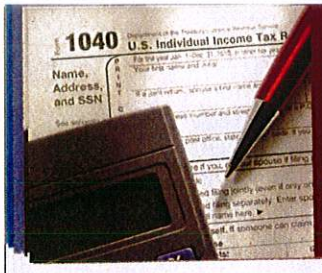

By **Emily B. Pickering** & **Richard W. Nenno**

Forestalling Forties Follies

Beware of Pre-Oct. 22, 1942 general powers of appointment

Are assets subject to a general power of appointment (GPOA) includible in the powerholder's estate? Yes, of course. Easy one. Right?

Unfortunately (or fortunately, for the savvy estate planner) this isn't always correct. If the trust giving the GPOA is sufficiently long in the tooth, that is, established before Oct. 22, 1942, there's an exception in which the assets subject to the GPOA aren't necessarily includible in the estate of the powerholder.

The United States has taxed the estates of decedents since 1916. There's been a gift tax in the United States since 1924. In the 1920s and 1930s, the gift and estate taxes were relatively new. Generation-skipping transfer tax and multiple trust rules for income tax purposes didn't exist. The common law rule against perpetuities (RAP) bound the practitioner at this time and only allowed the practitioner to extend the life of the trust for the lifetimes of the beneficiaries of the trust plus 21 years. These trusts[1] are still around today, although in 2019, the youngest then-living beneficiaries of these trusts are approaching their 80s.

The Internal Revenue Code gives these trusts special treatment due to their creation during a development phase of the federal transfer-tax system. This treatment extends to the GPOAs given by these trusts. Exercises of these POAs are addressed in the IRC and the Treasury regulations; the Internal Revenue Service recently has tackled the exercises, releases and lapses of the powers in three private letter rulings. These exercises, releases and lapses can create unexpected and innovative opportunities for estate planners.

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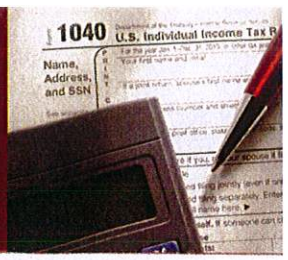
Pre-Oct. 22, 1942 GPOAs

Terms. A GPOA is a power that's exercisable in favor of a decedent, a decedent's estate, a decedent's creditors or the creditors of a decedent's estate.[2] If an ascertainable standard relating to the health, education, maintenance or support of a decedent limits the power, it isn't a GPOA.[3] Additionally, a POA isn't a GPOA if the decedent can exercise the power only with another person under certain limited circumstances.[4]

In PLR 201218001 (May 4, 2012), an authorized representative submitted a ruling request as to whether the exercise and proposed exercise of certain POAs would be included in the beneficiary's gross estate.[5] Under the terms of the trusts in question, both of which were irrevocable prior to Oct. 22, 1942, a separate trust was created for the primary benefit of the settlor's daughter. The settlor's daughter had a testamentary POA among her issue and the settlor's issue and exercised her power to create a trust to benefit her daughter and her descendants. The settlor's granddaughter had a testamentary power to appoint the new trust to or for the benefit of any one or more of the daughter's descendants living at the granddaughter's death, and any unappointed property was to be held in further trust for her then-living descendants. All of the trusts were to be terminated within the applicable RAP period. The IRS found that these powers weren't general, and thus their exercises didn't cause the value of the trusts to be included in the daughter's and/or the granddaughter's gross estates.

Date. It's always prudent to review the date of the trust or will creating a GPOA. For a GPOA created under a standalone irrevocable trust, the date of the irrevocable trust governs. However, a GPOA created by



will executed before Oct. 22, 1942 is considered a power created before such date if the person executing the will died before July 1, 1949 without having republished the will, by codicil or otherwise, after Oct. 21, 1942.[6]

Includibility. The IRC provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which a GPOA created before Oct. 22, 1942 is exercised by the decedent.[7] The IRC specifically notes, however, that the failure to exercise such power or the complete release of such power isn't an exercise of the power.[8]

Failure to Exercise a POA

A beneficiary may fail to exercise a pre-Oct. 22, 1942 GPOA by: (1) letting the power lapse, (2) releasing the power, or (3) disclaiming the power.

Letting the power lapse is the most straightforward option: The beneficiary does nothing. This is an unqualified failure to exercise the power, and the assets subject to that power won't be includible in the powerholder's gross estate.

The release of the power is the deliberate relinquishment of the GPOA during the beneficiary's lifetime. Again, this is an unqualified failure to exercise the power, and the assets subject to that power won't be includible in the powerholder's gross estate.

The third option, disclaiming, is the most complex approach.

How to Disclaim and Why?

A qualified disclaimer is a refusal by a beneficiary to accept an interest in the property. A disclaimer must follow a rigid set of rules set out in IRC Section 2518 and comply with state law disclaimer requirements.[9] It's unnecessary to disclaim an entire interest: A beneficiary can disclaim an undivided portion of the interest as well.[10] A power with respect to such property is treated as an interest in that property.[11] A beneficiary can disclaim to avoid federal estate and gift tax. If there's a successful disclaimer, the disclaimed assets pass to the contingent beneficiary without any tax consequences to the person disclaiming the property.[12]

If an individual makes a qualified disclaimer, the disclaimed interest in property is treated as if it had never been transferred to her.[13] A POA with respect to property is treated as a separate interest in the property, and a beneficiary may disclaim a POA independently from any other interests separately created by the transferor in the property.[14] The value of the decedent's gross estate for purposes of the federal estate tax doesn't include the value of the property over which the decedent made a qualified disclaimer.

