TRUSTEE GRANT OF POWER
- A SIMPLER APPROACH TO MODIFYING GST EXEMPT TRUSTS –

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I. Introduction

Broadly, this paper addresses the ways trusts are modified and the effect of the generation skipping tax ("GST"). Narrowly, it focuses on the limitations associated with modifying trusts that are grandfathered from GST under Chapter 13, but its conclusions can extend to trusts exempt as a result of GST exemption allocation. Though much is written about modifying trusts through "decantings," the conclusion of the author is that in certain situations a trustee's ability to appoint or grant powers of appointment to beneficiaries offers a simpler and often safer means of modifying trusts, without violating the constructive addition or other limitations that jeopardize grandfathered status or loss of exemption that has been allocated or that can be allocated in the future.

An irrevocable trust is grandfathered from Chapter 13 (the "GST system") if it was created prior to September 25, 1985. A grandfathered trust is disadvantaged by new law as a result of the settlor relying on prior law and circumstances during the trust's creation, when in the future beneficiaries find it advantageous to modify the trust. A grandfathered trust is, however, restricted from modification to secure various types of advantages under Treasury regulations. A Generation Skipping Tax Exempt Trust ("GSTT") has grandfathered status in a limited number of circumstances provided by regulations. One of these circumstances is where a beneficiary

holds and exercises a non-general power of appointment. When granting and exercising powers, however, special rules must be followed to avoid loss of grandfathered status and taxation under Chapters 11-13. Where a current beneficiary does not hold a non-general power of appointment that can be used to modify an irrevocable trust, this article argues that a trustee of a grandfathered GST trust, in some circumstances, may grant a power of appointment over trust property to the intermediate beneficiary ("a non-skip person") who may, in turn, exercise the power to modify the trust. This power can be exercised to perpetuate trust property over the lives of additional beneficiaries, subject to relevant perpetuities period limitations. There is nothing in the regulations that prohibit this from occurring in a GSTT that is either grandfathered from Chapter 13 (a "GGSTT") or exempt under Chapter 13 as a result of the allocation of the GST exemption.

II. Why Consider Modifying Irrevocable Trusts

A trust can either maintain its terms or there may be a desire to change its terms in an unlimited number of ways. When doing so, however, a variety of tax issues must be addressed. Normally changes are made to address shortcomings not originally contemplated by the settlor that aren't inconsistent with the settlor's presumed intent. Before methods of modification are addressed though, it is important to understand why one may desire to modify trusts. One might think that if a trust estate has been properly constructed there should be no need for a modification. This is correct to a degree, but laws and family circumstances evolve and change. For example, it would be beneficial to modify a trust: where beneficiary's become exposed to creditor rights; where a divorce is contemplated; where GST exemption amounts will be sacrificed or are inefficiently allocated; to harmonize multigenerational estate plans; where a grandfathered status is not extended as long as it could; or where there is a change in family circumstances, such as a

situation involving an illness, disability, or substance abuse. For purposes of this article, a simple example will be used: grandfather created an irrevocable trust for son in 1982, and on son's death the trust liquidates in favor of grandson. Grandson was alive on the creation of the trust. If grandson has become wealthy or became exposed to any of the foregoing circumstances where modification of the trust would further protect grandson and his family, it would be beneficial to extend the protections and grandfathered status of the trust post grandson's death. Throughout this paper this is referred to as "our Example."

A. *Creditor Protection*

Trusts should be modified when trust property is unwillingly exposed to creditors, as a matter of state law. When a trust terminates, as in our Example, the remainder beneficiary's interest vests and becomes subject to creditor's claims. In order to protect this interest in trust property, a trustee with sufficient powers or a beneficiary holding a power of appointment may appoint this property to a new trust (a "decanting"), which can continue in a protected format over the life of the beneficiary and future or alternate beneficiaries. Alternatively, the trustee or beneficiaries may hold sufficient powers to simply modify by amendment the existing trust as a continuing trust.

B. *Extend Exclusion from the Wealth Transfer Tax System under Chapter 11 and 12 of the Internal Revenue Code*

Trusts should also be modified to avoid situations where GST exemption amounts will be sacrificed or are inefficiently allocated or where a grandfathered status is not extended as long as it could. As in our Example, if an intermediate beneficiary, such as a settlor's son, is a current

income beneficiary and on his death the trust corpus passes outright and free of trust to the son's children, the property comprising the trust will become subject to the estate and gift tax requirements under Chapter 11 and 12 after the son's death. If one or more of those grandchildren of settlor were alive on the creation of the trust, as in our Example with grandson, the applicable perpetuities period could extend 21 years after grandson's death, escaping Chapters 11-13 for one more generation. This situation would also arise when GST exemption has been inefficiently allocated or automatically allocated to a GSTT, but the trust has not been drafted to properly utilize the exemption. Poor or shortsighted estate planning can lead to the GST exemption being inefficiently allocated, exposing property to premature taxation under Chapter 11, 12, or 13.

C. *Harmonize Multigenerational Estate Plans*

A trust should be modified to harmonize multigenerational estate plans so that, over time, multiple trusts can be consolidated. Situations arise where multiple generations of trusts name the same beneficiaries. In order to promote efficiencies, minimize trustee fees, promote economies of scale, and provide for tax optimization, it is often advisable to consolidate trusts when able, which often involves modification to harmonize their terms. In our Example, if son held a power of appointment and son desired to parallel his own planning in favor of grandson he could do so if he held the requisite power. A modification to achieve this objective could be appropriate if son was not provided a power of appointment on creation of the trust.

D. *To Address Changes in Family Circumstances*

Unforeseen family dynamics and circumstances can warrant a modification of a trust instrument. Drug or alcohol addictions, a separation or divorce, psychological well being, and fam-

ily values can all be impacted through access to money. Modification of trusts can address these changes in family circumstances, that were not contemplated by the settlor when creating the trust.

III. The Impact of a Modification on a Grandfathered GSTT's (a "GGSTT")

A GGSTT may not effectively use its exempt status in an optimum manner. It may fall short in duration as a result of premature termination or because it becomes exposed to reach by creditors. This is the case in our Example because on son's death the trust corpus will vest in grandson, even though the perpetuities period could extend the trust past grandson's death. Modification may avoid these exposures from occurring, for example, by extending the duration of nonvested interests beyond the death of an intermediate beneficiary (son in our Example), otherwise known as a "non-skip person" (a person one generation below that of a settlor). However, modification must be done carefully to avoid loss of grandfathered status.

A. *Constructive Addition*

A constructive addition to a GGSTT will sacrifice grandfathered status. This means that property within the GGSTT generally escapes taxation under Chapters 11-13 of the Internal Revenue Code (Estate, Gift, and Generation-Skipping Tax), except where "constructive additions" are made (additions of property to the trust that are not themselves GST exempt). Whenever there is a constructive addition to a grandfathered trust, the trust will lose grandfathered status to varying degrees.[1] To the extent the trust loses grandfathered status, it may become subject to the GST and potentially also Chapters 11 and 12. The Tax Court has stated the purpose of the

[1] 26 C.F.R. § 26.2602-2(b)(1), (2), (3).

grandfathered exception is to protect those taxpayers who have taken irrevocable action in reliance on the law before the effective date and "could not escape from such arrangements."[2] Constructive additions are in a sense what the IRS feels would be taking an unfair advantage of the exempt status of a grandfathered GSTT (a "GGSTT"). For example, it wouldn't be fair for an intermediate non-skip person (son in our Example) to add property to a GGSTT and have it exempt from Chapters 11-13. What constitutes a constructive addition, however, is not always clear.

