deduction under IRC §2055, nor can they limit or alter the rights of a beneficiary in any trust assets held by the trust before the trust protector’s amendment.

(b) Who Should Serve a Trust Protector?

Broad powers are often granted to a related or subordinate trustee which are not then imputed back to the grantor. The same should be true for a trust protector who is related or subordinate to the grantor. However, no law we can find provides authority for that position. On the contrary, in the several PLRs we reviewed in which a trust protector was part of the plan, the IRS specifically mentioned in the fact pattern that the trust protector was not related or subordinate to the grantor. Accordingly, in the absence of legislative, regulatory or judicial guidance on this point, it is best that the trust protector role be filed by someone who is not related to subordinate to the grantor.

WealthDocs™ goes one step further and requires that the trust protector not be related or subordinate to either the grantor or to any beneficiary. This conservative position should prevent any claim of the creditor’s rights doctrine by a creditor of a beneficiary to whom the protector is related or subordinate. It should also avoid an inadvertent estate tax inclusion issue.

WealthDocs™ will then present a repeating dialog to enter the name(s) of the Trust Protector.

(c) Will the Trust Protector serve in a fiduciary or nonfiduciary capacity?

Because the Trust Protector holds unique powers, they do not necessarily serve in a fiduciary capacity, as a trustee does. Also, because of such limited case law defining the role of the Trust Protector, many prospective trust protectors are willing to be bound to fiduciary standards. On the other hand, by not attaching a fiduciary standard to the role of trust protector, the position is further removed from that of Trustee,
further clouding the precise understanding the Trust Protector’s role and the scope of its powers.\footnote{The question involves the cases \textit{Estate of Vak v. Commissioner}, 973 F.2d 1409 (8th Cir. 1992) and \textit{Wall v. Commissioner}, 101 TC 300 (1993), which permit beneficiaries to remove and replace trustees, would extend to apply to a power to remove and replace a trust protector. Because the trust protector’s powers are generally much broader than the trustee’s powers (e.g. power to amend the trust agreement, powers of appointment over property, power to grant powers of appointment, powers to add or eliminate beneficiaries, etc.), granting the beneficiaries the power to remove and replace the trust protector may cause the court to distinguish the office of trust protector from the trustee. This concern is amplified when the trust protector serves in a nonfiduciary capacity, because the Vak and Wall cases involved \textit{trustees}, bound to fiduciary standards. There is concern that, if the rationale is not extended to the power to remove and replace trust protectors, the tax court could hold that the power to remove and replace, if held by a beneficiary (or a subordinate or related party) results in the beneficiary being treated as the power holder, thus causing estate tax inclusion for the beneficiary under IRC §§2036, 2038 and/or 2041.}

\textbf{(d) The Trust Protector shall have the ability to remove Trustees except:}

<table>
<thead>
<tr>
<th>Trust Advisor - Power to Remove Trustee</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Trust Advisor has the right to remove any Trustee except:</td>
</tr>
<tr>
<td>○ A descendant of the Grantors.</td>
</tr>
<tr>
<td>○ No exceptions.</td>
</tr>
</tbody>
</table>

\textbf{(e) Who shall have the power to remove and replace the Trust Protector?}

<table>
<thead>
<tr>
<th>Trust Advisor - Removal and Default of Designation</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the name of the individual or entity that may remove a Trust Advisor with or without cause and appoint a successor Trust Advisor for a trust if the office of Trust Advisor is vacant and there is no effectively named successor Trust Advisor?</td>
</tr>
</tbody>
</table>

Leave blank or enter NONE to exclude this provision.

This should be someone who is not related or subordinate to any of the beneficiaries of the trust, e.g. a law firm or CPA firm. Note if the individual or entity is unwilling or unable to make the designation, any beneficiary can petition to the court to fill the vacancy.

Although prior versions of WealthDocs allowed beneficiaries to remove and replace the trust protector, members of WealthCounsel’s editorial committee reexamined the issue of whether or not the rationale expressed by the tax court in the cases \textit{Estate of Vak v. Commissioner}, 973 F.2d 1409 (8th Cir. 1992) and \textit{Wall v. Commissioner}, 101 TC 300 (1993) (which permit beneficiaries to remove and replace trustees without attributing the trustee’s power of distribution to the beneficiary) would extend to apply to a power to remove and replace a trust protector. Because the trust protector’s powers are generally much broader than the trustee’s powers (e.g. power to amend the trust agreement, powers of appointment over property, power to grant powers of appointment, powers to add or eliminate beneficiaries, etc.), granting the beneficiaries the power to remove and replace the trust protector may cause the court to distinguish the office of trust protector from the trustee. This concern is amplified when the trust protector serves in a nonfiduciary capacity, because the Vak and Wall cases involved \textit{trustees}, bound to fiduciary standards. There is concern that, if the rationale is not extended to the power to remove and replace trust protectors, the tax court could hold that the power to remove and replace, if held by a beneficiary (or a subordinate or related party) results in the beneficiary being treated as the power holder, thus causing estate tax inclusion for the beneficiary under IRC §§2036, 2038 and/or 2041.
tax court could hold that the power to remove and replace, if held by a beneficiary (or a subordinate or related party) results in the beneficiary being treated as the power holder, thus causing estate tax inclusion for the beneficiary under IRC §§2036, 2038 and/or 2041.

Because of these concerns, WealthDocs™ 6.2 no longer includes an option to give beneficiaries the power to remove and replace the trust protector. Rather, the grantor should give this power to a party who, for the purposes of IRC §672(c), is not related or subordinate to any grantor or beneficiary. If the grantor does not name a party to hold this power, WealthDocs™ provides that any beneficiary will have the right to petition a court to remove or replace the trust protector. Although this approach is more conservative than prior versions of WealthDocs™, we believe that it minimizes the risk of estate inclusion for beneficiaries.

(f) Understanding the Tax Considerations when Selecting a Trust Protector

There is not a great deal of law on the tax considerations associated with selecting a trust protector. In an income tax case, the IRS in a Field Service Advice 199952014 found that a husband’s powers as ‘protector’ of two foreign trusts did not cause the husband or his wife to be treated, under the grantor trust rules, as the owners of any portion of the trusts. The initial transfers of funds to the two trusts were made by nonresident aliens. The husband and wife were both U.S. citizens. They were also the beneficiaries of one of the trusts which was, in turn, the beneficiary of the other trust. The husband was the protector of the two trusts. The declaration of trust for each trust provided that the protector had the power to approve or veto virtually all actions taken by the trustees; but, significantly, did not have the power to vest in himself, his creditors, his estate, or the creditors of his estate any portion or all of the capital or income of the trust funds or to have any incidents of ownership in the trust.

IRS advised that the husband and wife would not be treated as owners of any portion of either trust under IRC §678 because the husband did not have a power exercisable solely by himself to vest the corpus or the income from either trust in himself, nor had the husband ever previously partially released or otherwise modified such a power. Keep in mind that this FSA only addressed a narrow income tax issue.

There are a few PLRs that address estate and gift tax issues in which the protector played a material role in the analysis. In those situations, the IRS has consistently taken care to underscore the factual assumption that the protector is not a related or subordinate party within the meaning of §672(c). When that condition has been satisfied, the PLRs have permitted the protector to provide flexibility to the trust arrangement in a manner that accomplished the grantor’s objectives. For example, in PLR 200120021, May 21, 2001, the IRS found that the trust protector’s discretionary power to satisfy the Settlor’s income tax liability attributable to the income of the trust would not cause the Trust property to be includible in the Settlor’s gross estate.

An interesting fact pattern is outlined in PLR 9332006 in which the grantors, who are siblings, control the corporate general partner of a limited partnership. These grantors also transferred an interest in the limited partnership to an offshore trust in which they, as well as other family members, were beneficiaries. The language of the trust
provided that only the protector could make distributions to either of the settlors. The protector was not a related or subordinate party, and the trust provided that the protector nor his estate could be a beneficiary of the trust. Under these facts, the IRS concluded that the value of the partnership interests would not be included in the gross estate of either of the settlors. Citing *United States v. Byrum*, 408 U.S. 125 (1972), 1972-1 C.B. 518, the IRS emphasized the fiduciary position of the settlors with respect to the other limited partners of the partnership. A copy of this PLR is instructive on a number of points relevant to this outline, and accordingly we have included it as an Exhibit to these materials.

If the protector is related or subordinate to the grantor within the meaning of IRC §672(c), the IRS might be able to successfully impute the powers of the protector back to the grantor. See PLR 9310012. A related or subordinate protector should not present a problem if the scope of the protector’s powers were merely of an advisory or precatory nature. It would also not seem be a problem if the protector was only authorized to exercise the right to remove and replace a trustee with another trustee that is not related or subordinate to the grantor. However, many of our clients will want to give the protector powers that extend beyond these basic powers. In that circumstance, then, the greatest flexibility will be afforded if the protector is not related or subordinate to the grantor within the meaning of IRC §672(c).

Care should also be taken in selecting a protector that is a “non-adverse party” if the protector is the individual designated in the trust to hold powers to act with respect to the trust in order to prevent transfers to the trust from being treated as current gifts. For example, the right to revoke the trust, if held by a non-adverse party, will allow unlimited transfers to the trust without gift tax implications. Arrangements such as these can be used effectively as tax-neutral asset protection devices. However, the protector in that instance could not be a spouse, child or anyone that is a beneficiary under the client’s will or trust because the nature of that person’s interest would almost inevitably be regarded as adverse.

### 8.02 Trustee Succession

The WealthDocs™ document assembly process is designed to get you close to your client’s intent; but *each document needs to be reviewed closely to make sure it is consistent with your client’s wishes!*

#### (a) Selecting a Successor Trustee

Normally the grantor or grantors will serve as the initial Trustee. Therefore, naming the successor Trustees becomes a very important issue in RLT drafting.

Grantors have three choices when selecting successor Trustees: (1) corporate fiduciaries, (2) professional advisors (such as attorneys, certified public accountants and investment advisors), and (3) relatives or friends. Each category has its pros and cons:
### Corporate Trustees

**Pros:**
- Professional and experienced in trust administration;
- May have deep pockets for collection if they breach their fiduciary duties;
- Are not emotionally involved and, therefore, objective in their dealings with the beneficiaries;
- Are regulated by state and federal laws; and
- Normally have a published investment record that can be obtained from the fiduciary.

**Cons:**
- Are not emotionally involved and may be too dispassionate; may not understand the family dynamics;
- Some companies have a high turnover among trust officers, making it impossible for them to get to know the beneficiaries and vice versa; and
- May be too conservative in their investments and the manner in which they interpret the trust provisions.

### Professional Advisors

**Pros:**
- Sometimes have an in-depth knowledge of the family dynamics, the family’s investments, and the family’s business interests;
- Hardworking and professional (some – like attorneys and CPAs are subject to strict ethical standards); and
- They are trained professionals.

**Cons:**
- Some may embezzle, speculate, or die;
- If engaged in other professional activities may not have the time to do the necessary work;
- May not have a deep pocket for collection if they breach their fiduciary duties;
- May have conflicts of interest; and
- May be extremely competent in some areas, but lack knowledge in others (i.e., a CPA may understand fiduciary accounting and taxation but lack knowledge or experience in investments or trust law.)
<table>
<thead>
<tr>
<th>Relatives or Friends</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pros:</strong></td>
</tr>
<tr>
<td>• Have an in-depth knowledge of the family dynamics;</td>
</tr>
<tr>
<td>• Sometimes have knowledge of the family’s investments, and the family’s business interests;</td>
</tr>
<tr>
<td>• May be empathetic to the needs of the beneficiaries and may get personally involved; and</td>
</tr>
<tr>
<td>• Some are very capable and have good common sense.</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Trustee succession provisions are very personal and important issues for clients’ estate plans. This issue needs to be discussed in detail with the client. After all, it is the successor Trustee who is charged with carrying out the estate plan!

(b) **Multiple Trustees**

The trust can be drafted so that successor Trustees serve together as Cotrustees and if desirable, to require that two or more Trustees always serve together.

(1) **Resolving Conflicts**

If the trust power is vested in three or more Trustees, the Trustees can act by majority vote.

A trustee who does not wish to participate in any decision made by the other trustees can abstain or dissent from a majority decision and, in so doing, be absolved from personal liability for the actions of the majority, but may still be required to take such action as is necessary to carry out the will of the majority. This is a standard WealthDocs™ provision.

If the trust power is vested in two cotrustees, the instrument should provide a mechanism to resolve a stalemate, short of applying to the courts. In WealthDocs™, the grantor can request that the Trustees settle any conflicts by mediation or arbitration.

(2) **Delegation of Authority**

A Trustee should be permitted to delegate any powers, including a discretionary power, to any other Trustee. This is a standard WealthDocs™ provision.
(c) **Resignation**

The trust provisions should clearly give any Trustee the right to resign. Most trust companies will not accept appointment without an express procedure for resignation. The resignation, however, should not be effective immediately and should be delayed until a successor Trustee is named and assumes its responsibilities. WealthDocs™ contains these provisions.

(d) **Limitation of Liability**

The trust should expressly provide that any successor Trustee is not liable for any acts or omissions of any predecessor Trustee. Most trust companies will require this language and also a provision that states the successor is under no duty to ascertain whether any predecessor has properly carried out its duties. This is a standard WealthDocs™ provision.

(e) **Trustee Removal and Replacement**

WealthDocs™ has a plethora of options for removal and succession provisions in the trust document.

1. **Non-incapacitated spouse can serve as sole Trustee upon incapacity of the one grantor:**

   **Trustee Succession - During Incapacity**
   
   Select one of the following options:
   - The non-incapacitated spouse shall serve as sole Trustee.
   - The non-incapacitated spouse, serving with a named Cotrustee, shall serve as a Cotrustee.
   - Neither of the above.

2. **Are the lists of Successor Trustees the same for both spouses:**

   **Trustee Succession - During Incapacity**
   
   If the other Grantor is unable to serve during the incapacity of a Grantor:
   - The list of successor Trustees are the same for both husband and wife.
   - The list of successor Trustees are different for husband and wife.
3. **Designate Successors Trustees who will serve if the grantor becomes incapacitated and the other is unable to serve:**

**Trustee Succession - During Incapacity**

List the successor Trustees to serve during the incapacity of either spouse, if the other spouse is unable to serve:

<table>
<thead>
<tr>
<th>List in the order they are to serve</th>
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<tbody>
<tr>
<td>1</td>
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</tbody>
</table>

The “Edit Row” button allows you to easily add Successor Trustees:

**New: Trustee Succession - During Incapacity**

List the successor Trustees to serve during the incapacity of either spouse, if the other spouse is unable to serve:

List in the order they are to serve:

If successor trustees are to serve jointly, list them on the same line and enter any details as to how they are to serve.

E.g. "John Smith and Sally Smith, jointly, if either fails or ceases to serve he or she shall be replaced by the following successor Trustee"
4. **Designate who will have the right to remove a named successor Trustee during the grantor’s incapacity:**

   **Removal of a Trustee During a Grantor’s Incapacity**
   
   During the incapacity of a Grantor the other Grantor may remove a Trustee. If the other Grantor is deceased or also incapacitated who may remove a Trustee?
   