PLR 201707003 (Feb. 17, 2017) explored this in depth. The trust in question was created prior to Oct. 22, 1942 and was for the benefit of the settlor's son. The son sued the trustee for abuse of discretionary authority regarding the distribution of income. The state court approved a settlement agreement that partitioned the trust into two subtrusts, one of which was referred to as Trust B. The son had a GPOA over Trust B. Pursuant to the settlement, the son renounced and disclaimed the GPOA over Trust B, as did the son's daughter (the granddaughter). Both of the disclaimers were qualified disclaimers under Section 2518 and applicable state law. Following the settlor's son's death, the trustee identified certain ambiguities when the granddaughter's disclaimer, another disclaimer and the settlement agreement were considered together. These ambiguities included the identity of certain beneficiaries and the standard used for distributing income. The authorized representative asked the IRS whether the granddaughter's qualified disclaimer created a transfer subject to federal gift tax or caused any part of the disclaimed interests to be includible in her gross estate for federal estate tax purposes. The IRS thoroughly analyzed the disclaimer, looking closely at Section 2518 and found that the disclaimer was a qualified disclaimer. Because it was a qualified disclaimer under Section 2518, the disclaimer didn't create any transfers subject to federal gift tax

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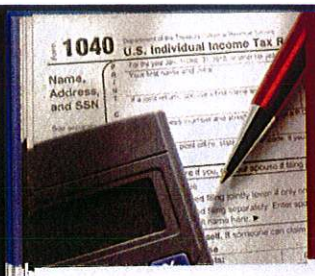

and didn't cause any part of the disclaimed interests in Trust B to be includible in the granddaughter's gross estate for federal estate tax purposes.

PLR 201803003 (Jan. 19, 2018) also explored this issue at length. In this PLR, the grantor and the grantor's spouse created an irrevocable trust for the benefit of their daughter on a date prior to Oct. 22, 1942. The trust was twice amended and restated by court order. The county court had determined that the daughter and the successor beneficiaries had general testamentary POAs, and, on the death of the daughter or a successor beneficiary, the intestate heirs would succeed to the beneficiary's interest in the trust. The beneficiaries of the trust sought a declaratory judgment concerning the operation, construction and effect of certain disclaimers that the beneficiaries had preplanned. The grandchildren planned to disclaim their respective interests in the GPOA by a qualified disclaimer. The authorized representative asked the IRS whether the children's qualified disclaimers created transfers subject to federal gift tax or caused any part of the disclaimed interests to be includible in their gross estates for federal estate tax purposes. The IRS thoroughly analyzed the disclaimers, looking closely at Section 2518, and found that the disclaimers were qualified disclaimers. Because they were qualified disclaimers under Section 2518, the disclaimers didn't create any transfers subject to federal gift tax and wouldn't cause any part of the disclaimed interests to be includible in the grandchildren's gross estates for federal estate tax purposes.

Partial Release and Legal Disability

If a decedent has partially released a GPOA created before Oct. 22, 1942 so that it's no longer a GPOA, the exercise of the power isn't an exercise of a GPOA if either: (1) such partial release occurred before Nov. 1, 1951, or (2) the donee of such power was under a legal disability to release such power on Oct. 21, 1942, and such partial release occurred not later than six months after the termination of such legal disability.[15] We would advise every practitioner to dust off their files and confirm there's no old piece of paper lying around showing a partial release or showing the legal disability of a beneficiary.

Proper Planning Required

It's easy to assume, when one sees a GPOA, that the assets of the trust will be includible in the estate of the individual who holds the GPOA. However, given that this isn't always the case, practitioners should be aware of this as these trusts wind down. With the current exemptions being at all-time highs, it's also worth looking at these trusts to see if a POA should be exercised to cause estate inclusion and get a stepped-up basis. At the same time, given that the residuary clause exercises GPOAs in some states,[16] practitioners should include language in wills to avoid inadvertent exercises of such powers.

Pre-Oct. 22, 1942 trusts seem archaic, but many of them still exist, have significant assets and are worthy of attention. We hope this article has given practitioners some tools to help plan appropriately for them.

Endnotes

1. This article will only discuss powers of appointment (POA) created before Oct. 22, 1942.
2. Internal Revenue Code Section 2041(b)(1).
3. IRC Section 2041(b)(1)(A).
4. Section 2041(b)(1)(C).
5. This private letter ruling and the other PLRs described in this article focus on the generation-skipping transfer tax implications of the treatment of the exercise, disclaimer or lapse of general POAs. It's important not to change or extend the vesting period for trusts when exercising a POA.
6. Section 2041(b)(3).
7. Section 2041(a)(1).
8. Section 2041(a)(1)(B).
9. IRC Section 2518(c)(2). Section 2518(c)(1) provides that a disclaimer with respect to an undivided portion of an interest that meets the requirements of Section 2518(b) shall be treated as a qualified disclaimer of such portion of the interest.
10. Section 2518(c)(1).
11. Section 2518(c)(2).
12. *Ibid.*
13. Treasury Regulations Section 25.2518-1(b).
14. Treas. Regs. Section 25.2518-3(a)(1)(iii).
15. *See supra* note 8.
16. *See, e.g.*, N.Y. Est. Powers & Trusts Law Section 10-6.1(a)(4).

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