B. *Powers of Appointment- General, Special, and Testamentary*

A power of appointment can either be in the form of a general power or special (non-general) power.[3] A general and special power may be exercisable during life, by will, or both.[4] If the power is exercisable by will, the power is referred to as a testamentary power. This testamentary power can come in the form of a general or special power. A general power of appointment grants the holder of the power the ability to appoint the assets to the holder, the holder's estate, the holder's creditors, or the creditors of the holder's estate.[5] A special power, or non-general power, of appointment grants the holder of the power the ability to appoint the assets as prescribed in the instrument, but not to the holder, the holder's creditors, the holder's estate, or creditors of the holder's estate.[6] These powers may either be retained by the settlor or granted to others, including trustees and beneficiaries. Relevant to this article, a trustee with broad discretion

[2] Simpson v. United States, 183 F.3d 812, 814 (8th Cir. 1999); Robert Kazior, *Tax Law-Having Your Cake and Eating It Too : Section 1433(b)(2)(a) of the Tax Reform Act of 1986: Effecting an Exception Where One Does Not Exist*, 32 W. New Eng. L. Rev. 515 (2010).
[3] 26 C.F.R. § § 25.2511-2(b), 20.2041-1(c).
[4] 5 American Law Of Property §23.1 – .66 (Casner ed. 1952).
[5] 26 C.F.R. § § 25.2511-2(b), 25.2514-1(c)(1); 26 U.S.C. § 2514(c).
[6] *Id.*

can be deemed to hold a special power of appointment over trust property and can appoint powers to beneficiaries, who in turn can exercise those powers to modify a trust.[7]

C. *Powers Held by Trustee*

Trustees hold the powers necessary and appropriate to carry out the trust purpose as well as those powers directly prescribed in the trust instrument.[8] A court will either imply, confer, or deny the trustee power to grant a non-skip person a special power of appointment when the trust instrument has granted a trustee a power to act under broad standard standards discussed later in this paper. Implied powers do not need court approval, however, a trustee can seek confirmation of a power from the court that a proposed action is viable and would not violate the regulations. A trustee has the powers granted to him in the trust instrument, but can also have the powers necessary and appropriate to carry out the trust purpose as long as it's not forbidden by the trust instrument.[9] Trustee powers are generally construed broadly. In fact, there is a growing trend by courts to interpret prescribed powers even more broadly.[10] For example, in *Abarbanel v. Weber*, the trustee was granted a power to allocate trust income for the support and education of minor beneficiaries after consideration of their parents ability to pay. The court determined the trustee had an implied power to accumulate income to meet college expenses in their future.[11] Trustees also can be conferred powers where they are necessary or appropriate to carry out the trust pur-

[7] See discussion, infra, text at note 65-68
[8] Crutcher v. Joyce, 134 F.2d 809 (10th Cir. 1943) (Citing the text and Restatement of trusts §186); Central States, Southeast & Southwest Areas Pension Fund V. Central Transport, Inc., 472 U.S. 559, 105 S. Ct. 2833, 86 L. Ed. 2d 447 (1985), citing text.
[9] Restatement (Second) of Trusts § 186 (1959).
[10] Restatement (Second) of Trusts § 186 (1959).
[11] Abarbanel v. Weber, 340 PA. Super. 473, 490 A.2d 877 (1985).

pose, which is not forbidden by trust terms.[12] Courts have conferred the power to sell, lease, or mortgage property where the trust purpose was stated as raising money for a particular purpose.[13] However, when implied powers are granted to trustees, the intention of the settlor or presumed intent is paramount. When a situation arises that warrants a trustee to sell property and there was no intention for the settlor to do so, the implied power to sell said property is not automatically granted.[14]

By analogy, and to the point of this article, a special power of appointment held by a trustee in favor of beneficiaries should be implied by a court when the trust instrument grants the trustee broad discretion. A power of appointment may enable the trustee to prolong the life of the trust property to the furthest extent the law allows, without subjecting the property to tax and often the reach of creditors.

Use of powers of appointment can result in constructive additions. The release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b)) is not treated as an addition to a trust (a "constructive addition") if:

> 1) Such power of appointment was created in an irrevocable trust that is not subject to Chapter 13 under paragraph (b)(1) of this section; and
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> 2) In the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gesta-

[12] Restatement (Second) of Trusts § 186 (1959).
[13] Restatement (Second) of Trusts § 186 (1959).
[14] Restatement (Second) of Trusts § 186 (1959).

> tion (the perpetuities period). For purposes of this paragraph (b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised. [15]

From a plain reading of the regulations, as long as (1) the power exists in a GGSTT, (2) the exercise of the power does not subject the trust to estate or gift tax, (3) the power holder does not possess a general power of appointment, and (4) the trust term is limited in duration to lives in being on the date of creation of the trust plus 21 years (or, alternatively, 90 years), a grandfathered trust with a special power will retain its grandfathered status. However, if any action runs afoul to these regulations, grandfathered status will be lost to the extent of the constructive addition.

IV. Methods of Modification

Trusts can be changed when the settlor's desired goals will not be accomplished or changes are not inconsistent with the settlor's presumed intent. These changes are formally known as modifications and can come in five main forms: modification by agreement of beneficiaries; by decanting to a new trust, with or without agreement or consent of beneficiaries; or by a trustee's exercise of discretion, with or without beneficiary agreement or consent. In the case of a trustee's exercise of discretion, the two questions that most often arise are whether the trustee's discretion is broad enough and whether it existed on creation of the trust.

[15] 26 C.F.R. § 26.2601-1(b)(1)(v)(A), (B).

A. *Common Law*

At common law, a trustee holds the ability to modify by decanting if the trustee holds the power to distribute property in fee.[16] Decanting can be a form of modification used for trusts that are exempt from GST tax. When a trust is decanted, a trustee exercises discretion to convey trust property to a new trust. This was first determined in *Phipps v. Palm Beach Trust Company,*[17] where the court held that anytime a trustee has the power to distribute principal to beneficiaries, he simultaneously holds the power to distribute principal to a new trust.[18] This distribution to a new trust was found to be a lesser interest than distribution of principal to beneficiaries, therefore warranting this implied power. The court in Phipps provided the general rule:

> …the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than the fee unless the donor clearly indicates a contrary intent.[19]

In reaction to the IRS's proposed regulations on modifications of GGSTTs under Notice 2011-101, the American College of Trust and Estate Council opined that, if the reasoning of Phipps is sound, "there is reason to believe the common law of every [state] confers a decanting power on all trustees who have the power to invade trusts for the benefit of their beneficiaries, as long as the trust instrument does not expressly prohibit such discretion or action." The American Bar

[16] Phipps v. Palm Beach Trust Company, 142 Fla. 782 (1940).
[17] *Id*.
[18] *Id.*
[19] *Id*.

Association, Section on Taxation, similarly supported this view by citing provisions of the Second and Third Restatements of Property.[20]

B. *Uniform Trust Code ("UTC")*

1. The Code and Many State Statutes Do Not Preempt Common Law

States that have adopted the UTC generally do not preempt the common law and permit decanting. Estate planners were wary to advise trustees to decant to accomplish modifications, for fear of liability. Therefore, many states took action and enacted decanting statutes. Many states have enacted statutes that explicitly grant trustees the power to decant, even though the common law under *Phipps* already provided a means.[21] However, one must use caution when decanting because there is a risk of jeopardizing the GST exempt status of the original trust. Safeguards to preserve exempt status, however, are provided in the regulations where:

> the terms of the governing instrument of a grandfathered trust authorize distributions to [a] new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court, or
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> at the time grandfathered trust became irrevocable, State law authorized distribution to [a] new trust or retention in the continuing trust, without consent or approval of any beneficiary or court, [while not violating the perpetuities period].[22]

[20] Letter dated April 25, 2012, citing Sections 11.1 and 19.4 of the Second Restatement and 19.14 of the Third Restatement of Property.