   (select one)
   - a majority of the children
   - person appointed guardian
   - person appointed conservator
   - Other

5. **Designate who can appoint a Successor Trustees when the grantor is incapacitated and no Successor Trustee is specifically designated in the document:**

   **Trustee Succession - Default of Designation**
   
   During a Grantor’s Incapacity, if there is no named successor Trustee, the other Grantor may name the successor Trustee. If the other Grantor is deceased or also incapacitated who may name the successor Trustee?
   
   (select one)
   - a majority of Grantors’ children
   - person appointed Grantors’ guardian
   - person appointed Grantors’ conservator
   - Other

6. **The RLT can specify how the successor death Trustees will be listed in the document.**

   a. One listing of successor trustees for all trusts created under the trust agreement, or
   
   b. Separate listing of successor trustees.

   **Trustee Succession - Listing Options**
   
   In listing successor Trustees select from one of the following options:
   
   - List Trustee Succession once for all trusts created after the death of a Grantor.
   - List Trustee Succession separately for each trust created after the death of a Grantor.

   Note: The answer to this question will determine the design of the Trustee Succession provisions. Subsequent dialog boxes will ask for the names of the successor Trustees.
If the option to separately list the succession of trustees, then WealthDocs™ will ask for “Administrative Trustees”

**Trustee Succession - Administrative Trustee upon Death of Husband**

List, in the successor Trustee(s) to serve during the period of administration, following the death of the husband, if wife survives:

<table>
<thead>
<tr>
<th>List in the order they are to serve</th>
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</thead>
<tbody>
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</tbody>
</table>

If successor trustees are to serve jointly, list them on the same line and enter any details as to how they are to serve, e.g. “John Smith and Sally Smith, jointly, either fails or ceases to serve they shall replaced by the following successor Trustee”

and then for “Testamentary Trustees”

**Testamentary Trustee Succession**

Name(s) of Testamentary Trust(s)

<table>
<thead>
<tr>
<th>Name(s) of Testamentary Trust(s)</th>
</tr>
</thead>
</table>

e.g. “Family Trust”; “Peter A. Client’s Separate Trust”

If successor trustees are to serve jointly, list them on the same line and enter any details as to how they are to serve, e.g. “John Smith and Sally Smith, jointly, either fails or ceases to serve they shall replaced by the following successor Trustee”

- [ ] Trustee(s) to serve:
  - [ ] Upon creation
  - [ ] If husband dies first
  - [ ] If wife dies first

*NOTE:* To select from list of names, click on "Edit Row" and then use the "Select" button.

*(NOTE: In this context, the term “Testamentary Trust(s)” refers to any trust created for the benefit of one or more individuals after the post mortem administration period.)*
7. The surviving spouse may serve as a sole Trustee, as a cotrustee, or neither:

**Trustee Succession - Upon Death**

Select one of the following options:
- The surviving spouse shall serve as sole Trustee of all trusts.
- The surviving spouse, serving with a named Cotrustee, shall serve as a Cotrustee of all trusts.
- Neither of the above.

8. Successor Trustees can be the same for both spouses or different:

**Trustee Succession - Upon Death**

If the surviving Grantor is unable to serve as sole Trustee upon the death of a Grantor the successor Trustee(ies):
- are the same for both husband and wife.
- are different for husband and wife.

9. Designate the specifically named Successor Trustees, upon the death of the grantor, in the same manner as disability Trustees:

**Trustee Succession - Upon Death**

List the successor Trustees to serve if the surviving spouse is unable to serve, upon the death of the other spouse:

<table>
<thead>
<tr>
<th>List in the order they are to serve</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
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<tr>
<td>10</td>
</tr>
</tbody>
</table>

If successor trustees are to serve jointly, list them on the same line and enter any details as to how they are to serve, e.g. "John Smith and Sally Smith, jointly, if either falls or ceases to serve he or she shall be replaced by the following successor Trustee"
10. The beneficiary of a separate trust may be given the ability to serve as a cotrustee or trustee at a stated age:

**Trustee Succession - Separate Trusts**

Upon creation of the separate trusts:
- [ ] Beneficiary may serve as a cotrustee at a stated age.
- [ ] Beneficiary may serve as sole trustee at a stated age.
- [x] Beneficiary may serve as a cotrustee at a stated age and then may serve as sole trustee at a stated age.
- [ ] No provision as to beneficiary’s right to serve as a trustee.

Age at which beneficiary may serve as a cotrustee of his or her separate trust share.
(enter 0 to omit any age requirement)

Age at which beneficiary may serve as sole trustee of his or her separate trust share.
(enter 0 to omit any age requirement)

11. To simplify administration of the trust when two or more trustees are serving, WealthDocs™ can include a provision allowing a single trustee to sign checks and execute documents on behalf of the trust:

**Authority of Single Trustee to Act**

Include a provision authorizing a single Trustee to sign checks, agreements or other documents on behalf of the trust when two or more Trustees are serving?
- [ ] Yes
- [ ] No

“Unless a Trustee elects otherwise in a written instrument delivered to the other Trustees, whenever neither of us is serving as a Trustee, if two or more Trustees are serving, any one Trustee may sign any checks, agreements or other documents on behalf of the trust with the same force and effect as if all Trustees had signed. Persons dealing with the signing Trustee in good faith may rely upon the signing Trustee’s authority to act on behalf of the trust without inquiry as to the other Trustees’ acquiescence to such action.”

This language is adopted from “Drafting the Estate Plan” with permission from David Handler in Chicago. David points out in a practice note:

This provision is a matter of convenience for co-executors and cotrustees, relieving them of the burden of sending papers around the country for signatures. However, it creates an opportunity for an executor or Trustee to take unauthorized action without his co-fiduciary’s prior knowledge.

Who might use this language? Clients who want more than one of their children to serve as cotrustees after their deaths, who have no or minimal concerns about conflicts between or among the Trustees, and want to build in administrative convenience as to third parties. Absence of such a provision in that situation can be viewed by children as: “Mom and dad wanted to be sure we all signed off on everything; otherwise they would have permitted separate signatures in the trust.”
12. **The surviving spouse can be given the right to remove and appoint current and successor Trustees:**

   **Trustee Succession - Surviving Spouse Right to Amend**
   
   - Give the surviving spouse the right to remove and appoint the current and successor Trustees?
     - Yes
     - No

   Please note that the power to amend Trustee succession is one that should be considered carefully. Giving the spouse such a power provides a great deal of flexibility to the surviving spouse. However, it can have significant estate tax inclusion issues.

   You must consider your response to this question with your responses to the later questions that deal with requiring the person or persons removing a Trustee to appoint an Independent Trustee to serve and who are the permissible appointees to a Trustee vacancy.

   If this question is answered in the negative, then WealthDocs™ can alternatively provide that the surviving spouse may remove a trustee. Select the desired choice:

   **Removal of a Trustee by Spouse**
   
   After the death of the first spouse, what provision do you want to include concerning the surviving spouse’s right to remove a Trustee?
   - Spouse may remove with or without cause.
   - Spouse may not remove a Trustee, except for cause.
   (select one of the above options)

13. **Designate who will have the right to remove a named successor Trustee after the grantor dies:**

   **Trustee Removal by Beneficiaries**
   
   After the death of the Grantors, what provision do you want to include concerning the beneficiaries’ right to remove a Trustee?
   - Majority of beneficiaries may remove any Trustee.
   - Unanimous decision of the beneficiaries may remove any Trustee.
   - Primary beneficiary may remove with or without cause.
   - A Trustee may be removed only for cause.
   (Select one of the above alternatives)
14. In the event a trustee is removed, the RLT can provide that the person(s) exercising the removal power must appoint an independent Trustee within the meaning of IRC §672(c):

<table>
<thead>
<tr>
<th>Trustee Removal - Require Appointment of Independent Trustee</th>
</tr>
</thead>
<tbody>
<tr>
<td>If a Trustee is removed by someone other than the Grantor, the person or persons removing the Trustee:</td>
</tr>
<tr>
<td>○ must appoint a successor Trustee that is a corporate fiduciary that is not related or subordinate within the meaning of Section 672(c) of the Internal Revenue Code.</td>
</tr>
<tr>
<td>○ must appoint a successor Trustee that is an individual or corporate fiduciary that is not related or subordinate within the meaning of Section 672(c) of the Internal Revenue Code.</td>
</tr>
<tr>
<td>○ must appoint a successor Trustee that is an attorney, certified public accountant or corporate fiduciary that is not related or subordinate within the meaning of Section 672(c) of the Internal Revenue Code.</td>
</tr>
<tr>
<td>○ are not required to appoint a successor Trustee. I want to rely on the other provisions of the trust agreement to control Trustee succession when a Trustee is removed.</td>
</tr>
</tbody>
</table>

**Tax Note Regarding Replacement of the Trustee.** If a beneficiary is given the power to remove the Trustee and replace that Trustee with any person, including himself or herself, the Internal Revenue Service will attribute that Trustee’s powers to the beneficiary whether or not the Trustee is actually removed.

Revenue Ruling 95-58, however, makes it clear that a decedent-grantor’s reservation of an unqualified power to remove a Trustee and appoint an individual or corporate successor Trustee who is not related or subordinate to the decedent (within the meaning of section 672(c) of the Code) is not considered a reservation of the Trustee’s discretionary powers of distribution over the property transferred by the decedent-grantor to the trust. This ruling dealt specifically with IRC §§2036 and 2038. But subsequent private letter rulings have expanded the rationale of Revenue Ruling 95-58 and held that the beneficiary’s power to remove and replace the Trustee with a Trustee who is not related or subordinate to the beneficiary within the meaning of section 672(c) will not cause the trust’s inclusion in the beneficiary’s gross estate under IRC §2041. See PLRs 200031019, 199942026, 9845014 and 9746007.

Some practitioners believe the successor Trustee does not have to be an independent Trustee to comply with Revenue Ruling 95-58 if the trust provisions elsewhere limit distributions by an Interested Trustee to ascertainable standards. See Rev. Rul. 78-398, 1978-2 C.B. 237. This approach can be selected as RLT language using WealthDocs™.

The conservative approach, however, is to limit appointment of the replacement Trustee to an independent Trustee.

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79 1995-35 I.R.B. 16. This revenue ruling was issued after the Service lost a series of court rulings on the issue. See Estate of Wall v. Commissioner, 101 T.C. 300 (1993), and Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992), rev’g T.C. Memo 1991-503.
15. **Designate who may be appointed to serve as Successor Trustee if there are no named Successor Trustees:**

**Trustee Succession - Default of Designation**

Following the death of a Grantor, any successor Trustee appointed to fill a vacancy other than a vacancy resulting from the removal of a Trustee shall be:

- a corporate fiduciary
- an individual or corporate fiduciary
- an attorney, certified public accountant or corporate fiduciary
- an individual or corporate fiduciary that is not related or subordinate to the person or persons making the appointment within the meaning of Section 672(c) of the Internal Revenue Code
- an attorney, certified public accountant or corporate fiduciary that is not related or subordinate to the person or persons making the appointment within the meaning of Section 672(c) of the Internal Revenue Code
- Other

---

16. **Indicate whether there should be a minimum number of Trustees when the grantor is incapacitated and after the death of the grantor:**

**Minimum Number of Trustees**

Do you want to require that there shall at all times be a minimum of two Trustees serving for each trust or trust share unless an individual Trustee is specifically authorized to serve as sole trustee or unless a corporate fiduciary is serving as a Trustee?

- Yes
- No

Some practitioners feel strongly that at all times the Grantor is incapacitated and following the Grantor’s death there should always be two Trustees serving, particularly if there is an “interested Trustee” serving.

By answering “Yes” to this question the following provisions is added to the Trust Agreement:

**Section __.07 Minimum Number of Trustees**

There shall at all times be a minimum of two Trustees serving under this agreement for each trust or trust share unless an individual Trustee is specifically authorized to serve as sole trustee or unless a corporate fiduciary is serving as a Trustee.

If, at any time there is only one individual Trustee serving as Trustee of a trust created under this agreement and no successor Trustee is designated in this agreement, our remaining Trustee shall notify in writing the income beneficiaries that they must name an individual or corporate fiduciary that is not related or subordinate to the person or persons making the appointment within the meaning of Section 672(c) of the Internal Revenue Code to act as a Cotrustee.
17. In the event a corporate fiduciary is appointed to serve, specify the financial requirements the fiduciary must meet to be eligible:

**Corporate Fiduciaries Capital Requirements**

A corporate fiduciary shall have a combined capital and surplus of at least:

$ 2,000,000

Do you want the trust agreement to provide that as an alternative to the capital and surplus requirement, a corporate fiduciary can meet the minimum requirement by having a stated minimum amount of assets under management?

- Yes
- No

Minimum dollar amount of assets under management.

$ 250,000,000

This option provides an option to require any corporate fiduciaries who serve to maintain a minimum amount of capital and surplus. In addition to requiring a minimum amount for combined capital or surplus, WealthDocs™ can also provide an alternative that in lieu of capital and surplus, the fiduciary have a stated minimum amount of assets under management. (Note: If you have established relationships with specific trust companies which you consistently recommend to clients, make sure the selections here are consistent with the fiduciaries’ capabilities.)

18. Indicate the method to determine the incapacity of a Trustee:

**Trustee Succession - Incapacity of a Trustee**

Incapacity of a Trustee may be established by the written certificate of the successor Trustee made in good faith, which certificate:

- must be supported by physician’s statement.
- need not be supported by physician’s statement.

- Check to provide that if the Trustee objects to removal within 10 days and signs any necessary releases for obtaining medical information, the statement must be supported by a doctor’s certificate.

If you want a different time frame than 10 days, enter it below:

Please note that with the new HIPAA guidelines it may be difficult to obtain a physician’s statement as to the incapacity of a Trustee absent written authorization from the Trustee. If this option is selected, consider preparing a HIPAA Authorization for named successor Trustees.

**Part IX**

**Trust Administration, the Trustee’s Powers, and General Provisions**

Most statutes grant to the Trustee all fiduciary powers conferred by state law, unless limited by the trust instrument. See e.g. RSMo Sec. 456.510. Most states also include in their statutes a broad list of statutory powers that are conferred on the Trustee unless so limited.
See e.g. RSMo Sec. 456.520. In these states, many drafters are content to define the Trustee’s powers by reference to this section.

It is usually preferable to make references to the statutory list and, in addition, include a lengthy list of specific powers (even if these duplicate certain statutory powers). This is the approach taken in the WealthDocs™ drafting system.

(a) Typical Provisions

WealthDocs™ contains many typical administrative and investment provisions:

- Authorization of distributions “in-kind;”
- Avoidance of court proceedings and bond;
- Authorization to employ professional to assist in the administration of the trust;
- Determination of Income and Principal;
- Rules regarding the exercise of testamentary powers of appointment granted to beneficiaries under the trust agreement;
- Trust accounting;
- Commingling or Severing Trusts;
- Authority to Terminate Trust;

 **Note:** This is usually done because the trust is no longer economical to maintain. If an individual beneficiary is also the Trustee, the IRS may take the position that this is a provision which grants the beneficiary a general power of appointment. For this reason WealthDocs™ limits this power to the Trust Protector or an Independent Trustee.

- Discharge of Third Parties;
- Payment of funeral and other expenses of the beneficiaries; and
- Assorted investment, business, and other powers.

(b) Drafting for Special Concerns

Some assets or tax rules require special drafting.

(1) Enhanced Powers

WealthDocs™ permits you to draft for certain assets requiring enhanced powers:
(2) GSTT Default Provisions

Anytime distributions are made through trust to a beneficiary who is a skip-person with respect to the grantor, there is a risk that, unless the skip-person is given a general power of appointment, the generation-skipping tax rules could apply to the trust. WealthDocs™ includes a provision that can be inserted and will hopefully protect against imposition of a GSTT tax if the generation-skipping tax rules are accidentally triggered through poor initial drafting or, more likely, amendments made to the trust by others who have not taken this course!

(c) Other Trustee Provisions

A trust should also contain other provisions regarding the Trustee. WealthDocs™ contains all of these provisions:

1. Compensation of the Trustee
2. Waiver of the Trustee’s bond
3. Provisions allowing an individual Trustee to appoint a cotrustee
4. Surplus and capital requirements for a corporate Trustee
5. Removal of an individual Trustee upon incapacity
6. Appointment of a special independent Trustee if a Trustee is unable to act
7. A recitation that each successor Trustee is subject to all restrictions imposed on the initial Trustee
9.02 Defining the Trustee’s Discretion

Throughout the trust agreement Trustees are granted discretion to make distributions and perform other acts. A number of practitioners add a phrase to further describe how a Trustee may exercise that discretion. One of the reasons for describing how a Trustee may exercise its discretion is to protect the Trustee from review by a court or a beneficiary. Others prefer not to further describe how a Trustee may exercise its discretion.

To provide flexibility and meet the differing opinions and practices WealthDocs™ offers choices that permit the document to be drafted according to the attorney’s preferences.

### Alternatives for Trustee Discretion

To make a distribution or perform an other act when a Trustee is granted discretion, select which phrase, if any, you want to use to describe how the Trustee may exercise the discretion granted to it:

- [ ] sole discretion
- [ ] sole and absolute discretion
- [ ] sole, absolute and unreviewable discretion
- [ ] none
- [ ] Other

9.03 Trustee Indemnification

WealthDocs™ includes an option to include a provision indemnifying a Trustee from good faith actions. A family member Trustee is a Trustee who is a beneficiary’s parent, child, grandparent, grandchild, child of a parent, or child of a grandparent. This may be particularly beneficial when the Trustee is not a professional fiduciary.

### Trustee Indemnification

- [ ] Do not include such a provision
- [ ] Indemnify family member Trustees
- [ ] Indemnify uncompensated Trustees
- [ ] Indemnify all Trustees

9.04 Clarify the definition of “Ascertainable Standards”

These options allow you to more precisely define the “ascertainable standards” terms used in documents. Note that the first option uses the verbiage that appears in the Treasury Regulations.

### Ascertainable Standards

What phrase do you want to use when referring to distributions limited to ascertainable standards?

- [ ] health, education, maintenance or support
- [ ] health, education, maintenance and support
- [ ] health, education and maintenance
- [ ] health, education, maintenance and support in reasonable comfort
The second option changes the word “or” to “and” from the exact phrase used in the Treas. Reg. §20.2041-1(c)(2). A number of practitioners believe that the phrase reads better using “and” in place of “or.”

The third option drops the word “support.” Treas. Reg. §20.2041-1(c)(2) specifically states that as used in this subparagraph, the words “support” and “maintenance” are synonymous and their meaning is not limited to the bare necessities of life. Some practitioners believe that including the word “support” might lead to a ruling that assets in a trust are available, and thus disqualifying, for Medicaid eligibility. It seems unlikely that dropping the word “support” would have an effect on Medicaid eligibility since the Treasury Regulations state the words “maintenance” and “support” mean the same thing; however, WealthDocs™ provides this option for practitioners who have this concern.

The fourth option is an alternative taken from Treas. Reg. §20.2041-1(c)(2).

Finally, remember that whether a trustee’s power is limited to ascertainable standards is a matter of state law.

9.05 Determination of Income and Principal

Determine the method by which the trustee shall determine apportionment between principal and income – either in accordance with applicable state statute or as the trustee independently determines. If the first option is selected, the name or citation of the applicable state’s principal and income act must be entered in order to properly merge. (This may be configured as a default setting in the WealthDocs™ “Set Preferences” interview.) If the second option is selected, the trustee may also be given the additional authority to allocate capital gains to income.

<table>
<thead>
<tr>
<th>Determination of Income and Principal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Select one of the following options for how the Trustee is to determine apportionment between principal and income:</td>
</tr>
<tr>
<td>• In accordance with the state’s principal and income act.</td>
</tr>
<tr>
<td>• As the Trustee determines in a fair, equitable and practical manner.</td>
</tr>
</tbody>
</table>

Do you want to include language authorizing the Trustee to allocate capital gain to income?

- Yes
- No

NOTE: The determination of whether capital gains can be allocated to income is generally governed by each state's Income & Principal Act. Make sure the selection you have made is permissible under your state's act.

9.06 Method of Exercising a Power of Appointment

Determine the manner in which a beneficiary who is given a power of appointment may exercise that power. Note that if the power is exercisable only by will, most states will require that a will exercising the power must be first proven in probate to give effect to the exercise of the power. If the power is exercisable either by will or trust, such power could likely be exercised either in an original trust created by the beneficiary or in an amendment to the beneficiary’s trust. The third option expands the exercise of the power to any “other
written instrument” that specifically refers to the power of appointment. (Refer to the inserted image below for a comparison of the merged language.) Conceivably, this third option eliminates all other formalities in the exercise of the power.

### Method of Exercising a Power of Appointment

- A testamentary power of appointment granted under any instrument may be exercised by:
  - Will
  - Will or living trust
  - Will, living trust or other written instrument
  - Other

### Section 12.07 Exercise of Testamentary Power of Appointment

A testamentary power of appointment granted under this agreement may be exercised by will or valid living revocable trust that specifically refers to this power of appointment. The holder of a testamentary power of appointment may exercise the power to appoint property among the permissible appointees in equal or unequal portions, and on such terms and conditions, whether outright or in trust, as the holder of the power designates. The holder of a testamentary power of appointment may grant further powers of appointment to any person to whom principal may be appointed, including a presently exercisable limited or general power of appointment.

My Trustee may conclusively presume that any power of appointment granted to any beneficiary of a trust created under this agreement has not been exercised by the beneficiary of the Trustee has no knowledge of the existence of a valid will or valid living revocable trust exercising the power within 3 months after the beneficiary’s death.

### 9.07 Discretionary Distributions for Specific Purposes

This dialog includes options to permit distributions of principal from the QTIP trust to the surviving spouse for the purpose of carrying out estate planning objectives, and authorizing the Trustee to make outright distributions to a beneficiary so that the beneficiaries can take full advantage of the full step-up in basis under the new income tax regime if the estate tax is repealed in 2010.

#### Discretionary Distributions for Specific Purpose

Include a provision granting the Trustee the authority to make discretionary distributions of principal from the QTIP trust to assist the surviving spouse in achieving estate planning objectives?

- Yes
- No

Do you want to provide that if there is no estate tax, a Trustee may distribute principal to the beneficiary of a trust to allow the beneficiary to take full advantage of the basis increase allowed under Section 1022 of the Internal Revenue Code?

- Yes
- No

#### (a) Distributions from QTIP to assist spouse in achieving estate planning objectives

This option allows additional distributions to the surviving spouse from QTIP principal for the purpose of facilitating further estate planning options of the surviving spouse. Because the value of the QTIP trust is included in the surviving spouse’s taxable estate, this provision can be useful to enable the surviving spouse to
make gifts or take advantage of other effective estate planning techniques. Bear in mind that the exercise of this provision may result in disposition of trust property in a manner inconsistent with the grantor’s intent.

“In addition to the distributions authorized under (Marital Trust Article), our Trustee, other than an Interested Trustee may distribute principal of the Marital Trust under this agreement to the Surviving Spouse to assist the Surviving Spouse in achieving the Surviving Spouse’s estate planning objectives and may distribute principal of the Marital Trust to the Surviving Spouse for any other purpose that our Trustee deems advisable and consistent with such intent.

Nothing contained in this Section shall require, nor may our Trustee require, the Surviving Spouse to transfer any of such distributions to third parties.”

(b) Distribution of principal to beneficiary to allow basis increase under IRC Section 1022

If this option is selected, the following section will be included in the trust administration article:

“If at any time there is no federal estate tax in effect and if I have given the Trustee of any trust created under this agreement the discretion to make distributions of principal to the beneficiaries of the trust, then the Trustee, other than an Interested Trustee, may, in its sole discretion, distribute to the beneficiaries of the trust then eligible for discretionary distributions of income and principal as much of the income and principal as the Trustee, from time to time, determines advisable so that the estate of the beneficiaries can take full advantage of the aggregate basis increase allowed under Section 1022 of the Internal Revenue Code.

Before making principal distributions under this Section, the Trustee should determine whether there are good reasons to retain the property in trust. These reasons may include the fact that the asset may be sold in the near future, creditor protection, protection from failed marriages and protection of assets for future generations. The Trustee shall not be liable to any beneficiary for the exercising or failing to exercise its discretion to make distributions under this Section.”

Note: Both of these options bestow a large amount of discretion upon the Independent Trustee. In addition, it is also important to take into consideration the other reasons the grantor may be intending to place the beneficiaries’ interests in trust – such as strong creditor or “predator” protection – that may be frustrated by including this provision in the trust agreement.

9.08 Administration of Trusts for Minor and Incapacitated Beneficiaries

Minor children and incapacitated persons cannot own or manage property in their names. This article provides options for the Trustee if an incapacitated beneficiary or an underage beneficiary will receive an outright distribution from the trust.
(a) Definition of “Underage”

WealthDocs™ allows you to determine when a beneficiary will be deemed to be old enough to handle outright distributions of money. “Minority” is an inadequate term because the age of majority in most states is now eighteen. Many clients do not believe an eighteen-year-old is mature enough to handle a large outright distribution. WealthDocs™, therefore, allows you to select a more appropriate age:

<table>
<thead>
<tr>
<th>Underage and Incapacitated Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>A beneficiary shall be considered underage if younger than:</td>
</tr>
<tr>
<td>years of age</td>
</tr>
<tr>
<td>Include Stand-by SNT provisions?</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ Yes, with Care Manager provisions</td>
</tr>
</tbody>
</table>

Note: Without the saving clause in the General Provisions Article, an age selected over 21 years would violate the lives in being plus 21 years common law rule against perpetuities.

This Article provides that the Trustee can hold the property in trust for underage or incapacitated beneficiaries. Alternatively, the distributions may be made as follows:

- Directly to the Beneficiary
- To a court-appointed guardian or custodian for the incapacitated beneficiary or underage child.
- To a custodian under a Uniform Transfers to Minors Act account.
- To an agent under a durable power of attorney for the incapacitated beneficiary.
- To a person or entity responsible for the care of the incapacitated beneficiary or underage child.

(b) Stand-by Special Needs Trust

Selecting this option will include SNT provisions in the Underage and Incapacitated Beneficiaries article for any beneficiary who is entitled to a distribution and is receiving or applying for needs-based government benefits.
9.09 General Provisions

The General Provisions article contains many important provisions, including:

<table>
<thead>
<tr>
<th>General Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dispute Resolution by Mediation</strong></td>
</tr>
<tr>
<td>Do you want to insert provisions stating Grantors’ desire that disputes with respect to administration of the trust and disputes between Trustees be resolved by mediation and if necessary arbitration in accordance with the Uniform Arbitration Act?</td>
</tr>
<tr>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Contest Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>What type of Contest Clause do you want to include in the trust agreement?</td>
</tr>
<tr>
<td>☐ Standard</td>
</tr>
<tr>
<td>☐ Expanded</td>
</tr>
<tr>
<td>☐ None</td>
</tr>
</tbody>
</table>

(a) Dispute Resolution

Select whether or not to include a precatory provision requesting the trustee and/or beneficiaries resolve disputes by means of mediation or arbitration. In addition, some faith-oriented clients may wish to include special faith-based conciliation provisions like those drafted by Peacemaker Ministries. For more information, visit [www.hispeace.org](http://www.hispeace.org), or explore the WealthCounsel Knowledge Base for sample language.

(b) Contest Provision

Choose between the “Standard” Contest Provision and the “Expanded” Contest Provision. (As should be obvious, selecting “None” omits any contest provision whatsoever.)

1. **Standard**

   The “Standard” Contest Provision reads as follows:

   “If, after receiving a copy of this Section, any person shall, in any manner, directly or indirectly, attempt to contest or oppose the validity of this agreement, (including any amendment to this agreement), or commences, continues or prosecutes any legal proceedings to set this agreement aside, then such person shall forfeit his or her share, cease to have any right or interest in the trust property, and shall, for purposes of this agreement be deemed to have predeceased both of us.”

2. **Expanded**

   The “Expanded” Contest Provision provides much greater detail in defining circumstances that will be deemed to present a contest to the trust. It reads as follows:

   “If any beneficiary of this trust or any trust created under this trust agreement, alone or in conjunction with any other person engages in
any of the following actions, the right of such beneficiary to take any
interest given to such beneficiary under this trust or any trust created
under this trust agreement shall be determined as it would have been
determined had such beneficiary predeceased both of us without
surviving descendants.

Contests by a claim of undue influence, fraud, menace, duress
or lack of testamentary capacity, or otherwise objects in any
court to the validity of (a) this trust, (b) any trust created under
the terms of this agreement, (c) either Grantor’s Will, or (d)
any beneficiary designation of an annuity, retirement plan,
IRA, Keogh, pension or profit sharing plan or insurance policy
signed by either Grantor, (collectively referred to hereafter in
this Section as “Document” or “Documents”) or any
amendments or codicils to any Document; or

Seeks to obtain an adjudication in any court proceeding that a
Document or any of its provisions is void, or otherwise seeks to
void, nullify or set aside a Document or any of its provisions; or

Files suit on a creditor’s claim filed in a probate of either
Grantor’s estate, against either Grantor’s trust estate, or any
other Document, after rejection or lack of action by the
respective fiduciary; or

Files a petition or other pleading to change the character
(community, separate, joint tenancy, partnership, domestic
partnership, real or personal, tangible or intangible) of property
already so characterized by a Document; or

Claims ownership in a court proceeding to any asset held in
joint tenancy by either Grantor, other than as a surviving joint
tenant; or

Files a petition to determine domestic partnership property as a
cohabitant of either Grantor; or

Files a petition for probate homestead in a probate proceeding
of either Grantor’s estate without the prior written consent of
the personal representative designated in such Grantor’s Will; or

Files a petition for family allowance in a probate of either
Grantor’s estate without the prior written consent of the
personal representative designated in such Grantor’s Will; or

Files a petition to impose a constructive trust or resulting trust
on any assets of the trust estate; or
Participates in any of the above actions in a manner adverse to the trust estate, such as conspiring with or assisting any person who takes any of the above actions.