[21] Example, N.Y.E.P.T.L Section10.6.6.; Alaska Stat. Section 13.36.157 through Section 13.36.159; Section 13.36.215 (definitions); Ariz. Rev. Stat. Ann. Section 14-10819; Del. Code Ann. tit. 12, Section3528; Fla. Stat. Section 736.04117.16; 760 ILCS 5/16.4; Ind. Code Section 30-4-3-36; Ky. Rev. Stat. Ann. Section 386.175; Mich. Comp. Laws Section 700.7820a; Mo. Rev. Stat. Section 456.4-419; Nev. Rev. Stat. Section 163.556; N.H. Rev. Stat. Ann. Section 564-B:4-418; N.Y. Est. Powers & Trusts Section10-6.6; N.C. Gen. Stat. Section 36C-8-816.1; Ohio Rev. Code Ann. Section5808.18; R.I. Gen. Laws Section18-4-31.

[22] 26 C.F.R. § 26.2601-1(b)(4)(i)(A)(1)(i),(ii).

This regulation safe harbor only protects the retention of grandfathered status of a GGSTT, but the service has extended it to GSTT's (exempt by allocation of exemption under Chapter 13).[23]

The regulations further provide that if the terms of the governing instrument do not authorize distributions and state law at the time of creation did not permit a trustee to appoint property to a new trust, but current state law now permits this action, grandfathered GST protection will not be lost if there is no shift in beneficiary interest to lower generations and the action does not extend the time for vesting beyond the perpetuities period of a life in being plus 21 years or 90 years.[24] However, if the trustee already has a discretionary power under 26.2601-1(b)(4)(i)(A), there is no need to consider whether there is a shifting of beneficial interest because the trustee already has the power.[25]

Most state statutes prohibit the trustee from adding additional beneficiaries when decanting.[26] However, the ability to include a limited power of appointment is not prohibited.[27] This, therefore, leaves decanting as a viable means to achieve the overall tax objective of perpetuating trust property over the lives of subsequent generations of newly appointed beneficiaries through a power of appointment, subject to the relevant perpetuities period.

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[23] See, e.g., PLR 200627005; PLR 200308045; PLR 200326029; PLR 200632003.
[24] 26 C.F.R. § 26.2601-1(b)(4)(i)(D).
[25] 26 C.F.R. § 26.2601-1(b)(4)(i)(A).
[26] 760 Ill. Comp. Stat. 5/16.4, N.C. Gen. Stat. §36C-8-816.1, Nev. Rev. Stat. §163.556, N.Y. Est. Powers & Trusts Law §10-6.6.
[27] Audrey Young, *The Mechanics of Decanting The Tax Adviser* (2014), http://www.thetaxadviser.com/issues/2014/apr/clinic-story-04.html (last visited Nov 21, 2016), 1.

2. With Court Approval

Another way to change the terms of an irrevocable trust is to amend with court approval. The amendment procedure differs from state to state, but is relatively the same throughout. The amendment procedure begins with the relevant group necessary to accomplish the amendment filing a petition with the court, which under the Uniform Trust Code ("UTC") is a trustee, a beneficiary, the settlor, or any combination of the three.[28] If the settlor has become incapacitated, the designated power of attorney, conservator, or guardian can replace him/her in the proceeding.[29] If all the beneficiaries and settlor consent to the modification, the court will approve even if "inconsistent with a material purpose of the trust."[30] If the settlor has since passed or does not consent to the modification but all the beneficiaries consent to the modification, the court shall approve "if the court concludes that modification is not inconsistent with a material purpose of the trust."[31] And, if the settlor has since passed or does not consent to the modification but only some of the beneficiaries consent to the proposed modification, the court may approve it if the modification is not inconsistent with a material purpose and the interests of the non-consenting beneficiary(ies) are adequately protected.[32] Finally, and in line with this article, the UTC states a trust can be modified to achieve the settlor's probable tax objective.[33]

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[28] Unif.Trust Code § 410(b).
[29] Unif.Trust Code § 411(a).
[30] *Id.*
[31] Unif.Trust Code § 411(b).
[32] Unif.Trust Code § 411(e). In this regard, see, e.g., Randall v. Randall, 60 F. Supp 308 (S.D. Fla. 1944), providing: The rule that the immediate parties to a trust indenture or settlement may, by mutual consent, change or revoke the same, and that persons having no vested interest under the trust have no ground for complaint, is approved in the annotations on "Revocation of Trust by Consent," in 131 A.L.R. 469; 91 A.L.R. 114, and 38 A.L.R. 965, and also by the following recent decisions: Commissioner of Internal Revenue v. Bacher, 1939, 6 Cir., 102 F.2d 500; Botzum v. Havana National Bank, 1937, 367 Ill. 539, 12 N.E.2d 203; Simon v. Reilly, 1940, 126 N.J.Eq. 546, 10 A.2d 474; McEvoy v. Central Hanover Bank & Trust Co., 1937, 274 N.Y. 27, 8 N.E.2d 265; Thatcher v. Empire Trust Co., 1935, 243 App.Div. 430, 277 N.Y.S. 874; Beam v. Central Hanover Bank & Trust Co., 1936, 248 App.Div. 182, 288 N.Y.S. 403; Dunnett v. First Nat. Bank & Trust Co., 1938, 184 Okl. 82, 85 P.2d 281; In re Donnan's Trust Estate, 1940, 339 Pa. 43, 13 A.2d 55; Bottimore v. First & Merchants Nat. Bank, 1938, 170 Va. 221, 196 S.E. 593; Fowler v. Lanpher, 1938, 193 Wash. 308, 75 P.2d 132.
[33] *Unif.Trust Code § 416.*

3. Without Court Approval

The UTC requires court approval for all modifications to trust instruments, but state statute can authorize a modification without court approval. California and Florida are two states that have done so.[34] These statutes state if the settlor and all the beneficiaries consent, they may compel the modification without petition of the court even if in contrast to a material purpose of the trust. Amending a trust is a viable means of accomplishing the goal of this article, however this process is more costly and could lead to granting more powers than originally intended.[35] Furthermore, the requirement of beneficiary agreement or consent can violate the GGSTT regulations.[36]

4. Trustee Discretion

A trust can grant a trustee the ability to use his or her discretion in interpreting the granted powers. For example, in a situation where the trustee is granted a power to "dispose of" a designated piece of property, a trustee can use his or her discretion in interpreting the circumstances surrounding this grant. With the right facts surrounding the granted power, a trustee could be found to have the power to lease, mortgage, sell or exchange this property due to the granted power of disposing of the property.[37] However, a court is reluctant to grant such power even if it can be inferred that the settlor would authorize the sale. Therefore, "the distinction must be borne in mind between a case where the court finds that the trustee has power and the case where the court confers power upon him."[38] It is determined on a case by case basis as to the powers implied or able to be court conferred.

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[34] Cal. Stat. Ann. § 15404; Fla. Stat. Ann. § 736.0412 (West).
[35] Unif.Trust Code § 411(a).
[36] 26 C.F.R. § 26.2601-1(b)(4)(i)(A).
[37] Restatement (Second) of Trusts § 186 (1959).
[38] Restatement (Second) of Trusts § 186 (1959).

C. *Powers Held by Trustee*

Trustees hold the powers necessary and appropriate to carry out the trust purpose as well as those powers directly prescribed in the trust instrument.[39] A court could either find an implied power or confer the trustee power to grant a non-skip person a special power of appointment when the trust instrument has granted the trustee a power to act for the beneficiary's comfort, for their best interest, for their welfare, in the trustee's absolute discretion, or for their benefit or enjoyment ("the Broad Standards"). A trustee has the powers granted in the trust instrument, but can also have the powers necessary and appropriate to carry out the trust purpose, as long as it's not forbidden by the trust instrument.[40] Trustee powers are generally construed broadly. In fact, there is a growing trend by courts to interpret prescribed powers even more broadly.[41] For example, In *Stuart v. Wilmington Trust Co.,* the court implied that a standard for the beneficiary's "support, maintenance, benefit, or education" would warrant the invasion of the trust for the purchase of a 4.5 million dollar jet.[42] It should be noted that in this case the purchase was not authorized by the court because the trust standard of "benefit" was actually in a conjunctive clause: "support, maintenance, benefit and education." The court noted that it was the "and" that prevented the invasion of the trust and that if the disjunctive "or" had been used, the expenditure would have been permissible.

[39] *Federal*: Crutcher v. Joyce, 134 F.2d 809 (10th Cir. 1943) (Citing the text and Restatement of Trusts §186); Central States, Southeast & Southwest Areas Pension Fund V. Central Transport, Inc., 472 U.S. 559, 105 S. Ct. 2833, 86 L. Ed. 2d 447 (1985), citing text.
[40] Restatement (Second) of Trusts § 186 (1959).
[41] Restatement (Second) of Trusts § 186 (1959).
[42] Stuart v. Wilmington Trust Co., 474 A.2d 121 (1984).

i. *Implied Powers*

Court approval is not necessarily needed when trustee powers are construed broadly or where the court is simply being asked to confirm the existence of an implied power, and this distinction becomes critical when modifying GGSTTs. The regulations state that:

> The distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of Chapter 13, if . . . the terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval or any beneficiary or court.[43]

Under *Phipps*,[44] when property of a trust can be distributed, the trustee also retains the ability to grant a power over that property. Therefore, if the trustee powers are broad enough, the trustee will not have to seek approval by beneficiaries or the court before granting a power of appointment over the trust property. Even if court approval were sought to confirm an implied power, such action would not appear to violate the consent or approval condition of the above regulation. The most common terms that might authorize a trustee to grant a power are: comfort, best interest, welfare, benefit, happiness, enjoyment, or absolute discretion. Many of these terms are found to be synonymous due to settlor's intent or adjectives used to further describe or limit discretion.[45] Any of these standards should authorize an invasion of the trust, but some limitations are discussed below.

[43] 26 C.F.R. § 26.2601-1(b)(4)(A)(i).
[44] Supra, note Phipps v. Palm Beach Trust Company, 142 Fla. 782 (1940).
[45] National Security Co v. Jarret, 95 W. Va. 420, 121 S.E. 291 (W.V. 1924); Combs v. Carey's Trustee, 287 S.W.2d 443 (Ky. 1955). *But see* Blodgett v. Delaney, 201 F.2d 589, 598 (1953), Finding that welfare and happiness are synonymous.

A "comfort" standard is the most restrictive of standards next to the "HEMS" (health, education, maintenance and support) standard. "Comfort embraces a variety of things, it is not limited solely to the necessities of life but may include things which bring ease, contentment, or enjoyment."[46] When the "comfort" standard is used, it is either used in isolation or used in conjunction with the term support (comfort and support or comfort and support).[47] When the term is isolated, this allows for a comfortable level of support.[48] When combined with support, the beneficiary's living situation and standards are taken into consideration and will not permit an invasion "for a beneficiary whose lifestyle is already at least reasonably comfortable."[49] With these statements in mind and to the point of this article, it is unlikely that a trustee will be able to grant a special power of appointment over all trust property where a "comfort" standard is used, because it generally is not construed broadly enough. An invasion will be permitted in a situation where the beneficiary's living situation is not "reasonably comfortable." State law may, however, alter this conclusion by defining the term further.[50]

A "best interest" standard permits distributions "not only for relief of poverty and distress, but may well comprehend whatever aides to their welfare and advancement, and enables them to establish themselves in life."[51] In order for a beneficiary to successfully establish themselves in life fully, a beneficiary should be able to receive the most tax efficient and protected access to property possible. There are many factors that can be considered when establishing oneself in life, including the responsibility to one's family. However, it is important to stress that

[46] Zumbro v. Zumbro, 69 Pa. Super. 600, 603 (1918).
[47] Restatement (Third) of Trusts § 50 (2003).
[48] *Id.*
[49] *Id.*
[50] See, e.g., Florida Stat. Ann. § 736.04117(b).
[51] Bowditch v. Attorney General, 134 N.E. 796, 800, 242 Mass. 168 (1945).

it is the beneficiary's best interest that is the focus, and not the best interests of others.[52] However, in *Fowler v. Hancock,* it was held that the best interest of a beneficiary includes the support of his dependents.[53] The "best interest" standard is more broad than a "comfort" standard and has been viewed as a general power of appointment for tax purposes.[54] It can be concluded that the trustee, under a "best interest" standard, has the ability to grant a special power of appointment over trust property to an intermediate beneficiary (son in our example) to help better support his dependents and harmonize other estate planning.

A "welfare" standard is generally given more leniency in trustee discretions. On one occasion, distributions of trust property sufficient to purchase a large country estate for the beneficiary was found permissible.[55] There are cases where a welfare standard has been found to be synonymous with happiness.[56] This standard is found fulfilled with whatever distribution or exercise makes the beneficiary happy without considering the beneficiary's resources, as required in situations under a "comfort" or a "best interest" standard.[57] [58] It would most certainly allow the trustee to grant a power of appointment to a non-skip person as in our Example, where father can exercise it to protect his son and grandchildren from creditor risk and estate and gift taxes. Therefore, a "welfare" or "happiness" standard should be viewed as granting a trustee sufficient powers to grant a non-general power of appointment to an intermediate beneficiary, such as the

[52] Fowler v. Hancock, 197 A. 715 (1938).
[53] *Id.*
[54] Renee M. Raithel, AVOIDING TAX PITFALLS AND FAMILY CONFLICTS WHEN A CHILD IS TRUSTEE, 25 Estate Planning 1-9, 1-9 (1998).
[55] Nettelton, 4 T.C. at 992, 993.
[56] National Security Co v. Jarret, 95 W. Va. 420, 121 S.E. 291 (W.V. 1924); Combs v. Carey's Trustee, 287 S.W.2d 443 (Ky. 1955). But see Blodgett v. Delaney, 201 F.2d 589, 598 (1953).
[57] Peter B. Tiernan, *Drafting Trusts That Include Broad Invasion Powers*, LXXVII The Florida Bar Journal 1–8, 1-8 (2003), 2.
[58] Estate of Utterback, 521 A.2d 1184 (Me.1987)

son in our Example, who can then exercise the power to accomplish a variety of family objectives.

A "benefit" standard has been found to warrant the distribution of the entire principal of the trust to the beneficiary.[59] This standard appears to be without bounds. However, one limitation to the permitted distributions under a "benefit" standard is a distribution to aid or benefit others.[60] The analysis associated with a benefit's standard would be similar to that under a "best interest" standard, as discussed above.[61] When a trustee is given a "benefit" standard would, a distribution for the sole purpose of funding a beneficiary's startup company would be proper.[62] Therefore, a benefit standard appears to be another standard that can be used by a trustee to grant powers to an intermediate beneficiary.

An "absolute discretion" standard may sound like it should have no limits, but it still requires a trustee to act honestly and "in a state of mind contemplated by the settlor."[63] This only limits the trustee's discretion to honestly believing the settlor would approve the contemplated distribution.