Our Trustee is hereby authorized to defend, at the expense of the trust estate, any violation of this Section. A “contest” shall include any action described above in an arbitration proceeding and shall not include any action described above solely in a mediation not preceded by a filing of a contest with a court, notwithstanding the foregoing.”

(c) Rule Against Perpetuities, Survivorship Presumption and Simultaneous Death

<table>
<thead>
<tr>
<th>General Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rule Against Perpetual Trusts</td>
</tr>
<tr>
<td>(Select which option you want to use)</td>
</tr>
<tr>
<td>☐ 1. Standard, lives in being plus 21 years.</td>
</tr>
<tr>
<td>☐ 2. Terminate pursuant to applicable Rule Against Perpetuities, if applicable rule is lives in being plus 21 years, lives in being includes descendants of the person named below.</td>
</tr>
<tr>
<td>☐ 3. Custom Rule Against Perpetual Trusts Clause.</td>
</tr>
</tbody>
</table>

- Use whose descendants as measuring lives?
  - John D. Rockefeller
  - Brigham Young
  - King George VI
  - Joseph P. Kennedy

<table>
<thead>
<tr>
<th>Survivorship Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>How many days must a beneficiary survive the Grantor before the beneficiary is deemed to have survived the Grantor?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Simultaneous Death Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case of simultaneous death who shall be deemed to have survived?</td>
</tr>
</tbody>
</table>
  - Husband survived
  - Wife survived
  - Each predeceased the other

==> Stand-by SNT questions have been relocated to the "Underage and Incapacitated Beneficiaries" dialog (was "Definition of Underage Beneficiary").

(1) Rule Against Perpetual Trusts

Select the applicable “Rule Against Perpetuities” provision. In order to provide additional planning flexibility, WealthDocs™ includes an option to expand the definition of “lives in being,” with the purpose of providing a longer RAP period in jurisdictions which have not otherwise expanded the rule under applicable state law. If the trust is to be sitused in a modified RAP jurisdiction, it will be desirable to select either this second options, or to select “Custom” and create a customized RAP clause. (This is done by editing the applicable custom template within the “Individual RLT Article Templates –
Custom” and “Joint RLT Article Templates – Custom” folders within the Revocable Trust Agreements folder in the Living Trust System.

(2) **Survivorship Provision**

It is important to specify the number of days a beneficiary must survive the grantor in order for the beneficiary to be *deemed* to survive for the purpose of the trust. This is necessary to reduce the likelihood of distributing an interest in trust to a beneficiary who dies shortly after the grantor, potentially necessitating a probate for the beneficiary’s share, or otherwise frustrating the grantor’s intent.

(3) **Simultaneous Death Provision**

In the event the husband and wife die under circumstances in which their order of death cannot be ascertained, select which will be the deemed survivor.

(d) **Other contents of General Provisions article**

This article contains other important provisions, including:

- Provisions in the event of a divorce
- Governing law
- Provisions allowing change of trust situs
- Construction of certain terms
- Definitions of key terms

9.10 **Formalities of Execution**

The trust must be validly executed in accordance with the formalities required by applicable state law.

(a) **Signatures**

The grantor (or both grantors if a joint trust) should sign the trust. Most state laws require the Trustee’s signatures, so WealthDocs™ automatically creates the trust with signature lines for grantors and initial Trustees. *(Note: In some states, the trust may be executed by an agent acting under a durable power of attorney.)*

(b) **Witnesses**

Most states do not require that a trust execution be witnessed. However, some, like Florida, require grantors to execute a living trust under the same formalities as a Last Will and Testament, so WealthDocs™ has an option to create the trust document in conformity with the law of these states:
Custom will attestations can be set up in the Layout Options dialog of the Set Preferences interview.

(c) Acknowledgments

Under the law of most states, the trust need not be acknowledged; however, in many states, only acknowledged instruments can be recorded so WealthDocs™ automatically includes state-specific acknowledgments for trusts created using the system.

WealthDocs™ also includes the ability to use a custom notary block, either by setting your preferences in the “Layout Options” dialog or by choosing to use a Custom Notary Block in the Notary Information dialog at the end of the template interview.

9.11 Custom Article Templates

WealthDocs™ enables you to create customized document templates, which can then be merged into the assembled document:
We generally recommend that to the extent possible, WealthCounsel members not customize any WealthDocs™ templates. The “custom” templates in WealthDocs™ are not maintained or improved upon by WealthCounsel staff, nor is the technical support team able to render effective support for customized templates or provisions. WealthCounsel invests heavily in maintaining and improving upon the “Default” document templates, and these templates receive substantial improvements in periodic software updates.

If a member is determined to customize templates, we strongly recommend that the member contact WealthCounsel for a recommendation on HotDocs® customizers who are familiar with WealthDocs™ programming to help minimize the likelihood that customization adversely affects the function of WealthDocs™ in the member’s office.
Part X
Ancillary Documents

10.01 Completing the Estate Plan

A well-designed trust-based estate plan depends on a number of other documents to ensure that the client’s estate planning objectives are met. WealthDocs™ includes many “ancillary” documents to create a comprehensive plan:

<table>
<thead>
<tr>
<th>Ancillary Documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Check the boxes next to the documents to assemble.</td>
</tr>
<tr>
<td>Click the button next to the boxes to enter information.</td>
</tr>
<tr>
<td>Select All</td>
</tr>
<tr>
<td>Set to All Default Templates</td>
</tr>
<tr>
<td>Clear All</td>
</tr>
<tr>
<td>Set to All Custom Templates</td>
</tr>
</tbody>
</table>

- (Default) Portfolio Inserts
- (Default) Trust Information Page
- (Default) Trust Summary
- (Default) Pour-Over Will
- (Default) Name and Fiduciary Summary
- (Default) Funding Instructions
- (Default) Durable Power of Attorney
- (Default) Certificate of Trust
- (Default) Affidavit of Trust
- (Default) Assignment of Personal Property
- (Default) HIPAA Authorization
- (Default) Healthcare Power of Attorney
- (Default) Living Will
- (Default) Property Agreement
- (Default) Personal Property Memorandum
- (Default) DocuBank Enrollment Form
- (Default) Legal Directives Enrollment Form
- (Default) Trust ID Cards
- (Default) Funding Reference Card

Each of the ancillary documents is described in brief below.
10.02 **Portfolio Inserts**
These are designed to separate the estate planning documents that you prepare for clients as you insert the documents into an estate planning binder, or portfolio. The inserts contain brief instructional information to help the clients better understand how each of the documents will be used.

10.03 **Trust Information Page**
This document simply states the name of the trust, the initial trustees, and the date the trust was executed. It is designed as a quick reference to assist clients or their trustees in funding the trust.

10.04 **Trust Summary**
This article-by-article explanation of the client’s trust is generated using the client’s answer file, making it unique for each client’s plan. It is intended as a layman’s guide to help the client better understand the purpose behind the provisions of the trust and can be used as an alternative to sending a complete trust draft to clients for review.

10.05 **Pour-Over Will**
The “Pour-Over” Will is a will that transfers any assets not held in the trust at the client’s death into the trust for administration in accordance with the trust terms. This Will is also used to name guardians of the minor children.

It is important that you and your clients understand that the Pour-Over Will is designed to complement, not replace, the trust funding process; for it to have legal effect the Pour-Over must be probated like any other Will. It is also important to coordinate allocation and payment of taxes and expenses with the terms in the RLT. WealthDocs™ contains language in both the RLT and the Pour-Over Will designed to ensure that expenses are properly allocated, and that the trustee and executor can work together as seamlessly as possible.

10.06 **Name and Fiduciary Summary**
This document is used to confirm the spelling of names and the assigned duties of each person named as a decision maker in the client’s estate plan. It identifies the client(s), their children (if any), and all fiduciaries and other decision makers.

10.07 **Funding Instructions**
This document is designed to help your clients (and you or your staff) better understand the process by which property will be transferred to the trust.
10.08 **Durable Power of Attorney**

The Durable Power of Attorney enables the client (“Principal”) to appoint one or more agents or “attorneys-in-fact” (often the same person as the grantor’s Successor Trustee) to transfer assets into the trust during the grantor’s incapacity. It also gives the agent broad authority over assets not owned by the trust, such as retirement accounts and life insurance policies.

The agent can also be granted other important powers, such as the power to pursue legal action on the principal’s behalf, power to receive Social Security benefits on the agent’s behalf, and power to transact other personal business for the principal. If the client intentionally has not transferred assets into the trust – like professional corporation stock or incentive stock options – those assets should be specifically mentioned in the power of attorney through custom-drafting in the assembled document.

The WealthDocs™ durable power of attorney contains extensive options and several classes of powers:

<table>
<thead>
<tr>
<th>Durable Power of Attorney</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DPA Agent Powers</strong></td>
</tr>
<tr>
<td>☐ DPA General Powers</td>
</tr>
<tr>
<td>☐ DPA Powers Regarding Trusts</td>
</tr>
<tr>
<td>☐ DPA Powers Regarding Insurance</td>
</tr>
<tr>
<td>☐ DPA Powers Regarding the Principal</td>
</tr>
<tr>
<td>☐ DPA Powers Regarding Gifting</td>
</tr>
<tr>
<td>☐ DPA Incidental Powers</td>
</tr>
<tr>
<td>☐ DPA Administrative Powers</td>
</tr>
</tbody>
</table>

10.09 **Certification or Affidavit of Trust**

These documents are used to prove the trust’s existence without revealing the dispositive provisions of the trust. The Certification is generally designed to stand on its own, listing only the name of the trust, the trust’s date, the original trustees, and a few other salient facts. The Affidavit, on the other hand, may have several of the trust’s articles attached to it. Many practitioners attach the following trust articles to an Affidavit of Trust:

- Establishing the Trust
- Trustee Succession
- Trust Administration
- Trustee’s Powers
- General Provisions

Other practitioners may insert only one or a few of these. Some attorneys may only attach a copy of the first page of the trust and a copy of the signature page. Decide which method is most effective and efficient in your area. (Note that you will manually attach the trust articles; WealthDocs™ will not do this for you. This is because of the broad diversity among
practitioners’ methods and the fact that many of those articles are often customized by WealthDocs™ users.)

10.10 Assignment of Personal Property

This document is designed essentially as a Bill of Transfer, assigning all of the client’s personal property to their trust. Remember that this does not obviate the need to formally transfer titled property to the trust. In addition, it is a good practice to have clients execute new Assignments of Personal Property from time to time. This may be a good benefit to add to your client trust maintenance program.

10.11 HIPAA Authorization

The HIPAA regulations also set forth the requirements for a written authorization to receive protected health information. The WealthDocs™ HIPAA Authorization incorporates these requirements while giving the drafter the flexibility to create broad authorizations or those limited in scope as to the type of information and the purpose for release.

It is important to specify the expiration period for the HIPAA authorization. It is often a good idea to have the authorization remain in effect for a period of time after the client’s death, to allow trusted individuals to access medical information in the event of a wrongful death or malpractice claim, or where access to medical information is otherwise needed after the client’s death. Make sure that the document complies with your state’s law. Some jurisdictions drastically limit the accessibility of medical information even with a HIPAA authorization, and some restrict the time frame of accessibility beyond the limitations of the federal HIPAA rules.

**Note:** Some health care providers (e.g., the Mayo Clinic) require specific mention of that particular provider by name before they will release protected health information pursuant to a written authorization. WealthDocs™ allows the user to specifically identify providers or to leave the medical provider blank to address this issue.

10.12 Health Care Power of Attorney

In addition to naming agents for health care purposes, this document serves to name the “Personal Representative” for purposes of receiving protected health information, as set forth under the HIPAA regulations (45 CFR Ch. 164). These regulations provide that only the Personal Representative named in a Health Care Power of Attorney has the same rights to protected health information as the patient.

The Health Care Representative named in this document may have other very potent powers, including the ability to obtain medical care on the principal’s behalf, coordinate with and replace health care providers, obtain psychiatric care on the principal’s behalf, etc. These decisions to grant or withhold these powers should be discussed with your clients.
10.13   Living Will
These documents are used so the client’s health care wishes can be carried out by medical personnel in the event the client becomes incapacitated or terminally ill. Generally, a “living will” and “health care proxy” is used. These are state-specific documents and will require modification – often times substantial – from the WealthDocs™ template documents. There are many state specimens in the State Specific Templates folder in WealthDocs™, and more will be scheduled for programming as members request.80

Because the Living Will typically deals with end-of-life decisions, you should integrate your client’s unique religious, ethnic, and personal preferences. There are sample documents and provisions on the Knowledge Base designed to help facilitate this process. The client’s clergy may be able to provide some recommended language, and you may find abundant resources on the Internet. But because of the great importance of the issues addressed in the Living Will, you must make it a point to tailor that document’s provisions to suit your client’s needs.

10.14   Property Agreement
This document memorializes the agreement between husband and wife concerning the ownership and characterization of their property as community or separate property, tenancy-in-common or joint tenancy.

10.15   Personal Property Memorandum
If your client reserves the power (in Article Six of their RLT) to dispose of tangible personal property by written memorandum (see the discussion at 3.20(d), above) this document is used for that purpose.

10.16   DocuBank® Enrollment Form
DocuBank® is an online storage service for clients’ medical directives and other health care documents. As a part of their service, DocuBank® issues a plastic wallet card to your client with reference information concerning your client and his or her medical documents. If your client has a medical emergency anywhere in the world, medical personnel can obtain access to your client’s medical document by calling a toll-free number. DocuBank® will then fax the medical documents to the medical service provider. For more information, visit www.docubank.com.

DocuBank® is a registered trademark of Advance Choice, Inc.

80 If a member requests the addition of a state statutory document form to the WealthDocs™ library, we ask the following to help expedite the process: First, we ask that the member provide us with a copy of the statute establishing the form, and a copy of the statutory form itself in an editable format. We will then schedule the new statutory form for release in a software update.
The DocuBank™ wallet card looks like this:

![DocuBank™ wallet card image]

### 10.17 Legal Directives Enrollment Form

Legal Directives Medical Access Program provides essentially the same services as those described in 10.16, above. An interesting feature unique to Legal Directives is their “Law Firm Program,” which allows the client’s estate planning attorney to brand the client’s wallet card with the law firm’s logo and contact information, providing another unique “branding” opportunity. For more information, visit [www.legaldirectives.com](http://www.legaldirectives.com).

### 10.18 Trust ID Cards

These ID cards can be printed on Avery™ card stock and given to the clients as a quick funding reference for them. Many WealthCounsel members attach the ID card to the back of the member’s business card and laminate them, creating a handy reference for the client. (This also helps “brand” your services!)

### 10.19 Funding Reference Card

This is a quick-reference card reminding the client about methods by which assets are transferred to their RLT.
EP101 – RLTs and Ancillary Documents

Appendices

1. Lifetime GPOA funding information
   a. PLR 200210051
   b. PLR 200210021

2. The Qualified Terminable Interest Property (QTIP) Election, WG&L Estate Planning Treatises

3. PowerPoint® presentation slides – Marital Deduction discussion
Dear [Name],

This is in response to the June 25, 2001 letter and other correspondence requesting rulings concerning the estate and gift tax consequences applicable to a trust. You have requested the following rulings:

**Headnote:**
For purposes of estate and gift tax consequences, value of entire trust instrument will be includible in gross estate of first spouse to die, surviving spouse's Code Sec. 2501; gift of entire interest in trust will qualify for marital deduction under Code Sec. 2523; and to extent that family trust is funded, any funds originating from surviving spouse won't be considered gifts.

**Reference(s):** Code Sec. 2033; Code Sec. 2038; Code Sec. 2041; Code Sec. 2501; Code Sec. 2523;

**Full Text:**

Person to contact:

Telephone Number:

In Re:

Refer Reply To:

CC: PSI: B04-PLR-135429-01

Date:

DECEMBER 10, 2001

Legend:

Husband

Wife

Trust

Date 1

Date 2

Dear [Name],

This is in response to the June 25, 2001 letter and other correspondence requesting rulings concerning the estate and gift tax consequences applicable to a trust.

You have requested the following rulings:
1. The value of the entire Trust will be includible in the gross estate of the first spouse to die.
2. On the death of the first spouse, the surviving spouse will be treated as making a gift that qualifies for the marital deduction to the deceased spouse with respect to the portion of the Trust property that is attributable to the surviving spouse's contributions to the Trust.
3. To the extent that the Family Trust is funded, any portion of the property that passes to the Family Trust that originated with the surviving spouse will not constitute a gift by such spouse.
4. Future payments from the Family Trust to beneficiaries other than the surviving spouse will not constitute a gift from the surviving spouse to these beneficiaries, and none of the property attributable to the surviving spouse held in the Family Trust will be includible in the estate of the surviving spouse.

The facts submitted are as follows:

Husband and Wife, collectively the Donors, created Trust on Date 1. Trust was amended and restated on Date 2. Trust is funded with assets that the Donors own as joint tenants with right of survivorship or in their individual capacity.

Article VI of Trust provides that the Trust may be altered or amended by either Donor with the consent of the trustee(s) while both Husband and Wife are living. Article VI further provides that during the joint lives of Husband and Wife, the Trust may be revoked by either of the Donors, in whole or in part, and the trustee(s) shall, if so directed, transfer and convey in accordance with the direction of the Donors, any or all of the Trust property then held. Upon the death of either Husband or Wife, the Trust will become irrevocable.

Article XVIII provides that during the joint lives of the Donors, the trustee(s) shall pay all of the net income to the Donors, unless the Donors request in writing that a portion of such income be added to the principal. Article XVIII further provides that the trustee(s) shall pay to the Donors, or in accordance with their instructions, so much of the principal as the Donors, or either Donor, may request.

Article XIX provides for division of Trust upon the death of the first of the Donors to die.

Article XIX, Paragraph A provides that an amount of Trust property equal to the maximum marital deduction allowable to the deceased spouse's gross estate reduced by the amount necessary to create the largest taxable estate, which after utilizing the unified credit, will result in no tax due is to be transferred to a Marital Trust. During the life of the surviving spouse, the trustee(s) shall pay the net income to the surviving spouse at least quarter-annually, and such amounts of principal as the surviving spouse may direct. Upon the death of the surviving spouse, the trustee(s) shall pay over any remaining principal to such persons that the surviving spouse shall appoint by his or her Last Will.

Article XIX, Paragraph B provides that the remaining balance of Trust property is to be placed in a Family Trust. During the life of the surviving spouse, the trustee(s) is to pay all the net income to the surviving spouse. The trustee(s) may also pay so much principal allocated to the Family Trust to or for the benefit of surviving spouse and the issue of both Donors, as the trustee(s) shall deem advisable for their health, support, maintenance, or education. Upon the death of the surviving spouse, the remaining income and principal in the Family Trust shall be distributed to the Donor's living issue per stirpes.

Article XXVII of Trust provides that the following persons will act as trustee(s) in the following order of succession: 1) Husband and Wife shall act as co-trustees during their joint lives, 2) the surviving Donor, 3) the living children of the Donors jointly or the survivor(s) of Donors' children, 4) trustee(s) chosen by a majority of the beneficiaries, and 5) additional or successor trustees may be appointed by the trustees then serving.

**LAW AND ANALYSIS**

**Ruling 1**

Section 2001 (a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2038(a) provides that the value of the gross estate includes the value of all property, to the extent of any interest therein, of which the decedent has at anytime made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the
enjoyment thereof was subject at the date of death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished this power during the three-year period ending on the date of the decedent’s death.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942.

Section 2041(b)(1) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent is not deemed a general power of appointment.

Section 20.2041-1 (b) (2) of the Estate Tax Regulations provides that the term "power of appointment" does not include powers reserved by the decedent to himself within the concept of sections 2036 to 2038.

Section 1014(a) 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 (or alternate valuation date).

Section 1014(b)(9) provides that, for purposes of section 1014(a), property acquired from the decedent includes property acquired from the decedent by reason of death, form of ownership, or other conditions, including property acquired through the exercise or non-exercise of a power of appointment, if the property is required to be included in determining the value of the decedent's gross estate for federal estate tax purposes.

Section 1014(e), however, provides an exception to the general rule of section 1014(a). Under section 1014(e), if 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.

In this case, each Donor holds a power to revoke the entire trust during their joint lifetime. Thus, the portion of the Trust property that the deceased Donor transferred to the Trust would be includible in the deceased Donor's gross estate under section 2038.

Either Donor has the power to direct the trustee(s) to pay so much of the principal as the Donor may request to himself or in any other manner in accordance with the Donor's instructions. This power is not limited to specific individuals, and can be exercised in favor of Donor, Donor's creditors, Donor's estate, and the creditors of Donor's estate. Thus, the portion of the Trust property that the surviving Donor transferred to the Trust would be includible in the deceased Donor's gross estate under section 2041.

In addition, section 1014(e) will apply to any Trust property includible in the deceased Donor's gross estate that is attributable to the surviving Donor's contribution to Trust and that is acquired by the surviving Donor, either directly or indirectly, pursuant to the deceased Donor's exercise, or failure to exercise, the general power of appointment over the Trust property.

Ruling 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself.

Section 2523 provides that where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

In this case, the surviving Donor will relinquish dominion and control over his or her interests in the Trust
property on the death of the first Donor. Accordingly, on the death of the first Donor, the surviving Donor will make a completed gift under section 2501 of the surviving Donor's entire interest in Trust. This gift will qualify for the marital deduction under section 2523.

Ruling 3

As discussed above, the surviving Donor is treated as making a completed gift of his or her interest in Trust on the death of the first deceasing Donor. Also, as discussed above, a portion of Trust property will be subject to inclusion in the deceased Donor's gross estate under section 2038, and a portion will be subject to inclusion under section 2041. Accordingly, to the extent the Family Trust is funded, property passing to the Family Trust is treated as passing from the deceased Donor, and not from the surviving Donor.

Ruling 4

Any future payments from the Family Trust to beneficiaries other than the surviving Donor will not constitute a gift from the surviving Donor to those beneficiaries. None of the assets held in the Family Trust will be includible in the surviving Donor's gross estate, since the surviving Donor will possess only an income interest with respect to the assets in the Family Trust.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Lorraine E. Gardner
Assistant to Branch Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy of letter for section 6110 purposes

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Private Letter Ruling 200101021, 1/08/2001, IRC Sec(s). 2033; 2038; 2041; 2501; 2523

UIL No. 2033.00-00; 2038.00-00; 2041.03-00; 2501.00-00; 2523.00-00

Headnote:

Trust for couple’s benefit will be included in decedent spouse's estate, with surviving spouse treated as making completed gift of all interest in trust upon spouse's death.

Reference(s): Code Sec. 2033; Code Sec. 2038; Code Sec. 2041; Code Sec. 2501; Code Sec. 2523;

Full Text:

Release Date: 1/5/2001

Date: October 2, 2000

Refer Reply To: CC:PSI:4 - PLR-118834-99

Re: ***

LEGEND:

Grantor A = ***

Grantor B = ***

Trust = ***

$x = ***

Dear ***

This is in response to your letter dated November 24, 1999, and subsequent correspondence, requesting a ruling concerning the estate and gift tax consequences of the creation of a proposed trust (Trust) under sections 2033, 2038, 2041, 2501, and 2511 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Grantor A and Grantor B, who are husband and wife, propose to create a joint trust (“Trust”). Grantor A will be the initial trustee of Trust. The Grantors will fund Trust with assets that they own as tenants by the entireties having a value of approximately $x.

Under the terms of Trust, during the joint lives of the Grantors, the trustee may apply income and principal of Trust as the trustee deems advisable for the comfort, support, maintenance, health and general welfare of the Grantors. The trustee may also pay additional sums to either or both of the Grantors or to a third person for the benefit of either or both Grantors as Grantor A directs, or if he is not capable of this decision, then as Grantor B directs. While both Grantors are living, either one may terminate Trust by written notice to the
other Grantor. If Trust is terminated, the trustee will deliver the trust property to the Grantors in both their names as tenants in common. Either Grantor may also amend the trust while both grantors are living by delivering to the other Grantor the amendment in writing at least 90 days before the effective date of the amendment.

Upon the death of the first Grantor to die, he or she possesses a testamentary general power of appointment, exercisable alone and in all events, to appoint part or all of the assets of Trust, free of trust, to such deceased Grantor's estate or to or for the benefit of one or more persons or entities, in such proportions, outright, in trust, or otherwise as the deceased Grantor may direct in his or her will.

If the first Grantor to die fails to fully exercise his or her testamentary general power of appointment, and providing the surviving Grantor survives the first Grantor to die by at least six months, an amount of Trust property sufficient to equal the largest amount that can pass free of federal estate tax by reason of the unified credit, is to be transferred to an irrevocable Credit Shelter Trust. Any amount in excess of the amount needed to fully fund the Credit Shelter Trust that has not been appointed by the deceased Grantor will pass outright to the surviving Grantor.

The terms of the Credit Shelter Trust provide that during the life of the surviving Grantor, the trustee is to pay or apply for the benefit of the surviving Grantor any part of the income and/or principal of the trust as is reasonably necessary for the survivor's support and maintenance. The trustee shall also have the authority to pay or apply for the benefit of the joint descendants of the Grantors any portion of the income and/or principal of the trust as the trustee deems necessary for such descendants' maintenance, support, and education. All distributions however, shall be limited by an ascertainable standard relating to health, education, support, or maintenance. Upon the death of the surviving Grantor, he or she shall have a limited power to appoint the Credit Shelter Trust assets to any one or more of the class consisting of the Grantors' joint descendants. Any assets not so appointed are to be divided into equal shares so as to provide one share for each living child of both Grantors and one share for the surviving issue collectively, per stirpes, of a deceased child of both Grantors.

You have requested the following rulings:

1. The contribution of jointly held assets to Trust will not constitute a gift by either Grantor A or Grantor B.
2. Payments to or for the benefit of either Grantor during the term of Trust will not be considered a gift, or, if so, the gift will qualify for the gift tax marital deduction.
3. The value of the entire Trust will be includable in the gross estate of the first Grantor to die.
4. On the death of the first deceasing Grantor, the surviving Grantor will be treated as making a gift that qualifies for the marital deduction, to the deceasing Grantor, with respect to the portion of the Trust property that is attributable to the surviving Grantor's contributions to the Trust.
5. To the extent that the Credit Shelter Trust is funded, any portion of the funds that will pass to the trust that originated with the surviving Grantor will not constitute a gift by such Grantor.
6. Future payments from the Credit Shelter Trust to beneficiaries other than the Surviving Grantor will not constitute a gift from the surviving Grantor to those beneficiaries, and none of the assets attributable to the surviving Grantor held in the Credit Shelter Trust will be includible in his or her gross estate.

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2038(a) of the Code provides that the value of the gross estate includes the value of all property of which the decedent has at any time made a transfer (except where there has been a bona fide sale for adequate and full consideration in money or money's worth) by trust or otherwise where the enjoyment thereof was subject at the date of death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished this power within the three year period ending on the date of the decedent's death.

Section 2041(a)(2) provides for the inclusion in the gross estate of any property to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942.

Section 2041(b)(1) provides that the term "general power of appointment" means a power that is
exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent is not deemed a general power of appointment.

Section 20.2041-1(b)(2) provides that the term power of appointment does not include powers reserved by the decedent to himself within the concepts of sections 2036 to 2038.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 25.2511-2(b) provides that as to any property, or part therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property to himself or herself.

Section 2523 provides that where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

Section 1014(a) 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 the decedent is the fair market value of the property at the date of the decedent's death (or alternate valuation date).

Section 1014(b)(9) provides that, for purposes of section 1014(a), property acquired from the decedent includes property acquired from the decedent by reason of death, form of ownership, or other conditions, including property acquired through the exercise or non-exercise of a power of appointment, if the property is required to be included in determining the value of the decedent's gross estate for federal estate tax purposes.

Section 1014(e), however, provides an exception to the general rule of section 1014(a). Under section 1014(e), if 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.

RULING #1. Grantor A and Grantor B propose to transfer property held as tenants by the entireties to Trust. The Grantors will each retain the power to terminate Trust by written notice to the other Grantor. If Trust is terminated, the trustee will deliver the trust property to the Grantors in both their names as tenants in common. We conclude that the initial contribution of assets to Trust as proposed will not constitute a completed gift by either Grantor under section 25.2511-2(c), since each will retain the right, exercisable unilaterally, to revoke their respective transfer, and revest title in themselves.

RULING #2. If either Grantor exercises the right to terminate Trust, each Grantor will receive an undivided 50% interest in the remaining balance of the Trust corpus, as a tenant in common. Therefore, distributions of Trust property to either Grantor during their joint lives will constitute a gift by the other Grantor to the extent of 50% of the value of Trust assets distributed. The gift will qualify for the gift tax marital deduction under section 2523.

RULING #3 AND #4. Upon the death of the first Grantor to die, he or she will possess a testamentary power exercisable alone and in all events, to appoint part or all of the assets of the Trust, free of trust, to such deceased Grantor's estate or to or for the benefit of one or more persons or entities, in such proportions, outright, in trust, or otherwise as the deceased Grantor may direct in his or her will.

We conclude that, on the death of the first Grantor to die, the portion of the Trust property attributable to the property the deceased Grantor transferred to Trust will be includible in the deceased Grantor's gross estate under section 2038. The balance of the property attributable to the property the surviving Grantor contributed to Trust will be includible in the deceased Grantor's gross estate under section 2041.

Further, on the death of the first deceasing Grantor, the surviving Grantor is treated as relinquishing his or her dominion and control over the surviving Grantor's one-half interest in Trust. Accordingly, on the death of the first deceasing Grantor, the surviving Grantor will make a completed gift under section 2501 of the surviving Grantor's entire interest in Trust. This gift will qualify for the marital deduction under section 2523.
In addition, section 1014(e) will apply to any Trust property includible in the deceased Grantor’s gross estate that is attributable to the surviving Grantor’s contribution to Trust and that is acquired by the surviving Grantor, either directly or indirectly, pursuant to the deceased Grantor’s exercise, or failure to exercise, the general power of appointment. See, H.R. Rept. 97-201, 97th Cong., 1st Sess. (July 24, 1981).