An "enjoyment" or "happiness" standard has been considered to be so broad that it may not have any bounds, at least in terms of viable distributions.[64] An "enjoyment" standard is more broad than an "absolute discretion" standard due to what the standard is modifying. An "absolute

[59] In Re Rachlin's Will, 133 N.Y.S.2d 151 (1954); Lees v. Howath, 131 A.2d 229 (1957).
[60] In Re May's Estate, 112 N.Y.S.2d 847 (1952).
[61] Fowler v. Hancock, 197 A. 715 (1938).
[62] Restatement (Third) of Trusts § 50 (2003).
[63] Restatement (Third) of Trusts § 87 (2007).
[64] Stafford v. U.S., 651 USTC 95, 629, 95, 631 (1964).

discretion" standard is modifying the discretion of the trustee while the "enjoyment" standard is in regards to the enjoyment of the beneficiary. The trustee will make distributions, and will be found liable for not doing so, "not only to satisfy the 'whims' and 'desires' of the beneficiary for her own wants but also to aid and assist others."[65] Therefore, the "enjoyment" standard is the most broad in terms of the different available purposes for distributions. As the most broad power, a trustee would certainly possess the requisite power to grant a non-general power of appointment over trust property to son in our Example (an intermediate non-skip person).

ii. *Conferred Powers*

Trustees can obtain court conferred powers where they are necessary or appropriate to carry out the trust purpose, which is not forbidden by trust terms.[66] However, these powers will not satisfy Treasury Regulations § 26.2601-1(b)(4)(A) and the requirement that a court confer the power would cause the trust to lose grandfathered status. Nevertheless, conferred powers could become useful with GSTT's that have GST exemption allocated to them. However, the IRS applies the grandfathered rules to GSTT's and would likely not favorably rule on this issue.[67]

D. *Exercise of Powers Held by Trustee or Beneficiary*

A trustee with powers under a Broad Standard of discretion should be able to grant a special power of appointment to a beneficiary to perpetuate trust property. A court can either imply or confer such a power. If a GGSTT, this should be permissible without violating the regulations

[65] Peter B. Tiernan, *Drafting Trusts That Include Broad Invasion Powers*, LXXVII The Florida Bar Journal 1–8, 1-8 (2003), 2.
[66] Restatement (Second) of Trusts § 186 (1959).
[67] See, e.g., PLR 200627005; PLR 200308045; PLR 200326029; PLR 200632003.

if the power is subject to the common law perpetuities period or 90 years. When the trust instrument states that the trustee shall act in the best interest of the beneficiary or in the most tax efficient way, the granting of a special power to help perpetuate the trust property over the lives of the next generation should be warranted. There is no case law on a special power being conferred or granted, but there is on general powers. However, courts are split in terms of their application of § 1433(b)(2)(A) of the Tax Reform Act of 1986 on the exercise, lapse, or release of general powers of appointment in GGSTT's.

When there are no meeting minutes or drafting documents directly on point, a Judge's statement in court can present either a troubling or favorable view. Judge Thornton, one of the authors of the 1433(b)(2)(A) exemption stated, "the transitional rule was not meant to apply to a limited power of appointment that ran afoul of the vesting requirements; and second . . . that the transitional rule was not meant to apply to exercise of a general power of appointment under an otherwise grandfathered trust."[68] An inference can be made from the first clause, that a limited power of appointment that did not run afoul of the vesting requirements would not result in loss of the grandfathered status. Although not binding, the exercise of a special power of appointment that does not cause the vesting outside of the perpetuities period will not cause the loss of GST exempt or grandfathered status. There is nothing to say that the IRS will not challenge such a position, but modifying a trust to provide a special power of appointment to an intermediate (non-skip) person appears to be permissible under the regulations and by this legislative history.

[68] Estate of Gerson, 127 T.C. at 165 (Thorton, J., concurring); Robert Kazior, *Tax Law-Having Your Cake and Eating It Too : Section 1433(b)(2)(a) of the Tax Reform Act of 1986: Effecting an Exception Where One Does Not Exist*, 32 W. New Eng. L. Rev. 515 (2010), 540.

Amending, decanting, and a trustee-grant of a special power of appointment appear to be viable options for modifying a trust. A trustee grant of a power may be a better form of modification compared to the others due to the settlor's intent not having to be considered in many instances. However, one main, overarching purpose of a GST trust is to provide for future generations in the most tax efficient and protective way. This would almost certainly be the intent of the settlor when establishing a trust in close to every instance. Therefore, it appears that amending, decanting, and trustee grant of powers are all viable forms of modifications warranted by law in situations where grandfathered status or GST exemption will be lost, subject to the relevant perpetuities period.

E. *Are a Trustees Powers, Powers of Appointment?*

The GGSTT regulations provide that a "power of appointment" contained in a GGSTT can be exercised to modify the trust without the modification causing loss of grandfathered status or a constructive addition.[69] The power of appointment, however, must be "created in an irrevocable trust that is not subject to Chapter 13."[70] It is unclear whether the quoted phrase would permit a power of appointment to be given to an intermediate beneficiary by modification and whether that would be considered "created in" a GGSTT. Arguably it does, since the rule doesn't say "must have originally existed on creation." Nevertheless, if the intermediate beneficiary (son, in our Example) does not hold the requisite power, can the power held by the trustee constitute a power of appointment that was created at inception of the trust?

[69] 26 C.F.R. § 26.2601-1(b)(1)(v)(B).
[70] *Id.*

Duke Professor W. Bryan Bolich, in his 1964 paper, The Power of Appointment: Tool of Estate Planning and Drafting, supported the view that a trustee's discretionary powers are powers of appointment.[71] Some discussions take the position that fiduciary powers of trustees are not powers of appointment, but comment g to § 17.1 of the Restatement (Third) of Property state that fiduciary powers are powers of appointment, but a trustee is subject to fiduciary duty when exercising them.[72] As such, in our Example, the trustee would constrain the power granted to son by limitations on the class of appointees to the descendants of the grandfather, among possible other limitations placed on the granted power. Furthermore, the *Phipps* case is regarded as the best reference for common law on the subject which in recognizing a trustee power to grant powers as a power of appointment, was supported by ACTEC and the American Bar Association and the Restatement of Property.[73] As a power of appointment, a trustee can exercise the power to create a power in another.[74]

V. The History of the Generation Skipping Tax as Applies to Powers of Appointment

Grandfathered status refers to a trust that retains the rule of law as it was when the trust was enacted. Grandfathered status comes to exist when there is an enactment of law that changes the governing law to a subject. The Internal Revenue Service ("IRS") has stated requirements for a trust to be grandfathered (discussed below), leaving the trust untaxed under Chapter 13. This

[71] Bolich, 32 Duke Law Review, 1964.
[72] See Bloom, *The Revocable Power of Appointment Device: Planning and Drafting Considerations*, 2012. It should be noted that fiduciary powers to disburse principal are not considered powers of appointment under New York law. See, EPTL 10-3.1(b).
[73] Letter dated April 25, 2012, citing Sections 11.1 and 19.4 of the Second Restatement and 19.14 of the Third Restatement of Property.
[74] Restatement (Third) of Property § 19.14(2011). See also Blattmachr, et al, *An Analysis of the Tax Effects of Decanting*, 47 Real Property, Trust and Estate Journal 141, 144. ("A trustee's power to invade corpus of a trust is. . . a power of appointment for property law purposes.").

means that property within the GGSTT generally escapes taxation under Chapters 11-13 of the Internal Revenue Code (Estate, Gift, and GST Tax), except where "constructive additions" are made (additives of property that are not themselves GST exempt). Whenever there is a constructive addition to a grandfathered trust, the trust will lose grandfathered status to varying extents.[75] To the extent the trust loses grandfathered status, it will be subject to the GST and potentially also Chapters 11 and 12. The Tax Court has stated the purpose of the grandfathered exception is to protect those taxpayers who have taken irrevocable action in reliance on the law before the effective date and "could not escape from such arrangements."[76]