RULINGS #5 AND #6. As discussed above, the surviving Grantor is treated as making a completed gift of his or her interest in Trust on the death of the first deceasing Grantor. Also, as discussed above, a portion of the Trust property will be subject to inclusion in the deceased Grantor’s gross estate under section 2038, and a portion will be subject to inclusion under section 2041. Accordingly, to the extent the Credit Shelter Trust is funded, property passing to the trust is treated as passing from the deceased Grantor, and not from the surviving Grantor.

Similarly, any future payments from the Credit Shelter Trust to beneficiaries other than the surviving Grantor will not constitute a gift from the surviving Grantor to those beneficiaries. None of the assets held in the Credit Shelter Trust will be includible in the surviving Grantor’s gross estate, since the surviving Grantor will possess only a special power of appointment with respect to the assets in the Credit Shelter Trust.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Associate Chief Counsel

(Passthroughs and Special Industries)

By: George Masnik

Branch Chief

Branch 4

Enclosure

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A series of private letter rulings over the past several years seemed to indicate that a gift to a predeceased spouse would qualify for the gift tax marital deduction and enable use of that spouse’s estate tax applicable exclusion amount. In Estate of Lee, the Tax Court, stating the obvious, recently held that a bequest to a predeceased spouse does not qualify for the estate tax marital deduction. The Tax Court’s decision, equally applicable in the gift tax marital deduction context, strongly suggests that practitioners would be wise to adhere to tried-and-true mechanisms for utilizing the estate tax applicable exclusion amounts of both spouses – regardless of who dies first. Beginning seven years ago, the Internal Revenue Service issued the first of four PLRs that seemed to suggest there was a way to use a less wealthy spouse’s applicable exclusion amount if that spouse were the first to die. The latest of these rulings was PLR 200604028.

Private letter rulings seemed to suggest spouses could share exemptions. But the Tax Court, in *Estate of Lee*, has spoiled the fun

A series of private letter rulings over the past several years seemed to indicate that a gift to a predeceased spouse would qualify for the gift tax marital deduction and enable use of that spouse’s estate tax applicable exclusion amount. In Estate of Lee, the Tax Court, stating the obvious, recently held that a bequest to a predeceased spouse does not qualify for the estate tax marital deduction. The Tax Court’s decision, equally applicable in the gift tax marital deduction context, strongly suggests that practitioners would be wise to adhere to tried-and-true mechanisms for utilizing the estate tax applicable exclusion amounts of both spouses—regardless of who dies first.

**Traditional Approaches**

Basic estate planning for a married couple with an aggregate net worth larger than one federal estate tax applicable exclusion amount often includes taking steps to ensure that both spouses' applicable exclusion amounts are utilized to the extent necessary to cause the federal estate tax at the death of the surviving spouse is as small as possible. At the beginning of the estate planning process, planners frequently find one spouse’s net worth is a good deal larger than the other’s and the other owns property worth far less than one federal estate tax applicable exclusion amount. Traditionally, the estate planner recommends in this situation that the wealthier spouse transfer to the less wealthy spouse, by inter vivos outright gift, assets with a
value that likely will be sufficient to enable full use of the less wealthy spouse's applicable exclusion amount if the less wealthy spouse is the first spouse to die. Such an inter vivos gift obviously qualifies for the federal gift tax marital deduction.1

For a variety of reasons, sometimes illogical and/or rooted in emotion, it may be impossible to convince the wealthier spouse to make a lifetime gift to the other spouse. The wealthier spouse's objections often boil down to a fear of giving the donee spouse unilateral control over the transferred property.

Occasionally, the recalcitrant spouse may be persuaded to make an inter vivos transfer to an irrevocable qualified terminable interest property (QTIP) trust. A transfer to such a trust facilitates using the less wealthy spouse's applicable exclusion amount if that spouse dies first, but the trust can be structured to confer no dispositive control on the less wealthy spouse. Moreover, depending on the provisions of the trust's governing instrument, the wealthier spouse can be the trustee without incurring adverse estate tax consequences. This approach, however, has its own set of problems, not the least of which is that an irrevocable transfer in trust is not easily recoverable if circumstances change down the road.

Siren Song

Beginning seven years ago, the Internal Revenue Service issued the first of four PLRs2 that seemed to suggest there was a way to use a less wealthy spouse's applicable exclusion amount if that spouse were the first to die-without the wealthier spouse's having to transfer any property while the less wealthy spouse was living. The latest of these rulings was PLR 200604028 (issued Jan. 27, 2006).

In PLR 200604028, the wealthier spouse (S1) created and funded a revocable trust (Trust A). Under Trust A's governing instrument, S1 retained the beneficial interests and powers ordinarily held by the grantor of a revocable trust. Upon S1's death, all remaining trust property was to be distributed outright to the less wealthy spouse (S2) if S2 were then living. Any assets S2 disclaimed were to pass to a typical bypass trust. S2 was to receive the entire net income of the trust and might receive discretionary distributions of principal for S2's health, education, maintenance and support. If S2 predeceased S1, then, upon S1's death, the assets of Trust A were to be held and administered in trust for the benefit of S1 and S2's children.

The governing instrument of Trust A also provided that, if S2 were to predecease S1, S2 would possess a testamentary general power of appointment with respect to Trust A's assets having a value equal to S2's applicable exclusion amount minus the value of S2's taxable estate determined without reference to the value of Trust A's assets subject to S2's testamentary power of appointment. S2 proposed to exercise this power of appointment in favor of his own revocable trust (Trust B).

Under the terms of Trust B, S2 retained the beneficial interests and powers ordinarily possessed by the grantor of a revocable trust. At S2's death, all remaining trust property was
to be distributed outright to S1 if S1 survived S2. Any assets S1 disclaimed were to pass to a
credit shelter trust from which S1 was to receive the entire net income and could, at the
trustee’s discretion, receive discretionary distributions of principal for S1’s health, education,
maintenance and support. If S1 predeceased S2, then, upon S2’s death, the assets of Trust B
were to be held and administered in trust for the benefit of S1 and S2’s children.

The IRS first ruled that, if S2 predeceases S1, S2’s holding the testamentary general power of
appointment will cause the value of the Trust A assets subject to the power to be included in
S2’s gross estate.

The IRS next ruled that, if S2 predeceases S1, S1 will be considered to have made a gift to S2
of the Trust A assets subject to S2’s testamentary general power of appointment and that such
gift will qualify for the gift tax marital deduction under Internal Revenue Code Section 2523.
Upon S2’s death, S1 will relinquish dominion and control over the Trust A property subject to
S2’s testamentary power of appointment, which will result in a completed gift by S1 to S2. Presumably because S1 will retain the powers to amend Trust A’s governing instrument, to
revoke Trust A and to withdraw assets from Trust A, S1’s conveyance of assets to Trust A will
not be a completed gift.

The IRS’ third ruling was that the assets passing from Trust A to Trust B by virtue of S2’s
exercise of the testamentary power of appointment will not be treated as a gift from S1 to the
other beneficiaries of Trust B (that is to say, the children of S1 and S2.) S2, and not S1, will
be treated as the recipient, owner and transferor of all assets subject to S2’s power of
appointment. This is the case even though S1 is in complete, unilateral control of the
disposition of Trust A’s assets right up until S2’s death.

Finally, the IRS ruled that, if S2 predeceases S1, the value of any property passing from Trust
A to Trust B that is then disclaimed by S1 will not be included in S1’s gross estate. S1 will not
hold a general power of appointment under IRC Section 2041 even though S1 will be the
beneficiary, for life, of a credit shelter trust under Trust B. Further, the value of such property
will not be includible in S1’s gross estate under IRC Section 2036 because S1, not being
considered the transferor of such property, cannot be treated as having made a transfer with
any retained interests or rights.

**Request for a Public Ruling**

This series of rulings, ending with PLR 200604028, generated considerable interest and
attention in the estateplanning community. Indeed, in July of 2004 shortly after PLR
200403094 was issued, Robert J. Rosepink, the then president of the American College of
Trust and Estate Counsel (ACTEC), sent a letter to the IRS requesting that the Service issue a
revenue ruling or other public pronouncement on which taxpayers may rely holding that: (1)
property belonging to a surviving spouse that is subject to a testamentary general power of
appointment held by a predeceased spouse is includable in the predeceased spouse’s gross
estate under IRC Section 2041; and (2) the gift made by the surviving spouse by granting the
general power of appointment to the first spouse to die qualifies for the gift tax marital
deduction under IRC Section 2523(a).

Almost four years later, the IRS has yet to comply with ACTEC’s request. It seems that, to
borrow a phrase from the immortal Jack Benny, the IRS is thinking it over.

**PLRs' Achilles Heel**

Perhaps the most troubling aspect of PLR 200604028 and its predecessors, notwithstanding the
potential benefit to taxpayers, is the IRS’ conclusion in the PLRs that, upon the death of the
first spouse to die, when the testamentary general power of appointment can no longer be
revoked by the surviving spouse, a gift has been made to the deceased spouse that qualifies for
the gift tax marital deduction. In the PLRs, the IRS simply pronounces that a gift qualifying for
the marital deduction under IRC Section 2523(a) occurs under the facts presented. No analysis
of or reasoning behind this conclusion is offered.

The conclusion, though taxpayer-friendly, defies common sense. It is illogical to posit that the
transfer that takes place when the testamentary general power of appointment can no longer be
revoked occurs before the death of the first spouse to die for the simple reason that the power
is testamentary—that is, it is exercisable only by will. It is axiomatic that a will has no legal
effect whatsoever until the death of the testator. It follows, then, that the transfer that takes
place when the power can no longer be revoked occurs at the death of the holder of the
power—in other words, when the holder is dead and his will becomes operative. Thus, to
believe that the technique seemingly blessed by the IRS in the PLRs works, one must believe
that it is possible to make a completed gift to a corpse and that such gift qualifies under IRC
Section 2523(a) for the gift tax marital deduction.

It’s beyond dispute that not one word in IRC Section 2523(a) supports the absurd notion that a
gift tax marital deduction results from a transfer from a living spouse to a dead spouse. Quite
to the contrary, IRC Section 2523(a) speaks of a gift of an interest in property "to a donee who
at the time of the gift is the donor’s spouse." Much as we might wish it were otherwise, a
deceased spouse is manifestly not such a donee.

Apparently, the Tax Court sees it the same way. Witness its ruling on Dec. 20, 2007 in Estate
of Lee v. Commissioner, T.C. Memo. 2007-371.5

Kyong Lee (the spouse) died on Aug. 15, 2001. Kwang Lee (the decedent) died on Sept. 30,
2001. The decedent’s estate was substantially larger than the spouse’s. Both intended that their
respective estate plans achieve the maximum tax benefits available. The spouse’s will contained
a provision stating: "[A]ny person who shall die within six (6) months after my death shall be
deemed to have predeceased me." The decedent’s will stated: "[A]ny person, other than my
wife, who shall die within six (6) months after my death shall be deemed to have predeceased
me . . . In the event that my wife shall die at the same time as I, or under circumstances such
as to render it difficult or impossible to determine who died first, my wife shall be deemed to have survived me."

The decedent's and spouse's estates were administered as if the decedent had predeceased the spouse. Under the decedent's estate plan, a marital trust was established for the benefit of the spouse as if she were still alive. The estate tax returns of the spouse and the decedent were constructed as if the decedent had died first. The decedent's estate tax return claimed the marital deduction with respect to the marital trust that was purportedly being held and administered for the spouse.

The decedent's estate argued that the decedent intended that the spouse be deemed to have survived him were he to die within six months after the spouse. The decedent's estate relied on IRC Section 2056(b)(3), which states: "For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if-(A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and (B) such termination or failure does not in fact occur." The decedent's estate concluded that this provision permits a deemed change in the order of the deaths of a husband and wife if they die within six months of each other.

In response, the Tax Court explained that "by its terms, section 2056 predicates the marital deduction on the presence of a 'surviving spouse'" and that "we read section 2056(b)(3) to permit a marital deduction even if the passing of an interest to the surviving spouse is conditioned upon the spouse's surviving the decedent by a period not exceeding 6 months, provided the spouse in fact survives the requisite 6 months." The Tax Court also said it construes the term "surviving spouse" in accordance with its ordinary meaning; therefore, a surviving spouse must actually survive, or outlive, his or her spouse.

Because the spouse predeceased the decedent, the court concluded that the spouse cannot be considered a surviving spouse for marital deduction purposes. The Tax Court summed up by saying, "While decedent may have intended that [the spouse], even though dead, be deemed to have survived him, the operation of a will or wills cannot alter the order of the actual deaths of decedent and [the spouse]."

Be Realistic

IRC Section 2523 differs from IRC Section 2056 in that the former does not use the term "surviving spouse" but instead uses the terms "donee" and "donee spouse" to refer to the recipient of a transfer. It cannot reasonably be inferred, however, that this distinction in terminology indicates Congress' intent that a decedent's bequest must be to a living spouse to qualify for the estate tax marital deduction, but a living donor's gift can be to a dead spouse and yet qualify for the gift tax marital deduction.
This difference in the manner in which the two sections refer to a recipient spouse reflects nothing more than Congress' realization of the obvious fact that, in the estate tax marital deduction context, the recipient spouse is always a "surviving" spouse because the transferor spouse is always deceased at the time of transfer. In the gift tax marital deduction context, there could never be a "surviving" spouse but, rather, only a "donee" spouse because the transferor spouse is always living at the time of transfer.

So, while it must be acknowledged that Lee addressed the availability of an estate tax marital deduction, rather than a gift tax marital deduction, this would appear to be an immaterial distinction. In light of Lee, it is hard to imagine the Tax Court's concluding that a gift tax marital deduction would ever be available for a transfer to a spouse who is not a donee but a decedent.

There is no advantage to be obtained by a wealthier spouse's conferring on the other spouse a general power of appointment, not exercisable until the other spouse’s death, with respect to any of the wealthier spouse’s property if conferring the power does not qualify for the gift tax marital deduction. Even before Lee, the plain language of IRC Section 2523(a) foreclosed marital deduction treatment in connection with the transfer of an interest in property to a deceased spouse. Lee has now confirmed this conclusion. Those estate planners who may have been intrigued and enticed by the smoke-and-mirrors approach seemingly encouraged by the four PLRs should return to the undeniably effective means for ensuring that both spouses’ estate tax applicable exclusion amounts are optimally utilized: judicious transfers from one spouse to the other, or from one spouse to an irrevocable QTIP trust for the other's benefit, while both spouses are alive.

[Sidebar] Yes, Lee was about the estate, not the gift tax marital deduction. But that distinction is immaterial.

Endnotes:

1. Internal Revenue Code Section 2523(a).

2. Private Letter Rulings 200101021; 200210051; 200403094 and 200604028.

3. IRC Section 2041(a)(2).


6. Ibid., citing Estate of Mackie v. Comm’r, 64 T.C. 308 (1975), aff’d, 545 F.2d 883 (4th Cir. 1976); and Estate of Shepherd v. Comm’r, T.C. Memo. 1989-610.
7. One might be tempted to argue that there is an advantage to be obtained if a wealthier spouse can, by conferring a testamentary general power of appointment on the other spouse, effectively divest himself of property without making a taxable gift. The theory would be that there can be no gift without a donee, and, with limited exceptions of which none is relevant here, only a living recipient can be a donee. If this argument were viable, it would, of course, make no difference whether conferring the testamentary general power of appointment generated a gift tax marital deduction, and the result would be an enormous loophole in the federal transfer tax system. For those who believe the argument has possibilities, the Brooklyn Bridge is still for sale.

[Author Affiliation]
Charles A. Redd is a partner in the St. Louis, Mo., office of Sonnenschein Nath & Rosenthal LLP
Estate of Kwang Lee, TC Memo 2007-371, Code Sec(s) 2056.

CASE INFORMATION:

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<td>Disposition:</td>
<td>Decision for Commissioner.</td>
</tr>
</tbody>
</table>

HEADNOTE

1. Gross estate—marital deduction—property transfer from decedent to surviving spouse. Estate wasn't entitled to marital deduction for property transferred to pre-deceased wife as if she had survived decedent: Code Sec. 2056(a) predicated deduction on existence of actual surviving spouse. Taxpayer's argument that Code Sec. 2056(b)(3)’s conditional provision permitted it to change spousal death order was misplaced because that provision still required actual surviving spouse. And surviving spouse by its ordinary meaning meant one spouse who outlived other/one who in fact died later. So, regardless of decedent's intent or attempt to use wills to alter death order, statute by its plain language couldn't be satisfied given wife's earlier death.

Reference(s): USTR Estate & Gift Taxes ¶20, 565.04(22) Code Sec. 2056

SYLLABUS

OFFICIAL TAX COURT SYLLABUS

D died 46 days after his wife, W. D's estate claimed a marital deduction for property that was transferred to W as if W had survived D. W's will states that D is deemed to have predeceased W for purposes of W's will if D dies within 6 months after W's death. Although not stated specifically in D's will, D's intention for purposes of D's will was that W also be deemed to have survived D if D died within 6 months after W's death.

Held: D's testamentary intent that D be deemed to have predeceased W will not be recognized as qualifying the estate for the marital deduction for Federal estate tax purposes because sec. 2056, I.R.C., requires that a spouse actually survive his or her spouse in order to be a “surviving spouse”.

COUNSEL
MEMORANDUM OPINION

Anthony J. Frese (Frese), acting in his capacity as executor of the Estate of Kwang Lee and with a mailing address in Hackensack, New Jersey, petitioned the Court to redetermine respondent’s determination of a Federal estate tax deficiency of $1,020,129, a section 6662(a) accuracy-related penalty of $204,026, and a section 6651(a)(1) addition to tax of $255,032 for untimely filing. Currently, this case is before the Court on respondent's motion for partial summary judgment under Rule 121. Respondent argues that he properly disallowed a marital deduction claimed by the Estate of Kwang Lee (decedent's estate) because Kwang Lee (decedent) was not survived by his wife, Kyong Lee (Ms. Lee). Petitioner argues that decedent's estate may benefit from the marital deduction because Ms. Lee survived decedent by operation of decedent's and Ms. Lee's respective wills. We decide whether the estate qualifies for the marital deduction under section 2056. We hold it does not.

Background

Ms. Lee died testate on August 15, 2001, leaving a Last Will and Testament dated June 21, 2001 (Ms. Lee's will). Ms. Lee's will was admitted to probate on September 14, 2001, on which day letters testamentary were issued to decedent.

Decedent died testate on September 30, 2001, also leaving a Last Will and Testament dated June 21, 2001. Decedent's will was admitted to probate, and letters testamentary were issued to Frese as successor executor. After decedent's death, Frese was appointed successor executor of Ms. Lee's estate pursuant to Ms. Lee's will. The wills of decedent and Ms. Lee were drafted by petitioner's counsel, Barbara L. de Mare (Ms. de Mare).

When the estate planning was performed, decedent and Ms. Lee suffered from a serious and ultimately fatal disease. Decedent and Ms. Lee had three children in their twenties and wished to establish trusts for those children. Decedent had been a corporate executive and, because of the nature of his work benefits, most of the assets of decedent and Ms. Lee were held in decedent's name. The joint assets and the assets titled in Ms. Lee's name alone constituted only a minimal portion of the combined estates.

Through their wills, a major objective of decedent and Ms. Lee was to obtain the maximum tax benefits for their respective estates. To fulfill this goal, Ms. de Mare drafted the wills with the following survivorship provisions. Article 9 of Ms. Lee's will states: "Ninth: For purposes of this Will, any person who shall die within six (6) months after my death shall be deemed to have predeceased me". Conversely, decedent's will states:

NINTH: A. For purposes of this Will, any person, other than my wife, who shall die within six (6) months after my death shall be deemed to have predeceased me.

B. In the event that my wife shall die at the same time as I, or under circumstances such as to render it difficult or impossible to determine who died first, my wife shall be deemed to have survived me.

Decedent and Ms. Lee intended that Ms. Lee be deemed to have survived decedent if decedent died within 6 months after the death of Ms. Lee.

The estates of decedent and Ms. Lee were administered as though decedent had predeceased Ms. Lee. The estate tax returns were filed as if decedent died first, and a credit shelter trust was established in decedent's name with the residuary thereof transferred to Ms. Lee as if she were still alive. Decedent's estate's tax return claimed the marital deduction as to the residuary purportedly transferred to Ms. Lee.

Discussion

A. Summary Judgment
Summary judgment is intended to expedite litigation and avoid unnecessary and expensive trials. Fla. Peach Corp. v. Commissioner, 90 T.C. 678, 681 (1988). Summary judgment may be granted with respect to all or any part of the legal issues in controversy "if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." Rule 121(a) and (b); Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), affd. 17 F.3d 965 [73 AFTR 2d 94-1198] (7th Cir. 1994). The moving party bears the burden of proving that there is no genuine issue of material fact, and factual inferences are drawn in a manner most favorable to the party opposing summary judgment. Dahlstrom v. Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982). Petitioner has raised no genuine issue as to any material fact. Accordingly, we conclude that this case is ripe for partial summary judgment.

B. Marital Deduction

Deductions are strictly a matter of legislative grace, and petitioner must show that the claimed deduction is allowed by the Code. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 [69 AFTR 2d 92-694] (1992). Petitioner argues that decedent intended that Ms. Lee be deemed to have survived him were he to die within 6 months after her. Petitioner argues that this intent establishes the ordering of decedent's and Ms. Lee's deaths for estate and related tax purposes. To this end, petitioner relies on section 2056(b)(3):

(3) Interest of spouse conditional on survival for limited period.—For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

(A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

(B) such termination or failure does not in fact occur.

Petitioner argues that section 2056(b)(3) permits the actual order of the death of spouses to be altered for estate and related tax purposes as long as the deaths are still within 6 months of each other.

Respondent argues that the marital deduction requires an actual surviving spouse. Because Ms. Lee died 46 days before decedent, respondent argues, decedent had no surviving spouse and decedent's estate is not entitled to benefit from the marital deduction. Respondent argues that the wills of decedent and Ms. Lee cannot operate to change the order of their deaths. Respondent further argues that the term "survivor" is undefined in the Code and therefore must be given its normal and customary meaning. Respondent states that the plain meaning of "survivor" is one who outlives another.

We begin our analysis with the applicable statute. Section 2056(a) provides for a marital deduction from the value of a decedent's gross estate:

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) Allowance of Marital Deduction. *** the value of the taxable estate shall *** be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

This provision permits a deduction from the value of a decedent's gross estate of an amount equal to the value of property interests that pass from a decedent to his or her surviving spouse. By its terms, section 2056 predicates the marital deduction on the presence of a "surviving spouse". See also sec. 20.2056(a)-1(a), Estate Tax Regs.

We find petitioner's reliance on section 2056(b)(3) to be misplaced. Petitioner argues that section 2056(b)(3) permits a change in the order of the deaths of a husband and wife if they die within 6 months of each other. We disagree. We do not read section 2056(b)(3) to permit any modification to the timing of the actual deaths of a husband and wife. Instead, we read section 2056(b)(3) to permit a marital deduction even if the passing of an interest to a surviving spouse is conditioned upon the spouse surviving the decedent by a period not exceeding 6 months, provided the spouse in fact survives the requisite 6 months, and thus the condition is satisfied. See Estate of Mackie v. Commissioner, 64 T.C. 308, 312 (1975), affd. 545 F.2d 883
As to the term "surviving spouse", we construe that term in accordance with its ordinary meaning. See United States v. Am. Trucking Associations, Inc., 310 U.S. 534, 543-544 (1940); Venture Funding, Ltd. v. Commissioner, 110 T.C. 236, 241-242 (1998), affd. without published opinion 198 F.3d 248 [84 AFTR 2d 99-6929] (6th Cir. 1999). The ordinary meaning of the word "survivor" is one who survives another; i.e., one who outlives another. Building on this definition, the term "surviving spouse" requires that a spouse actually survive his or her spouse; i.e., the later-dying spouse must actually outlive his or her spouse. Because Ms. Lee did not actually survive decedent, i.e., Ms. Lee predeceased decedent, we conclude that Ms. Lee is not a surviving spouse within the meaning of section 2056(a). While decedent may have intended that Ms. Lee, even though dead, be deemed to have survived him, the operation of a will or wills cannot alter the order of the actual deaths of decedent and Ms. Lee. Cf. sec. 20.2056(c)-2(e), Tax Regs. (a presumption, whether supplied by local law, the decedent's will, or otherwise, may operate to determine the order of the deaths of spouses if the actual order of their deaths cannot be determined).

An appropriate order will be issued granting respondent's motion for partial summary judgment. We have considered all arguments by petitioner for a holding contrary to that which we reach herein. To the extent not discussed, we conclude that those arguments are irrelevant or without merit.

An appropriate order will be issued.

1

Rule references are to the Tax Court Rules of Practice and Procedure. Unless otherwise noted, section references are to the applicable versions of the Internal Revenue Code (Code).
15.04 The Qualified Terminable Interest Property Election

15.04[1] The Terminable Interest Rule, Generally

Under Section 2056(b), property interests passing to a surviving spouse that may terminate or fail as a result of the occurrence or nonoccurrence of any event or contingency, resulting in the property in question passing to some other person or persons, are designated as “terminable interests.” Such interests generally do not qualify for the federal estate tax marital deduction. The most common example is the trust in which the surviving spouse will receive the income for life, or until remarriage, or until the youngest child attains a certain age, at which point the interest of the surviving spouse terminates and the trust continues for other beneficiaries. The interest of a surviving spouse in such a transfer does not qualify for the federal estate tax marital deduction. A principal exception to the above rule is described in Section 2056(b)(7), which provides that when the surviving spouse receives all of the income from the transferred property at least annually, and has either a lifetime or a general testamentary power of appointment over that property, which may be exercised by the surviving spouse alone, the transfer will qualify for the federal estate tax marital deduction. This exception applies only if the interest of the surviving spouse in the income is substantially identical to that of a life tenant in property, and if no other beneficiary has an interest in the subject property during the lifetime of the surviving spouse.

In Estate of McCune v. Commissioner, a provision in the will that should the surviving spouse remarry, the monies received by her would be transferred to children and grandchildren, was held not to create a terminable interest, as under state law this was construed to be precatory language not binding on the surviving spouse.

An important element of the terminable interest rule, discussed in connection with the widow's allowance, is that the interest of the surviving spouse be ascertainable at date of death. Thus, a so-called equalization clause, under which the marital deduction bequest is reduced under a formula based on the value of the estate of a surviving spouse, was unsuccessfully attacked by the Service in Estate of Smith v. Commissioner. In Action on Decision File No. 1984-049, the chief counsel recommended acquiescence in this decision.

A more recent example is Private Letter Ruling 8451013, where the will provided that if the estate included nonliquid assets that would not qualify for the marital deduction because they were not reasonably income-producing, the trustee had the option to liquidate them to fund the marital deduction trust. The Service held that the marital deduction would be limited to the value of the remaining assets available to fund the marital deduction trust, since the action of the trustee was not determinable at date of death. As a result, the marital trust was underfunded.

A proposed codicil to a will required all beneficiaries, including a surviving spouse, to execute a release of a right to contest the will within six months after death, and specified that a failure to do so would result in a lapse. Private Letter Ruling 9244020 held this was not a terminable interest, as it merely presented the spouse with alternatives.

In Estate of Grimes v. Commissioner, pursuant to a joint and mutual will, the surviving spouse ended up with a life estate without a general power of appointment. The trust provided that all income was payable to the surviving spouse. It also contained an unusual provision, apparently motivated by state law, stating that the surviving spouse would have no power of appointment over the trust if an election could be made to claim the marital deduction under state law. However, if such an election could not be made, the spouse would have a general power of appointment over the trust. No QTIP election was made and, apparently, the election was not available under state law; the estate now contended that the provision for a general power of appointment kicked in. The Service ruled that it did not qualify since it was not exercisable by the surviving spouse in all events, but only in the event the executor did not make an election under state law that would qualify the trust.
In Private Letter Ruling 8910043, a clever attempt to make a QTIP election was unsuccessful. The surviving spouse made a disclaimer intended to qualify under Section 2518. The property thereupon passed to the decedent's son. He then intended to return it to the estate, where it would pass in a form that would qualify for a QTIP. However, the Service held that the interest of the surviving spouse could not so qualify, since she had made an irrevocable disclaimer and a transfer of the property back to the estate. This would be deemed a transfer from the son, not the decedent.

Where there was a bequest to a spouse in fee simple, but a provision the estate would pass to others on the death of the spouse, the Service construed state law to find the bequest was in fee simple, not a terminable interest. 77

Technical Advice Memorandum 9511002 involved a revocable trust funded with community property. The deceased spouse's community interest was transferred to a trust under an agreement the surviving spouse could amend or revoke. The trust also provided for distribution of income or principal as the surviving spouse directs, but if the spouse became incapacitated, such distributions would only be made to the extent necessary for the health, support, or maintenance of the spouse. The ruling notes that because of the incapacity provision, the trust could not qualify for the marital deduction, because the spouse was not entitled to all income annually. However, since there was no apparent limit on the power of the spouse to revoke the trust, she was deemed to have a right to all income annually under the regulations in any case. The marital deduction was allowed.

A decedent in the state of Washington left the residue of his estate to his spouse provided that she "survives distribution" and "survives distribution of the remainder of my estate." Under state law, title to real property vests automatically in a devisee at death, but personal property must actually be distributed. In Estate of Bond v. Commissioner 78 the court held that the real property would qualify for the marital deduction, since it vested immediately at death, but the personal property would not, since distribution could be postponed beyond the maximum six months for survivorship under the terminable interest rule.