The GST was enacted to end the estate planning practice of creating a trust to benefit successive generations, completely avoiding any tax on these transfers under Chapters 11 and 12. Before enactment of the GST, a transfer of wealth was only taxed when there was a completed transfer of ownership or control from one who owned or possessed unrestricted control over the property.[77] When property is placed in trust, the beneficiary of a trust can be granted powers that do not trigger an estate or gift tax. These powers include: the right to income for life, a right under a so-called 5 and 5 power, a right to receive revenue or principal at such time as determined by an independent trustee, or a power to appoint by will or otherwise to someone other than himself, his estate, his creators, or creditors of his estate. The beneficiary can be the sole trustee of a trust for his benefit settled by another if his right to principal is limited to an ascertainable

[75] 26 C.F.R. § 26.2602-2(b)(1), (2), (3).
[76] Simpson v. United States, 183 F.3d 812, 814 (8th Cir. 1999); Robert Kazior, *Tax Law-Having Your Cake and Eating It Too : Section 1433(b)(2)(a) of the Tax Reform Act of 1986: Effecting an Exception Where One Does Not Exist*, 32 W. New Eng. L. Rev. 515 (2010).
[77] Pub.L.No. 94-455, 90 Stat. 1736.

standard.[78] Therefore, property that was conveyed in trust with limited powers, enabled the property to benefit successive generations tax free. This enabled property to remain in trust for a period potentially longer than the common law rule against perpetuities periods and sometimes indefinitely, depending on the local law.[79]

As this practice became more common, academics began proposing solutions to this abuse.[80] The American Law Institute even proposed a surtax on the creation of a trust that would skip more than one generation.[81] In 1976, the 1976 Tax Reform Act enacted Chapter 13 of the Internal Revenue Code. Under this Act, the generation skipping tax was implemented to tax trust property that was shifted from the grantor's generation to two generations below, to a skip person.[82] This tax was widely criticized due to the complex nature of its workings. The tax tried to emulate the tax on the property had it been transferred outright.[83] Due to the criticism of the Act, the Assistant Secretary of the Treasury for Tax Policy, John Chapoton, proposed a new, simplified GST in a letter written to the Senate Finance Subcommittee chairman.[84] Relevant to this pa-

[78] 26 U.S.C.A. § § 2041(b)(1)(A), 2514(c)(1) (West). See Appendix A for more on ascertainable standards.
[79] Bloom, *Transfer Tax Avoidance: The Impact of Perpetuities Restrictions Before and After Generation-Skipping Taxation*, 45 Albany L. Rev. 261 (1981).
[80] Mills, *Transfers from Life Tenant to Remainderman in Relation to the Federal Estate Tax*, 19 TAXES 195 (1941); Vickrey, *An Integrated Successions Tax*, 22 TAXES 368 (1944); Eisenstein, *Modernizing Estate and Gift Taxes*, 24 TAXES 870 (1946).
[81] A.L.I., Federal Estate and Gift Taxation (1969).
[82] General Explanation 1976 TRA, 565.
[83] See, e.g., Baetz, 121 Trusts & Estates at 17–20; Moore, *Generation-Skipping Testimony Before Senate Estate and Gift Tax Subcommittee*, 12 Prob. & Prop. 1 (Fall 1983); Powers, *The Generation-Skipping Tax — Problems of its Creation and Why it is Unconstitutional*, 83 Tax Mgmt. Est., Gifts & Tr. J. 13 (Jan./Feb. 1983).
[84] For the letter's text, see BNA Daily Tax Rept., No. 84, J-1 (1983).

per, the new GST was on a direct skip taxed on a tax inclusive basis.[85] A direct skip is defined as the grantor passing property to a skip person or a trust composed of skip persons.[86] A skip person is a natural person two or more generations below the transferor.[87] A non-skip person is anyone other than a skip person.[88] Again, the overall policy of this tax was to tax a transfer of "property" (not powers) to a skip person.

VI. Exceptions that are Relevant to Modifications

With almost every enactment of law comes exceptions. Section 1433(b)(2) of the Tax Reform Act of 1986, contains three exemptions from Chapter 13 and the GST taxing regime: (1) a generation skipping transfer under a trust that was irrevocable on Sept. 25, 1985, (2) a generation skipping transfer under a will executed before enactment of the 1989 Tax Act if the dependent died before January, 1 1987, and (3) a generation skipping transfer under trust where the grantor was under continuous mental disability from date of enactment through the Grantor's death.[89] Courts have been inconsistent with their application of these exceptions along with the corresponding regulations.[90] The corresponding regulations regarding application of these exceptions provide, in relevant part, that 1433(b)(2)(A):

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[85] Staff of Comm. on Tax'n, *Summary of Tax Reform Option for Consideration by the Committee on Ways and Means*, (JCS-43-85) §XII, C (Sept. 26, 1985). The summary on the generation-skipping transfer tax consisted of 13 lines of text in two paragraphs. The summary stated that the tax would apply retroactively to inter vivos transfers after Sept. 25, 1985.

[86] 26 U.S.C.A. § 2612(c)(1).

[87] 26 U.S.C.A. § 2613(a)(1).

[88] 26 U.S.C.A. § 2613(b).

[89] Tax Reform Act of 1986, § 1433(b)(2)(A), (B), (C).

[90] Estate of Gerson v. Comm'r, 507 F.3d 435, 437 (6th Cir. 2007); Bachler v. United States, 281 F.3d 1078 (9th Cir. 2002); Simpson v. United States, 183 F.3d 812 (8th Cir. 1999); E. Norman Peterson Marital Trust v. Comm'r, 78 F.3d 795, 796-97 (2d Cir. 1996).

> does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as taxable under Chapter 11 or Chapter 12[91]

and that,

> the release, exercise, or lapse of a (special) power of appointment . . . is not treated as an addition to a trust if . . . such power of appointment was created in an irrevocable trust that is not subject to Chapter 13 . . . and . . . the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation . . . or 90 years (measured from the date of creation of the trust).[92]

So, as long as there is no constructive addition or the existence, lapse, or exercise of a general power, and the perpetuities period is not extended, a power of appointment can be granted or exercised without subjecting the trust property to Chapter 13.

A. *Those Where no Constructive Addition*

The regulations state that the exercise of a power of appointment is not treated as a constructive addition if, "such power of appointment was created in an irrevocable trust that is not subject to Chapter 13 under paragraph (b)(1) of this section (a GGSTT)."[93] A modification or exercise of trustee discretion that exists in a GGSTT to grant a power to a beneficiary should constitute a power "created in an irrevocable trust" because it could have been originally provided and could be consistent with the settlor's presumed or expressed intent. Alternatively, the

[91] 26 C.F.R. § 26.2601-1(b)(1)(i).
[92] 26 C.F.R. § 26.2601-1(b)(v)(B)(2).
[93] 26 C.F.R. § 26.2601-1(b)(v)(B)(1). It should be noted that a lapse of a general power of appointment constitutes a taxable gift under Chapters 11 and 12 since the power holder can exercise in favor of themselves, but not necessarily a GST.

power held by a trustee to grant a power through its discretion does exist on creation, so it is unnecessary to look to whether the donees power is deemed to exist on creation.

B. *Those Where a Non-General Power of Appointment is Granted, Exercised, or Both*

The exercise or release of a non-general or special power of appointment is generally not treated as a transfer for gift or estate tax purposes.[94] However, if the power is utilized to create another power, Code § § 2041(a)(3) and 2514(d) provide exceptions to the general rule. This exception only is triggered if the creation of the new power begins a new rule against perpetuities period under state law without reference to the starting date of creation of the first power. If these exceptions are triggered, the exercise of the special power is treated as the exercise of a general power. Also, if the trust can extend past the perpetuities period, the exercise of the special power to create a new power is deemed a transfer of property for estate and gift tax purposes to the extent of the property subject to the new power.[95] Section 2041(a)(3) and 2514(d) were implemented to prevent a succession of special power of appointments, creating a new power at each generation in a jurisdiction whose perpetuities period begins at the exercise of the power instead of the creation of the power.

The above exception to the exemption for non-general powers is referred to as the "Delaware Tax Trap" because in Delaware you are able to utilize this misnomer due to the jurisdiction's perpetuities period start date.[96] For the purpose of this paper, the Delaware Tax Trap will not be discussed further due to the nature of the grandfathered trust regulations under § 26.2601.

[94] 26. U.S.C. § § 2041(a)(3), 2514.
[95] 26. U.S.C. § § 2041(a)(3), 2514(d).
[96] Blattmachr & Pennell, *Using Delaware Tax Trap to Avoid Generation-Skipping Taxes*, 68 J. Tax'n 242 (1988).

The Regulations and the Delaware tax trap coincide, except that the Delaware Tax Trap has a less stringent perpetuities period compared to the grandfathered regulations.[97] Therefore, as long as the grandfathered GST regulations are met, the trust will not fall into the trap.

C. *Cases Concerning General Powers and Split in Circuit*

The existence of powers alone can cause transfer taxation under Chapters 11-13. Courts have not applied the GGSTT regulations consistently or clearly. For example, the 2nd Circuit held a lapse of a general power of appointment constitutes a constructive addition, subjecting the whole trust to the GST tax as a result of loss of GGST status.[98] The 8th Circuit held the exercise of a general power of appointment, where no portion of trust property remained in trust after the exercise, was exempt from the GGSTT under 26.2601-1(b)(i)(v) because there was no constructive addition.[99] The 9th Circuit adopted the 8th circuits reasoning finding the exercise of a general power of appointment over all the trust property as exempt from the GGSTT.[100] Finally, the 6th circuit reviewed Treasury Regulation 26.2601-1(b)(1)(i) under the Chevron deference to determine its validity, finding that the 8th and 9th Circuits did not analyze a general power of appointment under 1433(b)(2)(A) correctly.[101] In response, the Commissioner stated in no way should a trust possessing a general power of appointment be exempt from GST tax, whether excised or lapsed and, "testators must cast the die before 1985 by including the skip transfer in the

[97] The Delaware Tax Trap will be sprung when state law does not measure the common law perpetuities period of a life in being plus 21 years from the original start date while the regulations have a perpetuities period of the date of creation plus 21 years or 90 years.
[98] E. Normal Peterson Marital Trust v. Comm'r, 102 T.C. 790, 796-800 (1994), aff'd, 78 F.3d 795 (2d Cir. 1996).
[99] Simpson v. United States, 183 F.3d 812, 813-816 (8th Cir. 1999).
[100] Bachler v. United States, 281 F.3d 1078 (9th Cir. 2002).
[101] Robert Kazior, *Tax Law-Having Your Cake and Eating It Too : Section 1433(b)(2)(a) of the Tax Reform Act of 1986: Effecting an Exception Where One Does Not Exist*, 32 W. New Eng. L. Rev. 515 (2010), 535.

trust instrument itself or conferring no more than a limited (special) power of appointment." The court did not explicitly state whether they agreed with both of these statements nor did they state opposition.[102] These statements alone are not binding, but provide the IRS's policy view on the possession, lapse, or exercise powers of appointment in 2007. The IRS' stance on the issue does not appear to have changed in the last 9 years. The Commissioner could challenge the addition of the power by modification as a constructive addition, but would have less latitude to do so if the power is viewed as originally held by the trustee who exercises it by granting another power to a non-skip person and the powers are not general powers. With consistency in mind, it does not seem just to allow retention of grandfathered status to a trust that was not subject to the GST tax, but then upon exercise of the power it is. Nevertheless, the exercise of a general power of appointment with regards to a grandfathered trust should result in the loss of its grandfathered status under 1433(b)(2)(A), but not the grant, exercise, or release of a limited power.

From a practical standpoint, this structure should be used knowing that there is risk of a challenge. When the Court of Appeals has already established a rule on a legal issue, the Tax Court will follow that rule to reduce the amount of unnecessary appeals.[103] However, State rights or court determinations are not binding on the Treasury if it has obtained a right to tax through statute or otherwise.[104] State determinations and rights are not binding retroactively.[105] The taxing event in the context of Chapter 11-13 are transfers or exercises of powers of appointment, so that if provisions of trusts are modified without causing a taxing events there is not realization of

[102] Estate of Gerson v. C.I.R., 507 F.3d 435, 437 (6th Cir. 2007).
[103] Golden v. Commissioner of Internal Revenue, 54 T.C.742 (1970).
[104] Rev. Rul. 73-142, 1973-1 C.B. 405.
[105] Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).

event that impacts the Treasury.[106] Therefore, a cautious estate planner would avail themselves of the 6th circuit jurisdiction where possible.

D. Special *Powers Held by Beneficiary*

Beneficiaries who hold a special power of appointment over a GGSTT property can exercise the power without risking loss of grandfathered status and subjecting the exercise to Chapters 11-13. Although not precedent, there is a law journal interpreting section 2601 directly to this point. A irrevocable trust granted a beneficiary a special power of appointment. That beneficiary exercised the special power of appointment post-86. It was held that the exercise did not subject the trust to Chapters 11-13 because the original trust was irrevocable and the daughter's action of exercising her special power of appointment did not constitute a constructive addition.[107] Therefore it can be concluded, as long as the trustee has the ability to grant a special power of appointment to a non-skip person, the subsequent exercise of the power will not be considered a constructive addition.[108]

VII. Granting Powers by Trustee Discretion or Modification

The exercise of trustee powers is a simpler form of modification to achieve the overall objective of keeping property in trust subject to the relevant perpetuities period. The powers able to be exercised by a trustee are referred to as fiduciary powers and are viewed by law as powers

[106] Rev. Rul. 73-142; Bosch, *Id*.
[107] Exercise of Testamentary Special Power of Appointment over Pre-Existing Trust Did Not Constitute A Constructive Addition to the Trust That Would Cause the Trust to Lose Its Exempt Status from GST Under Section 2601. Lr 9, 113 Banking L.J. 854 (1996), 26 C.F.R. § 26.2601-1(b)(1)(v)(B).
[108] See 26 C.F.R. § 26.2601-1(b)(v)(B)(2)

of appointment.[109] "The power of appointment is the most efficient dispositive device that the ingenuity of Anglo-American lawyers have ever worked out."[110] The exercise of a trustee power of appointment can be a more efficient way to grant a non-skip person a special power of appointment over trust property than a modification to amend a trust to confer such a power because it is simpler, it can allow the next senior family member to direct trust property in harmonizing estate plans, and eliminates the potential for constructive additions to the trust. See Appendix "B" for a form Trust Deed in Grant of Power of Appointment.