A trust that directed payment of a fixed annuity to a surviving spouse for ten years, after which the trust will terminate, qualified for the marital deduction. The trust provided that it would be distributed to the spouse at the end of the term, but did not indicate what would happen if she died during the term. The Service interpreted state law (Texas) and held that it would pass to the estate of the surviving spouse. Therefore, it qualified for the marital deduction, since there was no interest passing to any other person. 79

§ 15.04[2] Annuities and Similar Payments as Terminable Interests

Where payments are to be made to the surviving spouse for a period of years or life, the value of the right to the annuity payment may be a terminable interest that does not qualify for the marital deduction. This will generally depend on whether or not any other person is entitled to receive any form of payment after the expiration of payments to the surviving spouse. Thus, a survivor annuity payable to a surviving spouse for life is not a terminable interest if there are no payments following the death of the annuitant. 80

In the First Trust Co. v. United States 81 decision, the court held that an annuity payable from the principle of the trust was not a terminable interest. Where a surviving spouse could elect to take payment of a death benefit annuity six years after date of death either in a lump sum or annuity, it was not a nondeductible terminable interest, according to Private Letter Ruling 9229034, since there was no other beneficiary who took an interest in the annuities after the death of the surviving spouse, unless the surviving spouse named one. If the spouse named such a beneficiary, she was making a taxable gift.

A spread-out election to claim insurance commissions over a thirty-year period with payment over to wife and children as contingent beneficiaries was held nondeductible terminable interest in Estate of Baker v. Commissioner. 82
In Private Letter Ruling 9008003, the decedent had an interest in corporate pension plans as well as a 50 percent interest in a Keogh plan. Although he had designated beneficiaries other than his surviving spouse, Employee Retirement Income Security Act of 1974 (ERISA) provisions mandated distribution to the surviving spouse. As a result, a full marital deduction was allowed.

Annuities and similar payments may qualify for the QTIP election.

¶ 15.04[3] Reduction for Claims, Death Taxes, and Expenses of Administration

The value of the marital deduction will be reduced to the extent any claims, death taxes, and expenses of administration can be charged to the marital bequest or marital trust. Whether or not this will occur depends on the language of the governing instrument and applicable state law.

In Estate of Street v. Commissioner and Estate of Richardson v. Commissioner, the Tax Court held that administration expenses and interest on deferred federal estate taxes are properly chargeable against fiduciary income of the marital deduction share of the decedent's estate without reduction or disqualification of the marital deduction. However, the practitioner should review Treasury Regulation Section 20.2056(b)-4, which suggests that the value of the marital deduction will be reduced to the extent that income, rather than being payable to a surviving spouse, is used to pay administration expenses. Further, there is a danger that a specific provision in a will or trust directing the payment of such expenses from income of a marital trust could disqualify the trust in its entirety. Where the will and trust agreement were both silent on the payment of inheritance taxes, this ruling held that part of the taxes would have to be paid from a qualifying QTIP trust, rather than from another trust created by the decedent.

The Sixth Circuit has affirmed in part and reversed in part the Tax Court decision in Estate of Street v. Commissioner. In that case, administration expenses and interest on state and federal death tax deficiencies was paid from post-death income under authority of state law and provisions in the will. The Tax Court held that the payment did not reduce the marital deduction. The Sixth Circuit held that the administration expenses reduced the marital bequest, since they accrue at date of death, but the interest payments did not, since they do not accrue at date of death. In this case, the entire residue net of taxes went to the marital deduction trust, so the expenses would have reduced the value of the assets passing under the marital bequest if not charged to post-death income. These amounts were all claimed as income tax deductions.

Where a decedent's will and living trust agreement contained a provision that her husband was to take the maximum marital deduction amount not reduced by estate taxes, a state apportionment that required allocation of taxes to the marital share was controlling, since the marital bequest would be net of taxes. On the other hand, where a will provided that death taxes be paid off the top of the residue of the estate, the Indiana apportionment statute did not apply, and the marital deduction had to be reduced by a portion of death taxes, despite an agreement among the heirs to the contrary.

Reversing itself, and the Tax Court, the Fourth Circuit has held a husband could not, under Virginia law, direct payment of taxes to property passing to his wife under a tenancy-by-the-entirety. Therefore, a marital deduction was fully allowed.

Where a decedent's will and living trust agreement contained a provision that her husband was to take the maximum marital deduction amount not reduced by estate taxes, she evidenced an intent that the bequest not be reduced either by such taxes or administration expenses, despite a state apportionment law to the contrary.

Technical Advice Memorandum 9005003 involved a residual bequest to the surviving spouse. Administration expenses claimed as income tax deductions were not deducted in computing the marital deduction. They should have been, since there was no provision for their allocation under the will and they would be charged to the residue.

In Estate of Preisser v. Commissioner, a debt owed by the decedent to a bank, equivalent to an amount he had loaned to his son, reduced the allowable marital deduction. The note was held an enforceable obligation of the estate.
In a reviewed decision, with two strong dissents, the Tax Court held that large amounts of administration expenses allocated to post mortem income as authorized by state law did not reduce the marital deduction or the charitable contribution deduction. The estate charged approximately $1.5 million of administration expenses claimed as income tax deductions to post mortem income from the residue. The residue, valued at $26 million, was divided between a marital and charitable trust. The Service argued these expenses had to reduce the residue for purposes of the marital and charitable deductions.

The court rejected both the arguments that these expenses were the same as claims against the estate that reduced the estate and therefore the marital deduction, and the argument that since the payment of these expenses reduced the post-death income that otherwise would have been paid to the surviving spouse, the value of the marital deduction would be reduced accordingly. The court followed its own decision in *Street*, and rejected the position of the Sixth Circuit in that case. One dissenting judge argued that the value of the estate under probate rules includes both principal and post-death income. The other took the position that since the payment of expenses from income reduced the income payable to the spouse by his calculation by more than $500,000, the marital deduction should have been reduced by the value at date of death of the then value of the administrative expenses paid over a five-year period after death.

In a split decision, the Eleventh Circuit affirmed the Tax Court in *Estate of Hubert*, holding that where administration expenses were allocated to post mortem income of the estate, they did not reduce the marital or charitable deduction. The Supreme Court attempted to resolve this issue by affirming the Tax Court and Eleventh Circuit (there was no clear majority in this case). The plurality specifically held that marital or charitable deductions are not reduced dollar for dollar by administrative expenses allocated to income. However, under Section 20.2056(b)-4(a), if the allocation of expenses to income imposes "material limitations" on the surviving spouse's right to income from marital deduction property, that must be taken into consideration in valuing the property passing to the spouse. This adjustment would be based on the present value of the amount necessary to pay administration expenses. The Supreme Court refused to reverse the Tax Court determination that the amount here was not material.

The Service has issued final regulations pertaining to the impact of the deduction of estate administration expenses on the marital and charitable deduction. The regulations divide all administration expenses into estate transmission expenses and estate management expenses. A husband and wife owned property subject to a mortgage as tenants by the entirety. When the husband died, his estate included half of the property, deducted half the mortgage, and claimed a marital deduction for half the property. In Private Letter Ruling 200104008, the Service found that half the property is included in the estate, half of the mortgage is deductible, and the marital deduction is half the property less half of the mortgage.

¶ 15.04[4] Impact of Survivorship Clauses

Several recent cases and rulings have dealt with a provision in a will or trust requiring survivorship of a spouse for a period that could exceed six months, which is a disqualifying terminable interest under Section 2056(b)(1). In Revenue Ruling 88-90, a clause requiring survival for sixty days or until a trust was funded did not qualify, since creditors have six months to file claims. In *Estate of Heim v. Commissioner*, a clause requiring survival until distribution of an estate, the marital deduction was denied. Compare Private Letter Ruling 8809003, where the spouse had to survive a sufficient period to receive the bequest. The marital deduction was allowed, since she was the executrix and, under state law, she could distribute to herself at any time. Compare Private Letter Ruling 8747003, where a bequest did not qualify because it would not vest until the terms of the marital deduction trust would become operative. Similarly, Private Letter Rulings 8810002 and 8816001 found a terminable interest where the period of required survivorship was one year in the first case and the total period of administration in the second case. These rulings also discuss the implications of an estate statute that attempts to cut down excessive survivorship periods to six months. That statute is also discussed in the *Heim* decision.

The Ninth Circuit has affirmed the Tax Court decision in *Estate of Heim v. Commissioner*, holding that a bequest to a spouse conditioned on her surviving distribution is a nondeductible terminable interest. Significantly, the case arose in California, and the court discussed California statutes intended to save the marital deduction from defective trust drafting where the intent to qualify for the marital deduction was
clear. A survivorship period in excess of six months would automatically be reduced to six months. The Ninth Circuit held that there was no evidence in the will itself of an intent to qualify the gift for the marital deduction, and other evidence could be admitted only to resolve an ambiguity. However, even that evidence in this case was insufficient to show the decedent was aware of the marital deduction.

The Fifth Circuit, affirming a federal district court, in an unpublished opinion has held that a bequest to a surviving spouse conditioned on that spouse surviving until the decedent’s will was admitted to probate is a nondeductible terminable interest. The fact the surviving spouse was also named executor was apparently irrelevant. There was no guarantee the will would be admitted to probate within six months. 98

A bequest of a residence to a surviving spouse conditioned on her survival for five years was a nondeductible terminable interest. 99 The paragraph in the decedent’s holographic will had been declared void by a California court, but the Service determined that the clause was not ambiguous and that the California six-month survival statute did not apply.

¶ 15.04[5] Consideration Paid by the Surviving Spouse

Under Section 2056(b)(4)(B), any marital bequest that is conditioned on a transfer or surrender of property rights or payment of consideration by the surviving spouse must be reduced by the amount or value of the consideration. This was applied to the surrender of community property rights in United States v. Stapf. 99.1 In Private Letter Ruling 200131001, a wife funded two trusts with $1 each, and provided in her will that an additional amount had to be added to the trusts to bring them to $1 million total. After her death, $625,000 was transferred to the trust from her estate, the entire residue of the estate went to her surviving husband. Over 1 1/2 years after her death, he contributed $375,000 to the trusts, and as a result, received an additional residuary bequest of $375,000. The estate claimed a deduction of the entire residuary bequest. In effect, the husband “bought” a $375,000 bequest by contributing that amount to the trusts created by his wife. The marital deduction is reduced accordingly. 99.2

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Estate of Smith v. Comm'r, 565 F2d 455 (7th Cir. 1977).

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Estate of Bond v. Comm'r, 104 TC 652.

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Priv. Ltr. Rul. 8604020.

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First Trust Co. v. United States, 89-1 USTC ¶ 13,805 (D. Mont. 1989).

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84  Estate of Richardson v. Comm'r, 89 TC 1193 (1987).


86  Estate of Street v. Comm'r, 974 F2d 723 (6th Cir. 1992).

87  Martin v. United States, 923 F2d 504 (7th Cir. 1991), rev'd 90-1 USTC ¶ 60,105 (D. Ind. 1990).

88  Estate of Ransburg v. United States, 91 USTC ¶ 60,052 (DSD 1990), reaff'd, 91 USTC ¶ 60,081 (SD Ind. 1991).

89  Estate of Reno v. Comm'r, 945 F2d 733 (4th Cir. 1991).

90  Martin v. United States, 91-1 USTC ¶ 69,555 (7th Cir. 1991).


92  Estate of Hubert, 101 TC 22, 76 AFTR2d 96-5177, 86 F3d 1045 (11th Cir. 1995).

93  Estate of Hubert v. Comm'r, 63 F2d 1083.

94  Comm'r v. Hubert, 117 S. Ct. 1124 (Mar. 18, 1997).

94.1  Treas. Reg. §§ 20.2055-3(b), 20.2056-4(d). See discussion at ¶ 5.04[1][f].


97  For a similar result, see Priv. Ltr. Rul. 8834002.

98  Estate of Robertson v. United States, 903 F2d 1034, 66 AFTR2d 90-5979 (5th Cir. 1990).
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Estate of Denman, 33 TC 361 (1959), aff'd, 287 F2d 725 (6th Cir. 1961).

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Intro to the Marital Deduction – IRC §2056

- Property passing to spouse is not taxed
  - Allowed methods of transfer:
    - Outright
    - “General Appointment” trust
    - Qualified Terminable Interest Property (“QTIP”) trust
    - “Estate” Trust
  - Special rules for non-U.S. Citizen surviving spouses
    - IRC §2056A

Intro to the Marital Deduction – IRC §2056

- Non-Citizen Surviving Spouse
  - Prevent U.S. citizen’s estate property from passing to non-citizen spouse under marital deduction, and non-citizen removing assets to foreign jurisdiction
  - No Estate Tax Marital Deduction except “QDOT”
  - Form of QDOT trust would otherwise qualify for MD if for citizen spouse, plus important modifications

Intro to the Marital Deduction – IRC §2056

- QDOT Requirements
  - At least one U.S. citizen trustee or domestic corporate trustee
  - Principal distributions must be approved by domestic trustee; trustee may withhold estate tax
  - Trust must comply with all Regulations under §20.2056A-2(d). (Deals with collection of estate tax)
  - “Qualified Domestic Trust” election made on decedent spouse’s 706
Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
Outright Distribution

- **Characteristic:**
  - Property ownership transferred to survivor's name

- **Advantages:**
  - Spouse has complete control
  - Simple to understand & administer

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Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
Outright Distribution

- **Disadvantages:**
  - Property subject to guardianship/probate at survivor's incapacity/death
  - Spouse has complete control
  - No creditor/predator protection
  - Power to disrupt grantor spouse's estate "plan"

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Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
General Appointment Trust

- **Characteristics:**
  - All income payable annually to spouse
  - Surviving spouse has lifetime and/or testamentary GPOA
  - Surviving spouse may compel conversion of nonproductive property to productive property

(Note: "productive" = income-producing)
Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
General Appointment Trust

- Advantages:
  - Property “wrapped” in trust – not subject to guardianship or probate
  - Spouse has complete control

- Disadvantages:
  - Surviving spouse has control
    - Lifetime GPOA eliminates creditor/ predicator protection (varies state-to-state)
    - Ag GPOA is a power to disrupt grantor’s estate plan by gifting assets to others
  - Spouse may compel trust to produce income
    - May result in disposal of special property (vacation home, closely-held business, etc.)
Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
QTIP Trust

- Characteristics:
  - All income payable annually to spouse
  - No one may appoint or distribute assets to any other during surviving spouse’s lifetime

- Advantages:
  - Property “wrapped” in trust – not subject to guardianship or probate
  - Preserves creditor/predator protection for surviving spouse
  - Grantor spouse retains control – ensures estate planning objectives are carried out

- Characteristics:
  - Surviving spouse may compel conversion of nonproductive property to productive property
    (Note: “productive” = income-producing)
  - Spouse may be given testamentary POA (general or limited; not required to qualify)

- Advantages:
  - Property “wrapped” in trust – not subject to guardianship or probate
  - Preserves creditor/predator protection for surviving spouse
  - Grantor spouse retains control – ensures estate planning objectives are carried out
Intro to the Marital Deduction – IRC §2056
Qualifying Transfers to Surviving Spouse
QTIP Trust

- Disadvantages:
  - Spouse may compel trust to produce income
  - May result in disposal of special property (vacation home, closely-held business, etc.)

Intro to the Marital Deduction – IRC §2056

- “Marital Deduction” property included in surviving spouse’s gross estate (IRC §2044) (unless consumed during lifetime)
- Marital Deduction not a permanent avoidance of estate taxes – simply deferral until “donee spouse” dies.
- Tax Trap: The deferral of tax to the death of the surviving spouse may result in higher taxes overall
  - Decoupled states
  - Tax uncertainty