When a trustee exercises a discretionary power under a Broad Standard to grant a special power of appointment, there is no constructive addition. The remainder interest is subject to divestment by the trustee, and the remainder beneficiaries can be viewed as only holding an expectancy.[111] However, a potential constructive addition could arise when a beneficiary possesses a vested remainder in trust property and consents to a trustee's grant of a special power of appointment to a non-skip person or upon an exercise by the non-skip person. The potential release of this remainder interest could be found to constitute a constructive addition of the interest back to the trust. There is no precedent directly on this issue, however this release of a vested interest can be analogized to a release of a general power of appointment. A general power holder can exercise the power to appoint trust property to themselves receiving an analogous amount to one who possess a vested interest. If there is any property left in trust after the release of a general power of appointment, the value of the released property will be considered a constructive addi-

[109] Restatement (Third) of Property § 17.1, comment g.
[110] Leach, *Powers of Appointment*, 24 A.B.A.J. 807 (1938).
[111] See, supra, Randall v. Randall, et al at note 32.

tion subjecting this amount to Chapters 11-13.[112] In fact, one who possesses a vested interest has a more complete interest in trust property than does a holder of a general power of appointment.

VIII. Conclusion

A trustee holding discretionary powers that are sufficient to decant or otherwise to distribute property to a beneficiary hold the power to grant powers over that property. This discretionary power to grant powers is provided on creation of the trust and, if grandfathered, satisfies the requirements of § 26.2601-1(b)(v)(B), provided it is not exercised in a manner that will postpone vesting beyond the common law rule against perpetuities or 90 years. However, if the power is exercised to create another power it must be restricted, so that it too may not exceed the perpetuities limitation.[113]

[112] 26 C.F.R. § 26.2601-1.
[113] 26 C.F.R. § 26.2601-1(b)(v)(B)(2).

Appendix A

Ascertainable standard

Even though the retention of a power by the settlor usually renders a gift incomplete, the gift is not deemed as such if the settlor retains only a fiduciary power "the exercise or nonexercise of which is limited by a fixed or ascertainable standard."[114] An ascertainable standard is defined in terms of the beneficiary's health, education, support, or maintenance. In order to meet the ascertainable standard exception to general power of appointment, the power must be reasonably ascertainable and related to the health, education, maintenance, and support of the holder.[115] A transfer of property with a retained fiduciary power limited by an ascertainable standard constitutes a completed gift because there exists a duty to act and there is no discretion of the settlor involved; the beneficiary can seek enforcement in a court of equity.[116]

In Rev. Rul. 76-547, the IRS ruled that the power of appointment must be limited by the definite bounds of health, education, support and maintenance ("HEMS"), and if not limited by such, state law will determine the nature and extent of the powerholder's rights.[117] A court ruling under state law would first determine if the power is narrowly limited by the HEMS standard and nothing more. Then, the court would determine if the power is sufficiently limited to an ascertainable standard under federal law.[118]

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[114] 25 C.F.R. § 25.2511-2(g).
[115] §2514(c)(1). See also Rev. Rul. 78-398, 1978-2 C.B. 237.
[116] 825 T.M., Powers of Appointment — Estate, Gift and Income Tax Considerations; Harris, "Ascertainable Standard Restrictions of Trust Powers under the Estate, Gift, and Income Tax," 50 Tax Law. 489 (1997).
[117] Morgan v. Comr., 309 U.S. 78 (1940); Rev. Rul. 76-547, 1976-2 C.B. 302.
[118] Sowell Est. v. Comr., 708 F.2d 1564, 1567 (10th Cir. 1983).

Two words that have repeatedly caused estate planners trouble are the words comfort and emergency. The regulations consider comfort to be an ascertainable standard if limited, such as "support in reasonable comfort." However, whenever the word comfort is used, there is a risk that the power will be construed as a general power of appointment and presumably interfere with the intention of the settlor. [119] In Miller v. U.S., the power was limited to the beneficiary's proper maintenance, support, medical care, hospitalization, or other expenses incidental to her comfort and well-being." The court ruled the discretionary power to be a general power of appointment, due to the word "incidental" modifying comfort and well-being. Due to the placement of the word "incidental," the power to consume was said to extend beyond the HEMS standard granting the holder a general power of appointment.[120] To the contrary, if the power is limited to "comfort, in order to defray expenses incurred by reason of sickness, accidents and disability", the IRS has stated this comfort to invade trust principal is sufficiently related to health-related costs and therefore would not be considered a general power of appointment.[121]

The IRS has stated if a power holder has the ability to distribute corpus for emergencies not limited to health, maintenance, and support, the power is a general power of appointment.[122] However, there is case law decisions that have concluded otherwise. Specifically, the phrase "emergency or illness" has been ruled non-ascertainable by the Tax Court, but overturned on appeal by the 10th circuit. The Tax Court found that by placing "or" between the two words, they should be viewed separately and therefore would not be considered an ascertainable standard. On

[119] 25 C.F.R. §25.2514-1(c)(2).
[120] Miller v. U.S., 387 F.2d 866, 868 (3d Cir. 1968).
[121] PLR 9203044.
[122] TAM 9044081; PLR 9012053.

appeal, the tenth circuit reversed the Tax Court's decision finding that the phrase related solely to the beneficiary's health.[123]

[123] Sowell Est. v. Comr., 708 F.2d 1564, 1566 (10th Cir. 1983), rev'g 74 T.C. 1001 (1980).

Appendix B

TRUSTEE DEED
IN
GRANT OF POWER OF APPOINTMENT

[Trustee(s)], [are/is the [Trustee/Co-Trustees (the "Trustee/Co-Trustee"), of [Trust Name], (the "Trust"), and hereby grants a Power of Appointment in favor of [Beneficiary Name], as the current income and principal beneficiary of the Trust (the "Beneficiary").

BACKGROUND AND GRANT

Pursuant to ARTICLE [#], Section [#] of the Trust, Trustee holds the power to make distributions to beneficiaries [in its absolute discretion for welfare, happiness, best interests or the comfort of the Beneficiary], with such powers being non-ascertainable for purposes of vesting or valuation of rights in all current and remainder beneficiaries of the trust. As a result, Trustee holds the power over such property to grant partial interests and power to hand over such property. Trustee herby exercises its power and grants Beneficiary the following non-general power of appointment:

> [Limited Power of Appointment. Trustee shall distribute the entire principal of the Trust Estate then remaining as [Beneficiary] shall appoint during life by written statement delivered to Trustee and all Qualified Beneficiaries (as defined under the Florida Trust Code), or at death, in trust or otherwise, by [his/her] Will, which specifically refers to and exercises this power of appointment granted by [settlor]. The power hereby granted, however, shall only be exercisable in favor of the issue of Beneficiary. Furthermore, any exercise by Beneficiary shall be subject to the vesting period applicable to the initial creation of such rights, estates, and interests in property existing in the trust on its creation, as required to avoid inclusion of such property in the gross estate of Beneficiary under § 2041(a)(3) of the Internal Revenue Code or violation of Treasury Regulation §§ 26.2601-1(b)(1)(v)(B) or 26.2601-1(b)94)(A) (the last sentence thereof) and the Trust's exempt and grandfathered status from Chapter 13.

TRUSTEE:

_____ _____

Witness [Trustee], Settlor and Trustee

_____

Witness

TRUSTEE:

_____ _____

Witness By:_____

Its:_____

[Trustee], Trustee

_____

Witness

ACKNOWLEDGMENT

The undersigned acknowledges and accepts this grant of power.

_____ _____

Witness [name], Beneficiary

_____

Witness

DISCRETIONARY CONSENT REMAINDER BENEFICIARIES:

The undersigned as remainder beneficiaries of the Trust hereby consent to this grant of power and indemnify Trustee against any breach of discretion that can or may be claimed, whether or not their consent is required and without claiming that their Consent is in fact required. Trustee asserts its discretion and compliance with Treasury Regulation § 26.2601-1(b)(4)(A) without regard to Treasury Regulation § 26.2601-1(b)(4)(D)(1), as a result of the parenthetical in the first sentence thereof.

_____ _____

Witness [name], Remainder Beneficiary

_____

Witness

_____ _____

Witness [name], Remainder Beneficiary

_____

Witness